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June 20, 1984

To: Members of the Executive Board

From: The Secretary

Subject: *Bolivia - Staff Report for the 1984 Article IV Consultation*

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Bolivia, which has been tentatively scheduled for discussion on Monday, July 16, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Kreis (ext. (5)8640).

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INTERNATIONAL MONETARY FUND

BOLIVIA

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the 1984 Consultation with Bolivia

Approved by E. Wiesner and Manuel Guitian

June 19, 1984

The 1984 Article IV consultation discussions with Bolivia were held in La Paz during the period January 30-February 23, 1984. The Bolivian representatives in these discussions included the Ministers of Finance, Planning, Labor, Mining, Energy, Agriculture, Interior, and Industry and Commerce; the President of the Central Bank; chief executives of the largest public enterprises; and other senior officials. The mission reviewed its findings with the President of the Republic, Mr. Hernan Siles Zuazo. The staff mission consisted of Eliahu S. Kreis (Head-FAD), Hans Flickenschild, Jorge Guzman, Peter Kohnert, John Leimone (all WHD), and Marsha Rubin (secretary-ETR) and was assisted by Joachim Harnack, the Fund resident representative in La Paz. Mr. Jaime Delgadillo, Advisor to the Executive Director for Bolivia, participated in some of the policy meetings. Mr. Kreis had further discussions with the authorities during a visit to La Paz from March 26 to April 12, 1984. New policy measures were adopted on April 12, 1984 following the installation of a new Cabinet. These measures, which are described in the paper, were discussed with the authorities on the occasion of another staff visit to La Paz during May 14-31, 1984.

The previous consultation discussions with Bolivia were held in March and May 1982. The relevant documents (SM/82/137, SM/82/162, and SM/82/137, Supplement 1) were considered by the Executive Board on January 10, 1983 (EBM/83/9). Bolivia accepted the obligations of Article VIII, Sections 2, 3, and 4 as from June 5, 1967.

I. Economic Background 1/

In recent years, Bolivia's economic performance has been characterized by a slump in economic activity, a rapid acceleration in the pace of inflation, and continued weakness in the balance of payments.

1/ It is difficult to assess economic and financial developments in Bolivia because of the paucity of reliable data due in large measure to the frequent changes in personnel and the marked deterioration in the management of the public administration. High inflation and the large devaluations of 1982, 1983, and 1984 have exacerbated this problem.

From 1981 to 1983 real GDP declined by a cumulative 17 percent (Table 1), while consumer price inflation accelerated from 36 percent in 1981 to an annual rate of around 2,500 percent in the five months ended May 1984. Over this period the sustained pressure on Bolivia's balance of payments resulted in a buildup of external public debt to around US$3.2 billion by end-1983, a depletion in international reserves, and a considerable accumulation of payment arrears despite debt relief obtained from foreign commercial banks and official bilateral and multilateral creditors.

Table 1. Bolivia: Selected Economic Indicators

	Average				Prel.
	1973-77	1978-80	1981	1982	1983
	(Rates of growth)				
Real GDP	5.8	2.1	-1.5	-8.7	-7.7
Consumer prices (average)	21.5	25.7	32.6	122.7	275.6
Wholesale prices (average)	...	29.6	35.5	228.0	416.0
	(As percent of GDP)				
Domestic savings	19.4	11.5	2.4	7.4	3.6
Domestic investment	21.2	17.1	9.9	10.7	6.2
Resource gap	1.8	5.6	7.5	3.3	2.6

Sources: Central Bank of Bolivia; National Statistical Institute; and Fund staff estimates.

Important among the factors underlying the deterioration in the economic situation was the marked worsening in the public sector's finances. The consequence of the increasing public sector deficit on the balance of payments and on inflation was initially masked by Bolivia's easy access to international sources of financing. In reflection of the very weak growth in revenues and the sustained rise in current expenditures, the overall public sector deficit reached the equivalent of 18 percent of GDP by 1983. This deficit was financed entirely by domestic sources of credit following the complete drying up of foreign sources of lending.

Another factor contributing to the economic deterioration of recent years was the highly volatile political situation. During the period 1978-83, Bolivia had three general elections, seven military and three civilian presidents, and 12 ministers of finance. Against this background, the confidence in the peso was eroded and capital outflows increased. In addition, domestic savings and investment in relation to GDP plummeted to levels only a fraction of those recorded in the mid-1970s (see Table 1).

The economic situation took a sharp turn for the worse in 1982. Real GDP fell by almost 9 percent, following a 1 1/2 percent decline in 1981. Despite attempts to intensify price controls, consumer price inflation rose from an average of 33 percent in 1981 to about 123 percent. The wholesale price index, which is less influenced by price regulations, rose by some 228 percent. In the external area, despite the rescheduling of amortization payments and a 50 percent drop in imports, net international reserves declined by US$70 million during 1982. At the same time, the Bolivian peso depreciated in the free market from $b 44 per U.S. dollar in February 1982 to about $b 275 per U.S. dollar in late September 1982.

The financial situation reached critical proportions in the third quarter of 1982 when Bolivia ceased servicing its foreign debt and inflation exceeded 20 percent a month. In October 1982, faced with a wave of strikes and a rapid erosion of confidence, the military government handed power over to a civilian government with Mr. Siles Zuazo as President. Immediately following its appointment, the new Government adopted a series of emergency measures.1/ These measures included increases in domestic prices of petroleum products and public tariffs, a moderate wage adjustment, and the conversion into pesos of foreign currency denominated contracts among residents, including bank loans and deposits. The exchange market was unified and the peso was depreciated in the official market from $b 44 to $b 200 per U.S. dollar. A temporary preferential exchange rate of $b 145 per U.S. dollar was introduced for the conversion of all foreign-denominated credit due during 1983 that had been extended by the banking system to the productive sectors. The introduction of this preferential rate gave rise to heavy losses to the banking system, including the Central Bank. Furthermore, the decree that barred foreign exchange contracts among residents effectively stopped all foreign borrowing by Bolivian banks because of the exchange risk involved in domestic lending operations based on foreign credits.

