FOR AGENDA

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Supplement 1

CONTAINS CONFIDENTIAL INFORMATION

September 18, 1985

To: Members of the Executive Board

From: The Acting Secretary

Subject: Bolivia - Staff Report for the 1985 Article IV Consultation - Supplementary Information and Information Notice

The attached supplement to the staff report for the 1985 Article IV consultation with Bolivia has been prepared on the basis of additional information.

Mr. Flickenschild (ext. 8621) or Mr. Sol Perez (ext. 8627) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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CONTAINS CONFIDENTIAL
INFORMATION

INTERNATIONAL MONETARY FUND

BOLIVIA

Staff Report for the 1985 Article IV Consultation--Supplementary Information and Information Notice

Prepared by the Western Hemisphere and the Exchange and Trade Relations Departments

(In consultation with the Fiscal Affairs and Legal Departments)

Approved by E. Wiesner and Manuel Guitián

September 17, 1985

On August 29, 1985, the new Government of Bolivia, which took office on August 6, announced a wide-ranging economic policy package aimed at eliminating the severe imbalances in the Bolivian economy. The authorities announced the modification of the exchange system by replacing the fixed exchange rate between the Bolivian peso and the U.S. dollar with a more flexible system determining the value of the Bolivian currency by means of periodic foreign exchange auctions. A liberalization of the foreign trade regime also was announced. At the same time, the Bolivian authorities announced steps to modify the financial system, the determination of prices and wages, and the organization of key state enterprises, as described in Section II below. All the measures are contained in a single decree, Supreme Decree No. 21060.

Developments in the exchange rate for the Bolivian peso were last brought to the attention of the Executive Board through a notification of a change in Bolivia's exchange system on June 3, 1985 (EBD/85/140). In July, the Bolivian peso appreciated in real effective terms by 70 percent. Under the procedures of the information notice system, this appreciation needs to be brought to the attention of the Executive Board.

I. The Exchange and Trade System

1. Modification of the exchange system

The new system envisages the introduction of a new currency unit, the Potosi, which will be equivalent to $b 1,000,000. The exchange rate between the Peso/Potosi and the U.S. dollar is determined by means of an auction system operated by the Central Bank of Bolivia. The official exchange rate is equivalent to the weighted average of the exchange rates resulting from the actual sales of foreign exchange during the auctions. These auctions take place twice a week, although they can be held more frequently at the discretion of the Central Bank.

The official exchange rate applies to all foreign exchange operations in Bolivia. 1/ The first auction took place on September 2, 1985 and established an exchange rate of $b 1,150,000 per U.S. dollar, representing a depreciation of the Bolivian peso of 93.5 percent in terms of the U.S. dollar (or 1,433.3 percent in terms of local currency) with respect to the previous official selling rate of $b 75,000. The exchange rate set at the following auction, held on September 3, was $b 1,109,000 per U.S. dollar. The exchange rate in the parallel market, which had risen to $b 1,400,000-1,500,000 per U.S. dollar before the announcement of the measures, fell to $b 1,150,000 per U.S. dollar in early September 1985.

The auctions are conducted by a Committee for Exchange and Reserves (Comité de Cambio y Reservas) in the Central Bank. The committee consists of the President of the Central Bank and two directors of the Central Bank chosen at random every week. In addition, the General Manager of the Central Bank and its Director of External Trade are permanent nonvoting members of the committee. Prior to each auction the committee decides on the amount of foreign exchange to be auctioned and a floor price, below which the Central Bank will not accept any bids. The Central Bank offers foreign exchange in minimum units of US$5,000, with successful bidders being charged the exchange rate they placed in their bid (Dutch auction system).

The sale of foreign exchange to the public is free of all taxes and commissions. Previously, a spread of 11.9 percent between the buying and selling rates had resulted from the imposition of a tax and various commissions on the sale of foreign exchange.

Under the new system all purchases of foreign exchange through the auction market are subject to a deposit requirement equal to 10 percent of the amount requested, payable at the time of submission of the bid. The purchaser is given a tax credit certificate (nota de crédito tributario) equivalent to the value of the deposit. This certificate--which is transferable and divisible and has unlimited maturity--can be used to pay import tariffs and profit remittance taxes.