The deterioration of the economic and financial situation intensified during 1983. Real GDP declined by almost 8 percent and consumer price inflation accelerated on average to 276 percent as adverse climatic conditions caused a 20 percent drop in agricultural production. The current account deficit of the nonfinancial public sector rose sharply and, although the contraction of investment outlays accelerated in real terms, the overall fiscal deficit reached an estimated 18 percent of GDP. The overall deficit in the balance of payments in 1983 was limited by the unavailability of financing. The relatively small current

1/ For a detailed listing of the November 1982 measures, see SM/82/137, Supplement 1 of January 4, 1983.

account deficit (about 2 percent of GDP) reflected a substantial compression of imports due to the reduced availability of foreign loans and the rationing of foreign currency (Table 2). Despite a moderate improvement in prices, exports were adversely affected by declining production of minerals, hydrocarbons, and agricultural products. At the same time, amortization payments exceeded new capital inflows, resulting in an overall balance of payments deficit estimated at US$335 million. However, extraordinary balance of payments financing in the form of rescheduling of medium-term debt and the refinancing of US$405 million of short-term liabilities of the Central Bank permitted Bolivia to show a gain of US$304 million in net international reserves.

II. Summary of the Discussions

In a situation of considerable uncertainty about economic policies, the consultation discussions were conducted in three stages. The first phase of the discussions focused principally on the remedial measures required to stabilize the economy and to bolster the balance of payments. Further discussions were held both before and after the installation of the new Cabinet in April 1984. These discussions centered on the package of measures announced by the new Government and sought to determine the areas where further measures were required.

1. Demand management

In Bolivia, general government expenditures are equivalent to over one fourth of GDP and state enterprises account for over two thirds of mineral production and about four fifths of Bolivia's exports. The authorities indicated that the policy of the present Government is that the public sector should play a major role in the country's economic development and that its role in the economy should increase over time. The Government also has embarked on a policy of increasing labor participation in the management of state enterprises, starting with the Bolivian Mining Company (COMIBOL), the largest state-owned enterprise.

The fiscal measures introduced in November 1982 were aimed at securing a substantial reduction in the overall deficit of the public sector. This package mainly rested on revenue measures, since expenditures were expected to be boosted by wage adjustments and by the impact of the devaluation on interest payments abroad and on imports of goods and services. The increase in domestic prices of petroleum derivatives was expected to generate additional revenue equivalent to over 5 percent of GDP. In addition, treasury receipts were to be bolstered by better administration, lower allowances for presumed costs in the mining sector,1/ new taxes on property and wealth, and the enforcement of tax

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1/ Taxable income in the mining sector is determined by world mineral prices and presumed costs, which are set by the authorities. The reduction of the latter, other things remaining the same, increases tax liabilities.

Table 2. Bolivia: Balance of Payments

	1979	1980	1981	1982	Prel. 1983
	(In millions of U.S. dollars)				
Current account	-365	-27	-490	-105	-117
Exports, f.o.b.	760	942	912	828	778
Imports, c.i.f.	-951	-703	-1,010	-520	-551
Interest payments (net)	-162	-249	-334	-380	-309
Other factor income (net)	-38	-43	-61	-55	-113
Other services (net)	-25	-34	-36	-24	-20
Transfers (net)	51	60	40	46	98
Capital movements	178	-467	60	-264	-219
Nonfinancial public sector 1/	218	61	241	28	-2
Banking system	23	-59	86	-25	391 2/
Private sector 3/	-52	-324	-145	77	79
Rescheduled debt, deferments and capital arrears	-11	-145	-122	-199	-614 4/
Overdue receipts for gas exports	--	--	--	-145	-72
Allocation of SDRs and gold monetization	8	8	9	2	1
Overall balance	-179	-486	-421	-367	-335
Special financing	16	385	262	298	639
General purpose loans	--	240	125	--	--
Unpaid debt service 5/	16	145	137	298	639
Rescheduling	--	--	167	100	484
Deferment	--	145	-65	35	178
Arrears	16	--	34	143	-23
Net international reserves (increase -)	163	101	159	69	-304 4/
	(As percent of GDP) 6/				
Memorandum items					
Current account balance	-7.5	-0.5	-7.9	-1.7	-2.0
Exports, f.o.b.	15.6	16.8	14.7	13.3	13.5
Imports, c.i.f.	19.5	12.5	16.3	8.3	9.6
Factor income (net)	-4.1	-5.2	-6.4	-7.0	-7.3
	(Percentage change)				
Terms of trade	28.4	6.4	-1.8	-2.4	9.2
Export prices	48.4	17.0	-8.5	-7.0	8.7
Import prices	15.6	10.0	-6.9	-4.6	-0.4

Sources: Central Bank of Bolivia; and Fund staff estimates.

1/ Excludes balance of payments support loans.
2/ Includes capitalization of interest and refinancing of principal of short-term debt.
3/ Includes errors and omissions.
4/ Includes refinancing of principal of short-term debt of the Central Bank amounting to US$370 million.
5/ Principal and interest.
6/ GDP calculated on the basis of real growth rates and changes in the U.S. wholesale price index (base year 1980).

and royalty transfers from state enterprises to the Treasury. At the same time, COMIBOL and YPFB (the state petroleum company) were expected to benefit from the devaluation of the peso as most of their revenues are in foreign exchange while most of their expenditures are in local currency.

The authorities readily acknowledged that the revenues yielded by the measures of November 1982 fell well short of what they had expected. In addition, there was little success in restraining expenditures, in particular because the 1983 budget was never approved by Congress and because minimum wages were indexed from March 1983. As a result the overall public sector deficit rose from 8 percent of GDP in 1982 to about 18 percent of GDP in 1983 (Table 3). The deficit would have been even larger had it not been for debt relief and substantial cuts in capital outlays.

Central administration current expenditures rose from 12 1/2 percent of GDP in 1982 to 19 1/2 percent in 1983 (Chart 1). This rise stemmed mainly from sharply increased wage expenditures and from a large jump in unclassified outlays. The latter are believed to consist mainly of interest and subsidy payments by the Central Bank on behalf of the Treasury. The authorities noted that the Central Bank as a guarantor was obliged to service the public debt and that this commitment had further eroded expenditure control as it had reduced pressure on the Treasury and the main state enterprises to contain expenditures financed with their own resources. The rapid growth in current outlays also had made it more difficult for Bolivia to raise the local counterpart funds required to use foreign development loans. This had contributed importantly to the decline in investment expenditures, to around 5 percent of GDP in 1983, as compared with an average of 12 percent in 1976-79.

Revenue collections by the Central Administration dropped in relation to GDP from over 10 percent in 1981 to less than 6 percent in 1983 (see Chart 1). A principal factor underlying the poor revenue performance was the limited payment of taxes by the state petroleum company (YPFB) due to heavy losses and cash flow problems . The authorities attributed the losses mainly to the delays in the adjustment of domestic oil prices. The company's ability to pay taxes also was hampered by delays in the receipt of payments for gas exports to Argentina totaling some US$200 million.1/ In addition, revenues were adversely affected by the failure of the state smelting company (ENAF) to transfer to the Treasury taxes withheld on mineral exports. ENAF used these export taxes to finance its mounting deficit, which resulted primarily from production problems and from large interest payments abroad. Fiscal revenues also were affected adversely by lower import duty collections occasioned by increased import prohibitions and the lack of foreign

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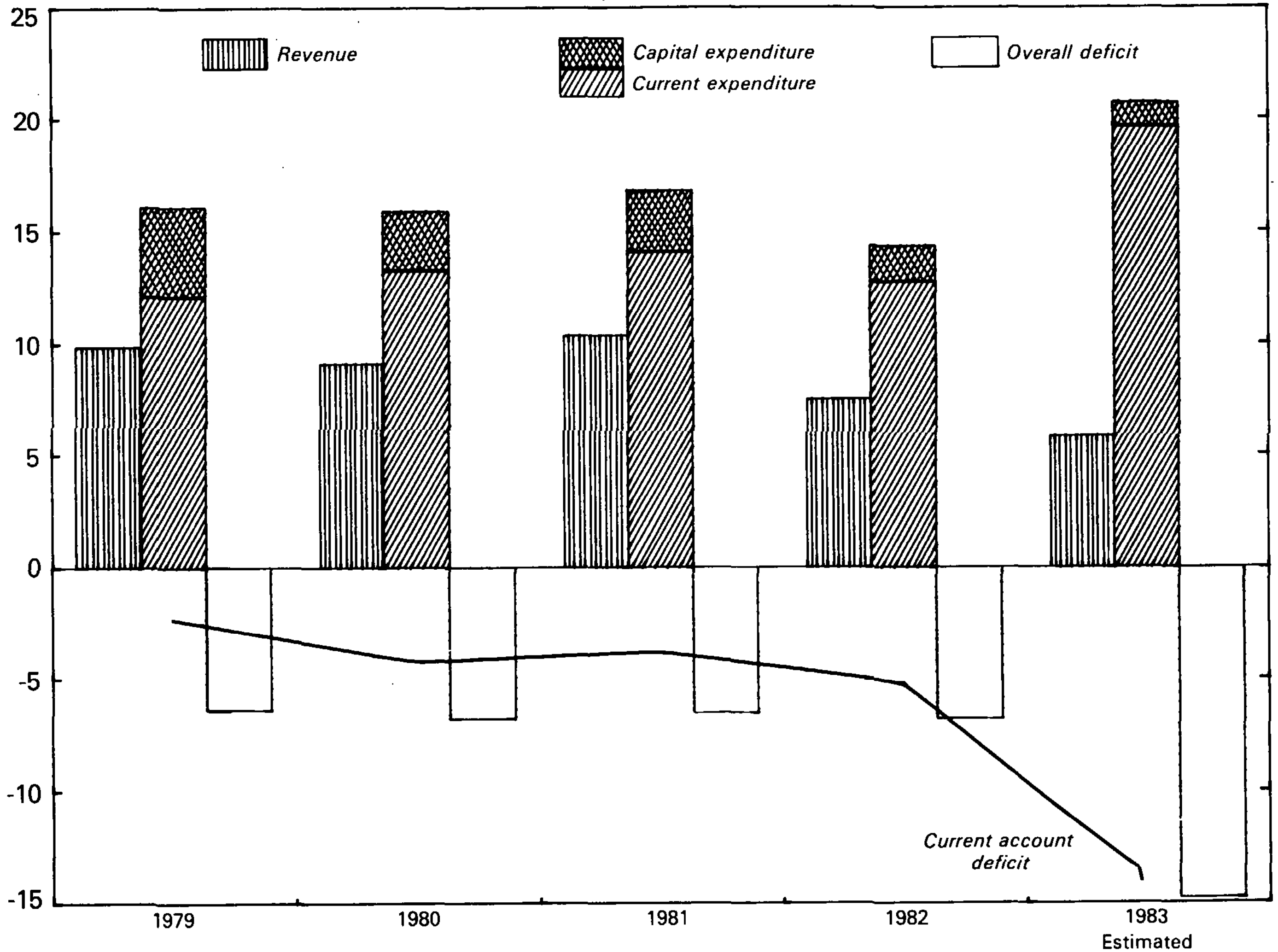
1/ An agreement was reached with Argentina in April 1984 to put all payments for Bolivian gas exports to Argentina on a current basis in the course of this year.

CHART 1

BOLIVIA

CENTRAL ADMINISTRATION OPERATIONS

(In percent of GDP)



Sources: Ministry of Finance; Central Bank of Bolivia; and Fund staff estimates.

Table 3. Bolivia: Summary of Nonfinancial Public Sector Operations

(As percent of GDP)

	1979	1980	1981	Prel. 1982	Est. 1983
General Government					
Revenue	12.5	11.8	11.6	9.9	9.2
Current expenditure	14.1	14.8	13.9	15.4	23.3
Current account surplus or deficit (-)	-1.6	-3.0	-2.3	-5.5	-14.1
Consolidated public enterprises					
Current account surplus or deficit (-)	3.1	1.1	1.8	4.5	1.7
Consolidated public sector savings	1.5	-1.9	-0.5	-1.0	-12.4
Capital receipts	0.2	0.2	0.5	--	0.4
Capital expenditure	9.8	6.2	6.5	6.9	5.0
Net lending	0.2	0.1	0.3	0.1	1.2
Consolidated public sector overall surplus or deficit (-)1/	-8.3	-8.0	-6.8	-8.0	-18.2
Central Administration	-6.4	-6.8	-6.5	-6.8	-14.8
Rest of general government	-0.6	0.7	0.4	0.5	-0.7
State enterprises	-1.3	-1.9	-0.7	-1.7	-2.7
Financing	8.3	8.0	6.8	8.0	18.2
External financing (net)	2.8	4.5	4.2	0.5	--
Internal financing (net)	5.5	3.5	2.6	7.5	18.2
Banking system (net)	(3.5)	(4.10	(2.8)	(9.7)	(19.3)
Other (net)	(2.0)	(-0.6)	(-0.2)	(-2.2)	(-1.1)
Memorandum item					
Consolidated public sector deficit including external interest deferred, rescheduled, or in arrears	-8.4	-8.1	-7.0	-9.7	-18.6

Sources: Ministry of Finance; Central Bank of Bolivia; and Fund staff estimates.

1/ After receipts from and transfers to the rest of the public sector.

exchange. In addition, income tax collections--equivalent to only 1.6 percent of GDP in 1983--were depressed by the weakness of economic activity, increased tax evasion, and the temporary reduction in rates on earned income introduced in November 1983.