The following provisions apply in relation to foreign exchange proceeds: (i) exporters of goods and services are required to surrender to the Central Bank all foreign exchange earnings resulting from the export, net of payments for insurance, freight, and processing abroad; (ii) exporters of goods are furthermore required to deposit with the Treasury an amount in local currency equal to 10 percent of the value of their exports on the basis of unit prices established every two weeks by the Ministry of Finance, in addition to any required payment of royalties and other export taxes. No export will be permitted without proof

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1/ Previously, the Bolivian exchange rate system comprised a fixed official rate, a freely fluctuating parallel rate, and two mixing rates resulting from retention privileges differentiating between traditional and nontraditional exports. For details see SM/85/253.

that the deposit has been made. Other sellers of foreign exchange to the Central Bank are not required to make this deposit; and (iii) all sellers of foreign exchange to the Central Bank are entitled to receive local currency at the official exchange rate for 100 percent of the foreign exchange surrendered plus an exchange reimbursement certificate (certificado de reintegro cambiario) in an amount equivalent to 10 percent of the amount surrendered. The certificate--which is transferable and divisible and has an unlimited maturity--can be used for the payment of the 10 percent deposit requirements for merchandise exports and foreign exchange purchases through the auction market.

Except for the requirement to surrender the net proceeds from the export of goods and services, all banks, exchange houses, companies, and individuals can buy and sell foreign exchange freely. However, banks must maintain a balanced spot position in foreign exchange at all times and sell to the Central Bank any excess international reserves at the end of each day. Foreign exchange purchased in the central bank auction market can be used for any purpose. Furthermore, all public sector institutions, including the public enterprises, must purchase foreign exchange for imports of goods and services through the central bank auction market. Other public sector requirements for foreign exchange (external debt service) will be supplied by the Central Bank at the official exchange rate prevailing on the date of purchase.

2. Information notice

The evolution of the real effective exchange rate for the Bolivian peso through July, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, the Bolivian peso appreciated in real effective terms by 70 percent in July.

The Executive Board was notified on June 3, 1985 of a devaluation of the peso of 33.1 percent on a mid-point basis that had been effected on May 16, 1985. 1/ The exchange rate for the Bolivian peso, however, was subsequently left unchanged until the above-described modification of the exchange system on August 29. In light of the high rate of domestic inflation, this policy resulted in a substantial real effective appreciation in the intervening months. However, the recent devaluation appears to have more than offset the previous real appreciation.

1/ On that date the Central Bank's buying rate for the U.S. dollar was raised from $b 45,000 to b$ 67,000 per U.S. dollar. New selling rates of $b 74,330 and $b 75,000 per U.S. dollar were set for exchange sales to commercial banks and the public sector and to the general public, respectively; previously, these selling rates had been $b 49,550 and $b 50,000 per U.S. dollar.

3. Modification of the trade system

Supreme Decree No. 21060 also modifies the external trade regime, as follows: (i) all goods may be freely imported and exported, except for those affecting public health or the security of the country; and (ii) import tariff rates have been lowered to a level equivalent to 10 percentage points plus 10 percent of the previously prevailing tariff level. Specific import taxes are maintained, and all exemptions to the payment of import taxes and tariffs are eliminated, except for those established by international agreement or the foreign investment law.

II. Other Measures

1. Financial system operations

Financial intermediaries were authorized to carry out operations in foreign exchange or in local currency with a maintenance-of-value clause. There is no legal reserve requirement for deposits denominated in foreign currency or with a maintenance-of-value clause. The minimum interest rate on foreign currency deposits is LIBOR, while interest rates on foreign currency denominated loans are determined freely. Interest rates on local currency deposits and loans have been freed. Legal reserve requirements on local currency deposits were lowered from 55 percent to 50 percent for sight deposits; increased from 5 percent to 10 percent for time deposits; increased from 5 percent to 20 percent for savings deposits; and increased from 60 percent to 100 percent for other deposits.