The growing financial needs of the public sector caused a sharp expansion of bank credit in 1982-83. The annual rate of expansion of the banking system's net domestic assets (relative to the stock of private sector liabilities at the beginning of each year) exceeded 180 percent in each of the last two years, with most of the increase originating in credit to the Central Government. The rapid expansion of credit occurred despite the growth of legally required reserve holdings from 24 percent to 41 percent of bank deposits during 1983; in the case of demand deposits, the required reserve ratio was raised in two steps from 40 percent to 60 percent during 1983. Credit to the private sector dropped by one half in real terms during 1983, reflecting the Central Bank's effort to limit such credit so as to accommodate the financing needs of the public sector. The financial position of many private firms weakened considerably, and as a consequence the ratio of nonperforming assets of the banking system rose sharply, making banks reluctant to expand their domestic credit operations.

Interest rates on savings and time deposits were raised to 45 percent a year in July 1983 to encourage financial savings. Although this measure was in the right direction, the authorities recognized that it fell far short of what was required since the average monthly rate of inflation exceeded 20 percent during the second half of 1983. As a result, the real value of private financial assets dropped by almost two fifths during the year.

The decree of November 1982 which prohibited credit operations denominated in foreign currency also required the banks to accept repayment of domestic loans denominated in foreign currency at a preferential exchange rate of $b 145 per U.S. dollar while they were required to service their foreign liabilities at the new official rate of $b 200 per U.S. dollar. As was noted above, the prohibition of foreign currency clauses also effectively prevented the commercial banks from using foreign lines of credit because of the high exchange risk involved.

2. Wage and price policies

In November 1982, the new Bolivian authorities declared that the maintenance of the real wage was a major objective of their economic policy, both on equity considerations and as an attempt to stimulate demand for domestically produced goods. To this end the Government adopted a wage indexation formula (escala movil) in March 1983 whereby minimum wages were to be adjusted to reflect domestic inflation at six-monthly intervals or sooner if consumer prices increased by more than 40 percent. Wages above the stated level were to be adjusted by an amount to be fixed in absolute terms on each occasion. The authorities indicated that it had initially been their intention to renegotiate the arrangement with the labor unions after one year, but that no such negotiations had taken place so far in 1984.

Under the wage formula, general wage increases were granted in March, August, and November 1983, and January 1984. The last two increases were retroactive to the preceding month and exceeded substantially the awards required under the adjustment formula. The application of the wage formula has added significantly to the fiscal deficit and thereby to demand pressures, which resulted in a marked acceleration of inflation. Following a reduction in the monthly rate of inflation from close to 20 percent during the second half of 1982 to less than 8 percent during the first half of 1983, inflation moved up again, reaching 20 percent a month in the second half of 1983. This occurred despite the freezing of certain prices and the introduction of larger subsidies for a number of basic commodities. A further consequence of the application of the wage formula with its provision for equal absolute wage increases above specified salary levels was a significant narrowing of wage differentials. In recognition of the undesirability of a further compression of wage differentials, the authorities began to grant part of wage adjustments in the form of equal relative increments with effect from December 1983.

Price controls currently apply to goods and services which comprise over one half of the cost of living index. However, their effectiveness is questionable since an increasing proportion of products subject to price control is being channeled to the black market. Also, smuggling to neighboring countries has increased, thus giving rise to shortages in Bolivia. The authorities recognized that delays in price and tariff adjustments were an important factor in the misallocation of resources, the irregular spurts of inflation, and the high public sector deficits. Nevertheless, the Government declared an additional 120-day price freeze on five basic commodities in January 1984 in response to demands from labor.

In November 1982, when the official exchange market was reunified and comprehensive exchange controls were imposed, the Bolivian authorities had indicated their intention to rely more heavily on exchange rate adjustments to correct balance of payments disequilibria. The exchange rate of the peso was to be altered in accord with external developments and with the relative movement of domestic and foreign prices. However, because of political pressures and the fear that devaluations would trigger demands for large salary adjustments, the rate was not modified until November 1983. This resulted in a real effective appreciation of the peso of more than 130 percent in the official market from November

1982 to November 1983 (Chart 2).1/ On November 21, 1983, the official buying rate was changed from $b 196 per U.S. dollar to $b 500 per U.S. dollar. At the same time the exchange rate in the illegal but tolerated parallel market was around $b 1,600 per U.S. dollar.

The authorities recognized that the long delays between exchange rate adjustments during highly inflationary periods had adverse effects on production and caused distortions in resource allocation. The failure to maintain a realistic level for the peso was a major factor for the weak financial performance of some public enterprises. It also encouraged over- and under-invoicing and unrecorded trade; while private exporters delayed the surrender of export receipts, importers could not obtain foreign exchange from the Central Bank and turned to the parallel market.

The outstanding external public debt at the end of 1983 amounted to about US$3.2 billion, equivalent to 55 percent of GDP (Table 4). After rising at an average annual rate of over 15 percent in 1980 and 1981, the outstanding debt rose by less than 2 percent in 1982. The debt rose by 13 percent in 1983, but this reflected the deferment of scheduled amortization payments and the medium-term conversion of short-term debts of the Central Bank mentioned above. Notwithstanding the accumulation of large payments arrears (described below) and an agreement with a consortium of foreign commercial banks to defer and reschedule payments of about US$475 million falling due in 1980-83, the public sector's debt service remained at about 30 percent of exports of goods and nonfactor services in those years except for 1983 when it rose to 38 percent. Including unpaid debt service obligations, the debt service ratio would have increased from 33 percent in 1979 to 90 percent in 1983. To a large extent, this increase resulted from the decline in export earnings and from substantially higher international interest rates.

During 1982 and early 1983 large external payments arrears were accumulated, including arrears on the debt which had been renegotiated with the foreign banks in 1981. Arrears reached US$180 million by April 1983, and in May 1983 Bolivia agreed with the commercial banks on a schedule for the complete elimination of arrears and for payments of all interest obligations due in 1983.2/ Bolivia broadly complied with the agreed schedule for arrears payments until April 1984.

1/ From November 1983 to March 1984, the real effective appreciation of the peso amounted to approximately 75 percent. In late March 1984, the exchange rate in the parallel market reached $b 3,100 per U.S. dollar compared with $b 500 per U.S. dollar in the official market. On April 13, 1984, the buying rate was moved to $b 2,000 per U.S. dollar (see Section III, below).

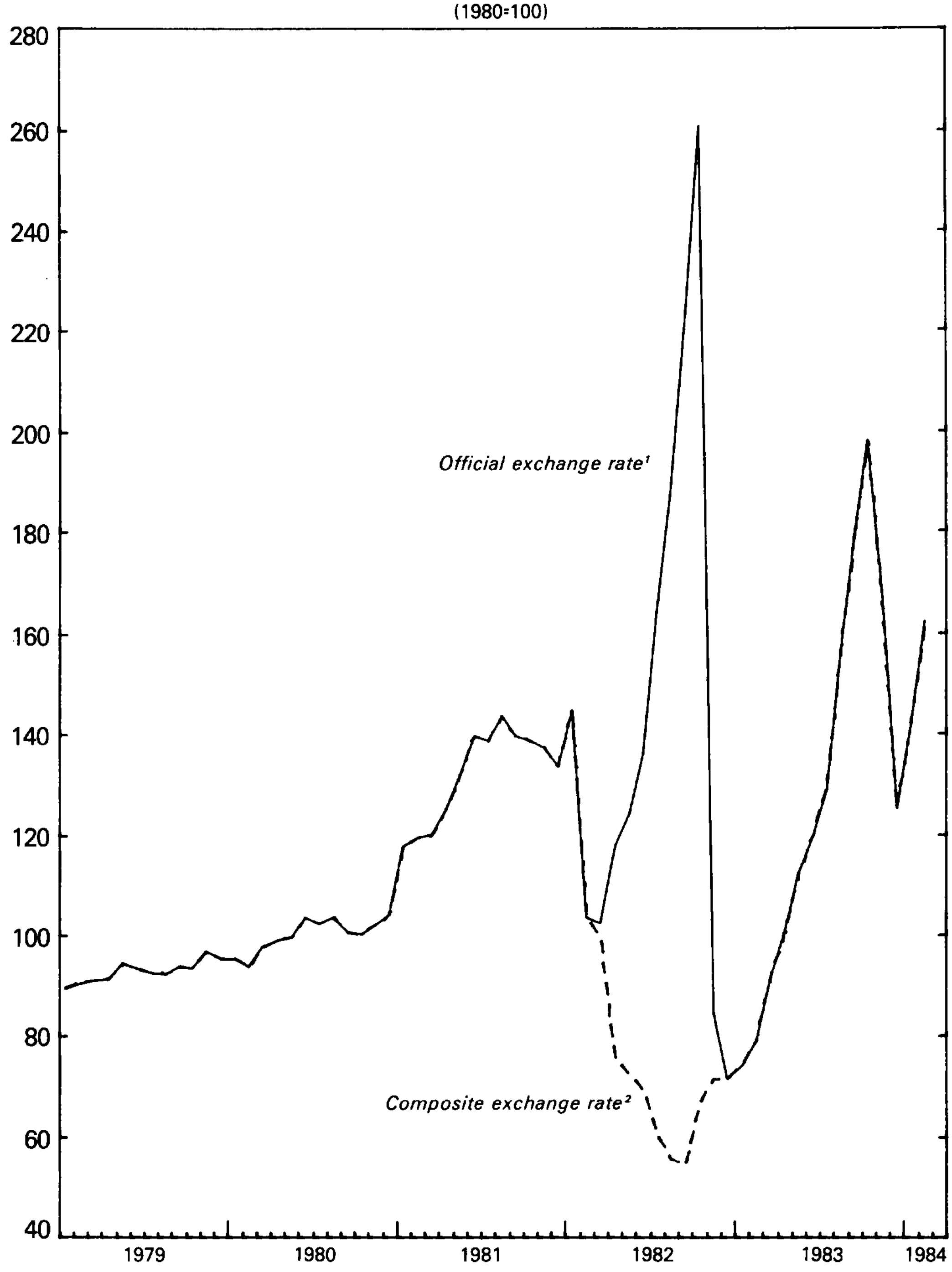
2/ For details of the debt renegotiations with foreign commercial banks, see Appendix II in SM/84/100.

CHART 2

BOLIVIA

INDEX OF REAL EFFECTIVE EXCHANGE RATE[1]

(1980=100)



Sources: Central Bank of Bolivia; and Fund staff estimates.

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

[2]Composite rate for trade transactions reflecting the fact that from late March 1982 to early November 1982 an estimated 60 percent of exports and about 80 percent of imports were channeled through the parallel market.

Table 4. Bolivia: External Public Debt Operations 1/

	1979	1980	1981	1982
	(In millions of U.S. dollars)			
Disbursed debt outstanding	2,034.3	2,312.4	2,752.6	2,803.3
International organizations	461.6	605.0	676.9	720.4
Government loans	566.6	592.3	641.1	659.0
Banks	713.1	836.8	1,132.9	1,125.9
Suppliers' credits	228.7	216.6	242.6	253.9
Bonds	64.3	61.7	59.1	44.1
Debt service obligations	281.6	411.3	629.9	732.3
Interest	124.4	167.5	205.7	273.6
Amortization	157.2	243.8	424.2	458.7
Debt service payments	265.6	289.3	295.0	284.6
Interest	119.5	163.0	186.2	177.1
Amortization	146.1	126.3	108.8	107.5
	(Ratios in percent)			
Disbursed debt outstanding/GDP 2/	41.8	41.2	44.4	45.0
Average interest rate 3/	6.5	7.7	8.1	9.8
Interest paid/GDP 2/	2.5	2.9	3.0	2.8
Debt service obligations/exports 4/	32.8	39.8	62.4	80.8
Debt service payments/exports 4/	31.0	28.0	29.2	31.4
Memorandum items				
Interest and commissions paid on private and public debt 5/				
In millions of U.S. dollars	164.5	262.9	333.6	287.2
In percent of exports 4/	19.2	25.5	33.0	31.7
Interest and commissions due on private and public debt 5/				
In millions of U.S. dollars	169.4	267.4	353.1	406.1
In percent of exports 4/	19.7	25.9	35.0	44.8

Sources: Central Bank of Bolivia; and Fund staff estimates.

1/ Public and publicly guaranteed debt with an original maturity of more than one ye
2/ GDP calculated on the basis of real growth rates and changes in the U.S. wholesal index (base year 1980).
3/ Interest due as a percentage of average debt outstanding during the year.
4/ Goods and nonfactor services.
5/ Includes interest on short-term debt and IMF charges.

The projected public sector debt service for 1984, including payment of arrears, would exceed total export earnings. Excluding payments arrears, the debt service obligations for 1984 would be around 50 percent of total export earnings.