2. Prices and wages

The Bolivian authorities have established that all prices will be freely determined by market forces, except for the following: (i) the price of gasoline with an octane rating of between 82 and 85 has been valued at the equivalent of US$0.30 per liter including taxes. The local currency price of gasoline will be adjusted every 15 days on the basis of the average official exchange rate for the previous 15 days; (ii) the price for urban transport will be fixed by local government authorities; (iii) the price of electricity for industrial use is not to exceed the equivalent of US$0.045 per kilowatt/hour, converted at the official exchange rate in effect when payment is made; (iv) the price of electricity for household consumption will be negotiated between the local governments and the utilities; (v) the price of railroad transportation will be set by the state railroad company (ENFE) subject to the approval of the Ministry of Transport; and (vi) prices for local telephone services will be set by local companies and approved by local governments.

On wage policy, the authorities decreed that most bonuses received by employees in the public and private sectors are to be consolidated into the basic annual salary; 1/12 of this amount will be received by the employee each month. Three bonuses are excluded from the overall

consolidation: the seniority bonus for years in service, the frontier areas bonus, and the production bonus. Once these changes are implemented, all public sector wages will be frozen until December 31, 1985. In addition, all public sector company stores (pulperías) selling goods at subsidized prices are abolished. Employees who benefited from these subsidized stores will receive as part of their base salary an amount equal to the difference between the subsidized prices which were charged by the company stores and the market price of those same goods as of August 30, 1985.

All enterprises and entities in the public and private sectors are authorized to lay off employees, whereas previously this was not the case. All employees laid off before January 1, 1986 may choose to receive the equivalent of three months' salary payable in a lump sum or their monthly salary payable for a period of six months. All benefits previously established by law will be respected. In the private sector, wage contracts are to be negotiated freely between employers and workers. Public sector entities and enterprises have been subjected to a hiring freeze.

3. Reorganization of state enterprises

The Bolivian authorities have introduced a number of structural reforms affecting the organization of state enterprises: (i) the state petroleum company (YPFB) will be decentralized into three enterprises: the Eastern Petroleum Company with headquarters in Santa Cruz and the Southern Petroleum Company with headquarters in Camiri, which will be responsible for exploration and production activities, and the Industrialization and Marketing Company with headquarters in Cochabamba, which will be responsible for refining and marketing of petroleum and gas. A holding company in La Paz will supervise the three companies; (ii) the state mining company (COMIBOL) will be decentralized into four mining enterprises: the Southern Mining Company with headquarters in Potosi; the Central Mining Company with headquarters in Oruro; the Northern Mining Company with headquarters in La Paz; and the Eastern Mining Company with headquarters in Santa Cruz. The four enterprises will be supervised by a holding company in La Paz, but each company will be autonomous, with management held responsible for the design of administrative and operational policies based on efficiency and profitability criteria; (iii) the state smelting company (ENAF) and the state lead-silver smelter (KARACHIPAMPA) cease to be independent enterprises. The tin-smelting complex located in Vinto, which was managed by ENAF, is now a division of the Central Mining Company, while the lead-silver smelter is now a division of the Southern Mining Company; (iv) the Bolivian Development Corporation (CBF), which is a holding company owning 23 enterprises operating in a wide range of agroindustrial and industrial activities, is dissolved. The companies which were owned by CBF will be transferred to the regional development corporations, while the Treasury will assume the liabilities of these enterprises; and (v) the state road transport company (ENTA), which had been created in 1983, was abolished, and its motor vehicles were transferred to the municipalities. These

local authorities are authorized to create their own transportation companies, or to sell the motor vehicles to the private sector on condition that they are maintained as part of the public transportation network. ENTA liabilities are to be assumed by the Treasury.