III. Changes in Cabinet and New Economic Measures

In April 1984 the President of Bolivia appointed a new cabinet. Shortly after its installation, the Government adopted a package of measures aimed at arresting the country's economic and financial deterioration. These measures sought to reduce the rate of inflation, strengthen the foreign sector, and reactivate the economy. These aims were to be achieved primarily through a reduction in the public sector deficit and the maintenance of realistic levels of controlled prices, interest rates, and the exchange rate. The authorities said they were aware that the success of these measures would depend on the firmness with which they were implemented.

The measures announced on April 12 included action in respect of fiscal, exchange rate, monetary, and income policies. To reduce the fiscal deficit, the package contained: (1) increases in the domestic prices of petroleum products of between 300 and 500 percent; (2) increases of 200 percent to 300 percent in transportation and electricity rates; (3) the commitment to maintain public sector tariffs and prices at the real levels of April 1984; (4) a reduction of bread and wheat subsidies and the freeing of all agricultural and livestock product prices; (5) a downward revision of presumed costs for the mining sector; and (6) instructions to all public entities to present a revised 1984 budget with major cuts in expenditure. Preliminary calculations indicate that if these measures were implemented fully, the overall deficit of the nonfinancial public sector for 1984 would be reduced to around 15 percent of GDP, from an estimated 40 percent of GDP in the absence of measures.

To compensate workers for the increased prices of basic foodstuffs and transportation, wages were increased in the form of two bonuses amounting to a 95 percent increase in the minimum wage and an overall average pay increase of 50-60 percent. In mid-May 1984, after a series of strikes by public and private sector employees and long negotiations between government officials and labor union leaders, the authorities offered to withdraw the bonuses and instead to increase wages by 100 percent, with effect from March, and to agree to a further increase of 15 percent in June. The wage increase offered for March 1984 would have restored average real wages to the level of March 1983 when the indexation of minimum wages was introduced; it is estimated that in the intervening period real GDP declined significantly. In the future, wages are to be reviewed every four months, but with a modification of the wage indexation formula in effect since March 1983. The new wage policy calls for more discretion in wage adjustments, with account to be taken of economic developments and conditions in the economic sector in question.

Regarding exchange rate policy, on April 12, 1984 the authorities announced the devaluation of the Bolivian peso from $b 500 to $b 2,000 per U.S. dollar,1/ together with the adoption of a crawling peg system whereby the peso was to be adjusted from time to time on the basis of the previous month's rate of inflation. The authorities also liberalized substantially the exchange control system by legalizing the parallel market for tourism receipts, imports other than those prohibited, and payments for travel, education, and health. In the official market, the newly established Monetary Board (described below) was to fix the amount of foreign exchange to be sold each month with separate quotas by industrial subsector for the private sector. In addition, the authorities eliminated the 8 percent tax on nontraditional exports and allowed sales of foreign exchange at the official exchange rate during a period of eight weeks for repayments abroad of private debt of less than US$3,000. Other external debt of the private sector, falling due after April 12, 1984, was required to be renegotiated for a period of not less than eight years, with a four-year grace period. The Central Bank undertook to provide foreign exchange for the repayment of such debt at the official exchange rate prevailing at the time the renegotiated maturities would fall due.

In the monetary area, it was announced on April 12, 1984 that loans could again be denominated in U.S. dollars, with interest rates of up to 16 percent a year for all new credits for export-related activities, direct imports, and operations based on external development assistance. Also, all complementary, retirement, and housing funds, which in November 1982 had been converted from U.S. dollars into pesos, would henceforth be indexed to the U.S. dollar and would pay interest of up to 5 percent a year. Furthermore, in May 1984, the Central Bank raised annual interest rates on savings deposits to 110 percent and on time deposits to 140 percent. Concurrently, the interest rate ceiling on loans in Bolivian pesos was fixed at 150 percent a year.

To assist in the implementation of these measures and to facilitate the pursuit of a more coherent economic policy in the future, a new Monetary Board was created to set monetary, fiscal, exchange, and other financial policies. The Board, which will be headed by the President of the Republic with the Finance Minister as his deputy, includes the four ministers in the economic area and the President of the Central Bank. Also, a new superintendency of banks was created within the Central Bank, but under the supervision of the Monetary Board.

Although the economic package announced in April 1984 falls short of the comprehensive economic stabilization program that would be indicated in the light of Bolivia's very difficult economic situation, its implementation would nevertheless go a long way in alleviating Bolivia's present economic difficulties. However, the measures have met with widespread resistance since their announcement. The employees

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1/ Following this announcement the premium of the U.S. dollar in the parallel market fell from over 500 percent to about 50 percent.

of the Central Bank staged a seven-week strike to prevent enforcement of the devaluation, thereby interrupting all foreign exchange transactions and domestic banking operations except for the payment of wages to public sector employees. Shorter strikes occurred in the public administration (including the Ministry of Finance), in major public enterprises (including YPFB), and in certain private sector activities (including mining). After protracted negotiations with the Government, the nationwide labor federation rejected the Government's wage offer (described above) and insisted on a price freeze for a number of basic foodstuffs. In early June 1984, the implementing regulations of various measures were still outstanding. Notwithstanding the intentions expressed earlier, the official exchange rate remained unchanged at $b 2,000 per U.S. dollar, even though inflation was very high in April and May 1984.1/

The authorities recognize the importance of fully implementing the April measures and have expressed their intention to adopt additional economic measures in the coming months. The measures under study include new taxes aimed at doubling central administration revenue (in 1983 equivalent to only 5.8 percent of GDP), revision of the legal reserve requirements, and a modification of the interest rate ceilings with a view to ensuring that rates would be positive in real terms.

After the formal expiry in January 1984 of the interim plan agreed upon with Bolivia's foreign bank creditors in October 1983 to pay US$7.5 million per month, Bolivia continued to make monthly payments of US$7.5 million until March 1984. Thereafter, the strike of the Central Bank employees prevented the making of further payments. In early May, an understanding was reached with the banks that, except for small amounts to be determined jointly, no interest payments would be made to the banks until mid-June. Around that time, a meeting would be held with the steering committee to discuss the Government's stabilization program and progress achieved in its implementation. Thereafter, a period of about three months would be allowed to renegotiate the bank debt on the basis of a financial arrangement with the Fund. In late May 1984 the Government announced that it had agreed with the labor federation to approach Bolivia's foreign bank creditors with a request to renegotiate outstanding bank loans. Pending the outcome of the renegotiation, Bolivia has temporarily suspended debt service payments to foreign commercial banks. Reportedly debt service payments due to official bilateral creditors also have been held up since the termination of the strike by the central bank employees.