4. Measures in other areas

(a) Rationalization of public sector operations

Supreme Decree No. 21060 introduces other measures with the aim of rationalizing the operations of nonfinancial public sector entities, including the following: (i) all public sector entities are prohibited from hiring additional personnel; (ii) investment activity by state enterprises and regional development corporations is prohibited until December 31, 1985. Projects in progress must be reevaluated and approved by the National Planning Council (CONEPLAN); (iii) all public sector entities must present to CONEPLAN, within 60 days, financial statements as of July 31, 1985, as well as provisional budgets for the remaining months of the year. The information will be reviewed and audited, particularly with respect to the reliability of the data. In addition, within 30 days, all public sector entities must prepare plans for the rationalization of their personnel, which must be implemented within 30 days once approved by CONEPLAN. The Central Bank will not grant credit to public sector entities that do not comply with the aforementioned requirements; and (iv) all public sector entities are prohibited from holding foreign exchange accounts, whether in Bolivia or abroad. These entities can only hold peso-denominated accounts, which must be deposited in the state development bank (Banco del Estado).

(b) Public sector internal debt (floating debt)

The Treasury has been given authority to issue fiscal credit notes with a maintenance-of-value clause in lieu of payment for existing public sector floating debt, i.e., domestic arrears of public sector entities, except those arising from overdue wages and other compensation payments. All nonfinancial public sector entities in need of budget support to liquidate their floating debt are authorized to request from the Treasury fiscal credit notes in the amounts required. When issuing the notes to other public sector entities, the Treasury will debit the accounts of the receiving entities. The fiscal credit notes have no specified maturity, are transferable within the public and private sectors, and can be used to pay obligations to the Treasury such as taxes, royalties, tariffs, and other debts. Public sector entities have 90 days to cancel all their floating debt by means of fiscal credit notes.

(c) Monopolies

All existing monopolies in production and distribution are abolished, except for those state monopolies established by law. The Government has not yet specified which state monopolies cannot be abolished. Anti-monopoly legislation is to be submitted to Congress within 90 days.

(d) Cadastral values

The authorities decreed that all cadastral values, which have a 1978 value base, are to be adjusted by an index which accounts for the depreciation of the exchange rate between December 31, 1978 and December 31, 1985. Subsequently, cadastral values will be updated annually on a similar basis. Tax payments made on the basis of old cadastral values before the publication of Supreme Decree No. 21060 are recognized as final.

(e) Revaluation of assets

Supreme Decree No. 21060 makes it obligatory for all public and private enterprises to revalue their fixed assets as of December 31, 1985. Annual revaluation of assets will be required each year thereafter.

III. Staff Appraisal

The Government that took office in early August has recently announced a package of wide-ranging measures aimed at correcting the internal and external imbalances of the Bolivian economy. The package includes significant changes of the exchange and trade system, together with modifications to the operations of the financial system, the organization of state enterprises, and the determination of wages and prices. Because of the magnitude of the changes and the weakness of the Bolivian data base, it has not been possible to assess the consistency and quantify the effects of the measures on the public sector finances, the financial system, and the balance of payments. The staff remains in close contact with the authorities for these purposes.

Subject to a subsequent quantification of the measures implemented, the staff is of the view that the actions announced by the authorities constitute steps in the right direction and should contribute to an improved economic performance. In particular, the intended unification of the exchange markets by means of an auction system--which has resulted in an initial depreciation of the Bolivian peso of over 93 percent--is a welcome development. For this action to lead to a sustained improvement of international competitiveness and resource allocation, it needs to be accompanied by appropriate supporting policies, including restrained fiscal and monetary policies.

The staff would urge the authorities to maintain open access for all bona-fide transactions and avoid intervening in the auction market, if the system is to help achieve the restoration and maintenance of a realistic exchange rate. As to the establishment of deposit requirements, equivalent to 10 percent of the value of exchange applications and of merchandise exports, the staff believes that it is important that these deposits should be managed so as not to give rise to a separate effective exchange rate or to constitute an impediment to normal trade flows. Finally, the staff notes that the use of the Dutch auction system and the 10 percent surrender bonus may give rise to multiple currency practices.

The authorities are to be commended for the announced elimination of restrictions on foreign trade and the reduction of import duties. In conjunction with a more realistic exchange rate, these changes should contribute to an improvement in the performance of the export sector.

The announced liberalization of the financial system and the freeing of interest rates should help to strengthen financial savings, which have deteriorated significantly in the past. Similarly, the liberalization of prices and the greater flexibility introduced in the operations of the labor market should help to improve the efficiency of the economy and raise output.

The reorganization of the public sector enterprises and the measures announced for the rationalization of public sector operations should contribute significantly to the improvement of the public sector performance. However, these measures can only be successful in the context of a comprehensive program aimed at reducing the current fiscal imbalances. This problem has not been addressed yet; it should be noted that the assumption by the Treasury of certain debts of the state enterprises and other public entities is likely to weaken the finances of the Central Administration. It should be emphasized that only if the public sector deficit is reduced sharply will the policy package succeed in lowering the rate of inflation, strengthening the balance of payments, and providing a basis for renewed growth over the medium-term. The staff therefore urges the authorities to proceed promptly in this area.

In summary, the authorities are to be commended for their effort to initiate adjustment and liberalize the structure of the Bolivian economy. The immediate task of the authorities is to design a comprehensive financial policy package to complement these measures. Success in stabilizing the economy will hinge on the prompt and sustained implementation of a comprehensive policy package; the staff recognizes that substantial technical assistance may be needed to strengthen Bolivia's administrative and institutional framework. Even if appropriate adjustment measures are successfully implemented, the Bolivian balance of payments is likely to be under considerable pressure for some time, requiring financial support from the international financial community, particularly with regard to the restructuring of outstanding obligations to both official and private lenders.

The staff urges the authorities to develop a financial program that would provide the basis for the elimination of external payments arrears. In the meantime, approval is not being proposed for the exchange restrictions maintained by Bolivia and any multiple currency practices that may arise from the operation of the auction system, the exchange surrender bonus, or the two deposit requirements.

Bolivia: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate 1/ 2/	Nominal Effective Exchange Rate 1/	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. dollars	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1980						
I	94.8	98.4	96.3	100.00	89.7	91.4
II	99.4	99.8	99.6	100.00	97.8	96.9
III	102.3	99.5	102.9	100.00	105.1	104.4
IV	103.6	102.4	101.2	100.00	108.3	107.3
1981						
I	117.9	107.4	109.8	100.00	123.0	125.6
II	128.4	118.5	108.3	100.00	127.7	128.2
III	141.5	127.4	111.0	100.00	137.8	136.1
IV	141.1	128.3	109.9	100.00	142.3	138.8
1982						
I	113.9	100.1	115.5	72.96	156.1	161.2
II	120.8	82.6	146.1	56.86	205.8	208.8
III	195.0	89.8	216.6	56.86	322.7	316.9
IV	148.4	47.2	329.4	28.19	515.3	494.6
1983						
I	79.0	22.1	356.8	12.50	587.2	612.4
II	104.4	23.6	441.5	12.50	770.3	789.9
III	157.6	25.3	620.8	12.50	1,160.6	1,134.1
IV	176.2	18.5	996.4	8.58	2,009.1	1,901.1
1984						
I	158.7	11.4	1,397.8	4.90	3,015.2	3,188.0
II	135.0	4.2	3,484.1	1.72	8,110.7	8,324.7
III	170.6	3.3	5,125.1	1.23	12,841.7	12,488.4
IV	309.5	2.4	14,514.4	0.82	39,429.5	37,298.5
1985						
I	263.2	0.5	69,563.1	0.15	206,029.1	221,254.6
II	232.4	0.1	171,664.1	0.04	558,976.8	567,133.1
Monthly						
1985						
April	174.9	0.2	104,655.5	0.05	327,434.7	356,121.0
May	206.8	0.1	139,842.3	0.04	451,075.8	483,113.7
June 3/	315.4	0.1	270,494.3	0.03	898,419.8	862,164.7
July	537.9	0.1	466,733.8	0.03	1,569,566.3	1,519,996.4
Percentage change						
June 1985-July 1985	70.5	-1.2	72.5	—	74.7	