1/ The exchange rate in the parallel market fluctuated in a narrow band of $b 3,200-3,400 per U.S. dollar after the devaluation; in this period individuals and companies were induced to liquidate foreign currency holdings to obtain cash balances because of disruptions in the operation of the banking system.

IV. Staff Appraisal

Bolivia is confronting a critical economic situation. Economic activity has slumped, the inflation rate has soared, and the balance of payments position has deteriorated markedly. The Bolivian authorities have made several attempts in the recent past to stabilize the economy, but these attempts have not produced lasting results. In April 1984 the authorities announced an economic plan which seeks to reduce inflation, strengthen the balance of payments, and reactivate the economy. These aims are to be attained through a significant reduction in the public sector deficit, the pursuit of more realistic exchange rate, interest rate and price policies, and a modification of wage policy. There is an urgent need to implement these policies to their full extent and to adapt them as needed in order to achieve the stabilization objectives.

At the heart of Bolivia's financial crisis has been the progressive worsening of the fiscal situation. In each of the last five years, revenue as a percentage of GDP has declined while current expenditure has increased. Public sector savings became highly negative, and in spite of severe cuts in capital outlays the overall deficit reached more than 18 percent of GDP in 1983. Control over the operations of state enterprises and decentralized agencies has weakened to the point where some entities have stopped paying taxes and transferring to the Treasury taxes collected on its behalf. During the past two years the public sector deficit was financed almost entirely by the Central Bank. Since the country's international reserves are minimal and external credit lines are not available the expansion of credit to the public sector led to strong inflationary pressures.

Implementation of the April 1984 measures--particularly the adjustment of public sector prices and cuts in expenditures--would make a contribution to the strengthening of the public finances. However, much bolder fiscal action, covering both revenue and expenditure, will be necessary if the fiscal imbalance is to be reduced as needed. The staff urges the authorities to enact without delay the tax package currently under consideration, and to take prompt action to secure greater control over expenditures and to improve the operation of the public sector agencies. The preparation and congressional approval of a budget for 1984 would be a necessary first step to establish control over public sector finances.

The fiscal efforts just referred to need to be complemented in due course by a more comprehensive plan designed to address structural deficiencies in the public sector finances. Such a plan should include the broadening of the tax base, the change of specific taxes to an ad valorem basis, the indexation of tax liabilities to inflation, and the strengthening of tax administration. Efforts also should be made to reorganize the administrative and financial structure of the state enterprises, so that they might contribute effectively to the development effort in the years to come.

If the Government is to make the public sector a key agent in fostering economic development, it is essential that this sector generate savings sufficient to finance badly needed investments, particularly since external financing is likely to be very limited. Moreover, in order to make best use of the limited financial resources available, public sector investment decisions should be subjected to rigorous scrutiny.

The unsettled political situation has resulted in a marked deterioration in the management of all public entities, and at the same time the flow of information has become increasingly unreliable. Effective implementation of an economic program will require substantial improvement in the availability and quality of economic data. Thus, the staff welcomes the authorities' requests for technical assistance, particularly the service of experts in the fiscal, monetary, and external debt areas.

In the field of monetary policy, the financing requirements of the nonfinancial public sector have resulted in a strong expansion of net domestic credit. At the same time, the acceleration in inflation has seriously eroded the real financial savings accruing to the banking system because of the application of interest rates ceilings. The existing regulations on interest rates, reserve requirements, and taxes on financial transactions constitute serious impediments to an efficient functioning of the financial system. It is the view of the staff that monetary policy instruments need to be revised and interest rate ceilings phased out in order to improve the capacity of the financial system to capture and allocate financial savings.

The staff shares the view of the authorities that the wage indexation formula needed to be modified in order to make it possible to deal with the inflationary spiral. Pressures for additional wage increases have intensified since wage arrangements were changed, however, and thus the authorities will need to stand firm if employment is to be protected as inflation is being reduced.

The policy of maintaining a fixed exchange rate at a time of high inflation has had adverse effects on production as it has reduced the competitiveness of the economy and distorted resource allocation. For these reasons, the staff welcomes the recent devaluation of the Bolivian peso and supports fully the authorities' intention to follow a flexible exchange rate policy. However, the failure until mid-June 1984 to put this policy into effect in the face of record inflation is a matter of great concern. In the staff's view the exchange rate should be adjusted as necessary to ensure that Bolivia achieves a degree of competitiveness sufficient to protect the balance of payments. Thereafter, the high rate of inflation currently experienced by Bolivia would indicate the need to adjust the exchange rate frequently so as to maintain a cost-price relationship consistent with a satisfactory balance of payments outcome. As public sector revenues in Bolivia are highly dependent on exports and taxes on international trade, such an exchange rate policy also would contribute to the strengthening of the fiscal position.

While implementation of the newly established exchange system would help to relieve balance of payments pressures over the longer term, such pressures are likely to continue to be strong in the immediate future. In view of the heavy burden of servicing the external debt and the country's weak foreign exchange position, the authorities intend to seek further debt relief from foreign commercial banks and other external creditors. A number of Bolivia's creditors have indicated that economic assistance and debt relief would be conditional upon Bolivia's framing an economic program that would qualify it for assistance from the Fund.

At present Bolivia maintains the following exchange practices subject to the Fund's approval jurisdiction under Article VIII: (1) external payments arrears, (2) minimum repayment terms on foreign credit, (3) restrictions on the availability of foreign exchange for imports and invisible payments, and (4) a multiple currency practice arising from the existence of a recognized parallel market. The staff would urge the Bolivian authorities to implement the policy measures that would enable them to phase out the multiple currency practice and restrictions on payments and transfers for current international transactions. In the meantime, Fund approval of Bolivia's exchange restrictions and multiple currency practice is not being proposed.

It is recommended that the next Article IV consultation with Bolivia be held on the standard 12-month cycle.

Bolivia--Basic Data

Area and population	
Area	1,098,000 sq. kilometers
Population (1983 est.)	6.8 million
Annual rate of population increase (1972-82)	2.66 percent
GDP per capita (1983)	SDR 792

Origin of real GDP (1983)	(percent)
Agriculture	16.6
Mining	7.8
Manufacturing	15.9
Construction	1.3
Transport and communications	12.5
Government	11.9
Other services	34.0

Ratios to GDP (1983)	
Exports of goods and nonfactor services	20.2
Imports of goods and nonfactor services	14.0
Central administration revenues	5.8
Central administration expenditures	19.7
External public debt (end of year)	55.1
Saving	3.6
Investment	6.2
Money and quasi-money 1/	12.4

Annual changes in selected economic indicators	1981	1982	Prel. 1983
		(percent)	
Real GDP per capita	-4.1	-11.1	-10.1
Real GDP	-1.5	-8.7	-7.7
GDP at current prices	27.3	114.2	238.2
Domestic expenditures (at current prices)	35.4	97.0	236.7
Investment	6.1	93.7	115.5
Consumption	39.7	96.8	251.2
GDP deflator	29.2	134.8	266.5
Cost of living (La Paz) (annual averages)	32.6	122.7	275.6
Central administration total revenues	45.0	56.6	161.7
Central administration total expenditures	35.0	82.5	388.6
Money and quasi-money 2/	29.3	234.1	167.8
Money	19.2	235.9	209.6
Quasi-money	46.4	231.6	110.0
Net domestic bank assets 3/	54.4	186.8	182.0
Credit to public sector (net)	20.2	117.0	212.4
Credit to private sector	18.7	24.0	36.7
Merchandise exports (f.o.b., in U.S. dollars)	-3.2	-9.3	-6.0
Merchandise imports (c.i.f., in U.S. dollars)	43.7	-48.6	6.1

Central administration finances	1981	1982	Prel. 1983
	(millions of Bolivian pesos)		
Revenues	18,018	28,209	73,831
Expenditures	24,626	47,680	249,583
Current account surplus or deficit (-)	-6,608	-19,471	-175,752
Overall deficit (-)	-11,364	-25,422	-188,197
External financing (net)	6,348	2,425	553
Internal financing (net)	5,016	22,997	187,644

Balance of payments	1981	1982	Prel. 1983
	(millions of U.S. dollars)		
Merchandise exports (f.o.b.)	912	828	778
Merchandise imports (c.i.f.)	-1,010	-520	-551
Factor income (net)	-396	-435	-423
Other services and transfers (net)	4	22	79
Balance on current and transfer accounts	-490	-105	-117
Official capital (net) 4/	244	-171	-617 5/
Unpaid debt service 6/	137	298	639 5/
Banking system, n.i.e. (net)	66	-48	373 7/
Private capital and errors and omissions (net)	-145	77	79
Arrears on gas exports (increase -)	--	-145	-72
Allocation of SDRs and gold monetization	9	2	1
Change in banking system net reserves (increase -)	178	92	-286 7/

International reserve position 8/	December 31 1981	1982	1983
	(millions of SDRs)		
Central Bank (gross)	132	182	167
Central Bank (net)	-221	-296	-21
Rest of banking system (net)	-47	-67	-88

1/ Average of end-of-month stocks.
2/ Banking system liabilities to private sector at end of year.
3/ In relation to the stock of money and quasi-money at the beginning of the period. Excludes contra-entry of SDR allocations.
4/ Includes principal falling due but left unpaid (deferments, refinancing and rescheduling, and arrears).
5/ Includes US$428 million of principal and interest on short-term debt refinanced as medium-term debt.
6/ Net variation of principal and interest deferred, refinanced or rescheduled and in arrears.
7/ Includes the conversion of US$405 million of short-term debt of the Central Bank into medium-term debt.
8/ Gold valued at US$42.22 per troy ounce.

Fund Relations with Bolivia
(As of April 30, 1984)

I. Membership Status

(a) Date of membership: December 1945.
(b) Status: Article VIII.

(A) Financial Relations

II. General Department

(a) Quota: SDR 90.72 million.
(b) Total Fund holdings of Bolivian pesos: SDR 170.25 million equivalent to 187.7 percent of quota
(c) Fund credit to Bolivia An amount of SDR 79.5 million, equivalent to 87.7 percent of quota:

	Millions of SDRs	Percent of Quota
Credit tranche		
Ordinary resources	16.16	17.82
Supplementary resources	20.99	23.14
Compensatory financing	17.90	19.74
Buffer stock	24.47	26.98

III. Stand-by Arrangements, Special Facility, and Trust Fund Loans:

(a) No current arrangement.

(b) Previous stand-by arrangements: Bolivia has had two stand-by arrangements since 1973. The last one, approved in February 1980, for SDR 66.38 million was cancelled in January 1981 with an undrawn balance of SDR 13 million.

(c) Special facilities: A purchase of SDR 24.47 million under the buffer stock financing facility was made in June 1982. Bolivia purchased SDR 17.90 million under the compensatory financing facility in January 1983.

(d) Trust Fund loans: Bolivia received two loans in 1978 and 1980 totaling SDR 36.2 million.

IV. SDR Department

(a) Net cumulative allocation: SDR 26.7 million.

(b) Holdings: SDR 1.58 million, or 5.9 percent of net cumulative allocations.

V. Gold Distribution and Distribution of Profits from Sales of Gold

Gold distribution:	Bolivia received gold amounting to 31,665.985 fine ounces.
Distribution of profits from sale of gold:	Bolivia received a total of US$5.89 million.

(B) Nonfinancial Relations

VI. Exchange Rate Arrangement: The currency of Bolivia is the peso. The exchange rate of the peso was unified on November 9, 1982 at a fixed rate of $b 196 per U.S. dollar (buying) and extensive exchange controls were imposed, requiring all foreign exchange transactions to be channelled through and approved by the Central Bank in accordance with certain priorities determined by the Government. An active but illegal parallel market continued to function. After the devaluation of the official rate to $b 500 per U.S. dollar (buying rate; $b 510.2 per U.S. dollar selling rate) effective November 21, 1983 the parallel rate stabilized at around $b 1,200 per U.S. dollar but subsequently rose to over $b 3,000 in mid-March 1984. With effect from April 13, 1984, the Central Bank's buying and selling rates for the U.S. dollar have been changed to $b 2,000 per U.S. dollar (buying) and $b 2,039 per U.S. dollar (selling). At the same time, the parallel market was legalized for specified transactions. The rate in the parallel market has moved in a narrow band of $b 3,200-3,400 since mid-April 1984. External payment arrears have continued to accumulate.

VII. Last Consultation: The 1982 Article IV consultation was concluded on January 10, 1983 (SM/82/137 and Sup. 1).

VIII. Technical Assistance: In 1983 there were two technical missions and an expert in central bank supervision in Bolivia. An expert in the area of budget preparation was in La Paz in May-June 1984.

IX. Resident Representative: Mr. Carl-Johan Lindgren was stationed as Resident Representative in Bolivia during the period September 1981-May 1983. His replacement, Mr. Joachim Harnack, took up his duties in June 1983.

X. Current Data: Generally not adequate because of conceptual and methodological problems in all areas. These problems have been aggravated in 1984 by reporting and compilation lags resulting from the pervasiveness of strikes.