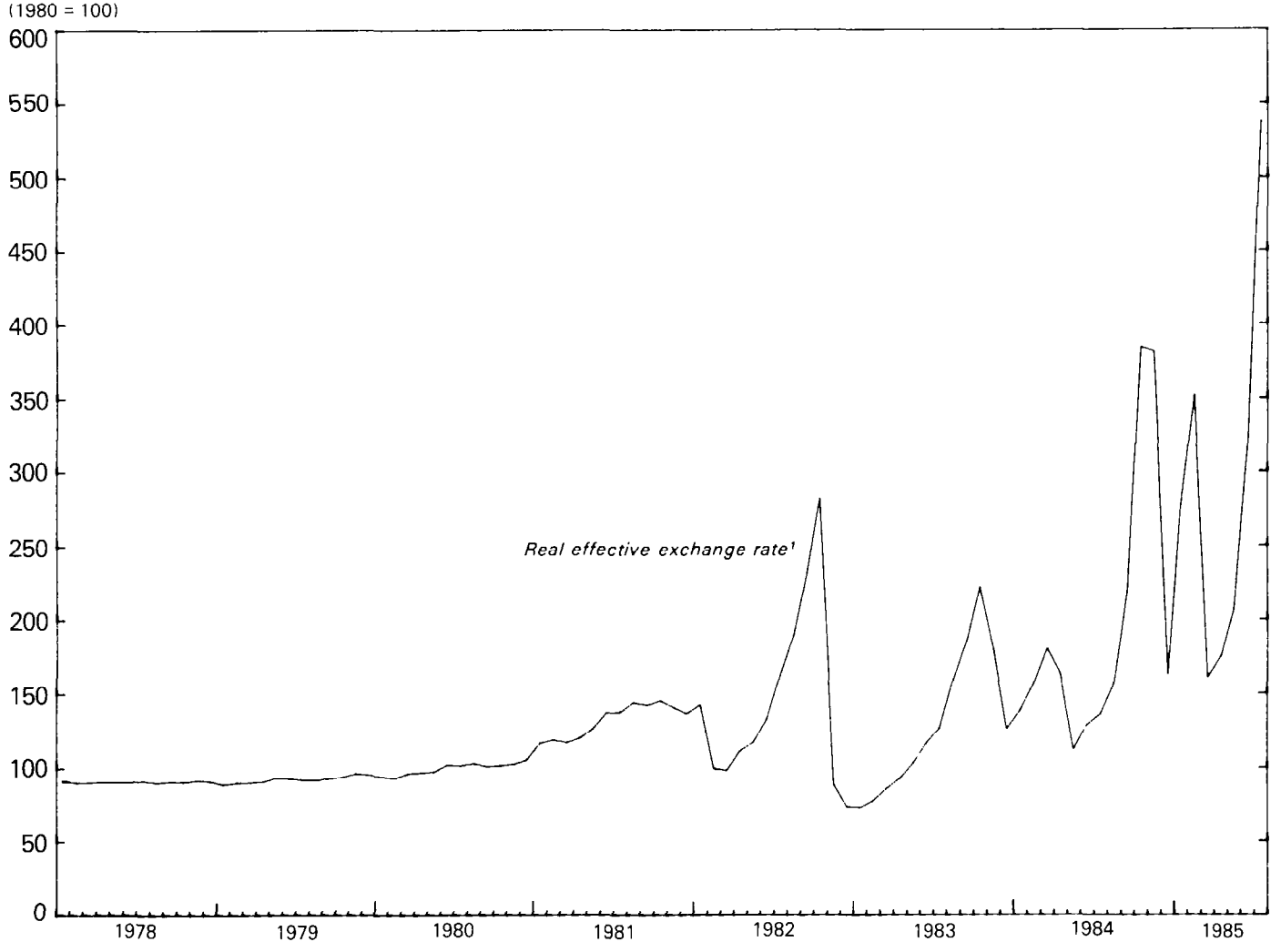
Source: Information Notice System.

1/ Increases mean appreciation.
2/ Using seasonally adjusted price indices.
3/ Date of latest consideration by Executive Board.

CHART

BOLIVIA

INDEX OF REAL EFFECTIVE EXCHANGE RATE



Source: Fund staff estimates.

[1] Trade weighted index of nominal exchange rate deflated by seasonally adjusted relative consumer prices. Increases mean appreciation.