

EBS/86/120
Correction 1

CONFIDENTIAL

June 16, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Bolivia - Request for Stand-By Arrangement

The following corrections have been made in EBS/86/120 (6/2/86):

Page 21, line 5: for "US\$143 million" read "US\$190 million"

line 6: for "US\$104 million" read "US\$224 million"

Page 24, Table 7, merchandise trade: for "-64 -11 22 44 61 66"
read "-67 -14 19 41 58 62"

Corrected pages are attached.

Att: (2)

short-term trade facility provided by the banks. The balance of payments projection for 1986 includes a provision for net cash payments to the commercial banks along these lines. A meeting with the Paris Club has been scheduled for June 1986 to consider Bolivia's request to reschedule an estimated US\$190 million of debt service in arrears at the end of 1985 and about US\$224 million of debt service falling due in 1986. Argentina and Brazil, Bolivia's largest and third largest official bilateral creditors (Statistical Appendix Table 19), are expected to participate in that meeting. Bolivia is seeking debt relief from the socialist countries and private creditors on terms comparable to those to be granted by the Paris Club.

As already mentioned, the understandings to be reached shortly with the creditors are expected to permit Bolivia to eliminate its arrears by early 1987. The authorities are determined not to extend any public sector guarantees to private debtors. Although short-term external indebtedness is currently very low, the Central Bank is setting up a reporting system for the contracting or guaranteeing of such debt by the public sector. If technically feasible, a ceiling on such debt will be set at the time of the mid-term review to limit the rise of short-term indebtedness after Bolivia's creditworthiness improves.

4. Structural and institutional reforms

Upon embarking on their new economic policy in August 1985, the authorities announced several measures to overcome structural rigidities and stimulate private investment and growth. They intend to continue with the implementation of these measures during the program period.

In the financial system, the authorities are planning to give more independence to the superintendency of banking by converting it from a department of the Central Bank to an autonomous entity directly responsible either to the Central Bank's board of directors or to the President of the Republic. The authorities also plan to remove development banking functions from the Central Bank and to set up a separate development bank to channel external lines of credit to the commercial banks and to the specialized banks (if it can be shown that the latter should be maintained). To provide the institutional setting for the development of a domestic financial market, the authorities are studying the feasibility of creating a national stock exchange.

Structural changes are being introduced in the state enterprise sector. The petroleum company and the mining company are being reorganized and decentralized with technical assistance from the World Bank. Prior to the reorganization, the assets of the smelting company (ENAF) and the lead-silver smelter (SCMK) were transferred to the mining company. Also, the assets of the enterprises fully owned by the development corporation (CBF) and the road transport company (ENTA) were transferred to regional and local bodies. Private sector concessionaires were invited to take over the local distribution of petroleum products.

Within the context of encouraging fixed capital formation in the private sector, direct foreign investment is welcomed by the authorities. To this effect, the vast exclusive exploration and exploitation rights of the state companies in the mining and hydrocarbons sector have been curtailed significantly. The previously mentioned elimination of the tax on profit remittances abroad and the recent liberalization of rules restricting foreign investment from, and profit remittances to, countries outside the Andean region also should help to improve the investment climate. In addition, the authorities are reviewing the relevant legislation and institutional arrangements governing private investment. Finally, an agreement with the U.S. Overseas Private Investment Corporation (OPIC) was signed in late 1985, and Bolivia signed the convention establishing the Multilateral Investment Guarantee Agency (MIGA) in early May 1986.

With the abolition of the labor stability regulations, employers in the private and public sectors are free to lay off workers for economic reasons. The Government does not intend to intervene in the wage determination process in the private sector, except that the minimum wage (currently at \$b 30 million a month) also applies to the private sector. Finally, the number of paid holidays has been reduced substantially.

The authorities have requested technical assistance from the Fund and other international organizations to help them in their efforts to rebuild institutions, strengthen administrative procedures, and improve the statistical data base. 1/

5. Performance criteria and mid-term review

To monitor the implementation of the program, the proposed stand-by arrangement relies on the following performance criteria: (i) limits on the borrowing requirement of the nonfinancial public sector, to be verified quarterly; (ii) ceilings on the net domestic assets of the Central Bank and subceilings on the net debtor position of the nonfinancial public sector, to be verified continuously; (iii) targets for the net international reserves of the Central Bank, to be verified quarterly; (iv) ceilings on external arrears, to be verified quarterly; (v) ceilings on external public and publicly guaranteed debt disbursed and outstanding in the one- to ten-year maturity range, to be verified quarterly; and (vi) the operation of the foreign exchange auction system during the program period in such a way that the premium of the exchange rate in the parallel market over the official exchange rate will not exceed 5 percent. In addition, the proposed arrangement contains the customary provisions on the exchange and trade system. The authorities are in the process of establishing a reporting and monitoring system for short-term public debt, which may be subjected to a ceiling at the time of the mid-term review, to be completed by November 15, 1986 as an

1/ Technical assistance provided by the Fund is described in Appendix I.

additional performance criterion. In view of the large uncertainties adhering to financial programming in Bolivia's circumstances and, in particular, the difficulty in assessing the impact of the tax reform package, the limits and targets corresponding to criteria (i) through (v) now are indicative beyond September 30, 1986; limits and targets for the remaining period of the stand-by arrangement will be established at the time of the mid-term review.

The mid-term review will focus on the progress made in the implementation of the program in general--especially on the expected improvement of collections of import duties and internal revenue taxes--and on the implementation of the tax reform package and of the investment program, which is undergoing a detailed review by the World Bank. In conducting the mid-term review, particular attention also will be given to policies with regard to the exchange rate, interest rates, wages, and state enterprise pricing, including the prices of petroleum products.

V. Medium-Term Balance of Payments and External Debt Scenarios

The authorities recognize that--even with the very substantial adjustment now being undertaken and the continued pursuit of restrained domestic financial policies--the medium-term outlook for the balance of payments remains difficult. On the basis of the limited scope for an expansion in export earnings in the near term and given the still considerable debt service burden, a financing gap would remain for a number of years after the program period (Table 7). Successive restructuring agreements would seem to be required to close this gap.

The balance of payments projection assumes that the volume of exports will increase substantially during 1987 and 1988, as the volumes of mining and nontraditional exports return to the levels reached at the beginning of the decade. Exports would continue to grow at a moderate pace in subsequent years, on the strength of some further growth in volumes and a modest recovery in major metal prices from their current low levels. In addition, it is assumed that the marked increase in disbursements expected for 1986 from multilateral development banks (in particular the World Bank and the Inter-American Development Bank) and official bilateral creditors will be maintained during 1987-91. As relations with the major creditors are normalized, it also is expected that there would be an upturn in suppliers' credits, particularly in the later years of the period. Net inflows of foreign direct investment also are projected to increase. Under these relatively favorable assumptions, the financing gap would narrow gradually over time.

The size of the projected financing gap is particularly uncertain for the period after 1988, when debt service obligations begin to fall due on the 1986 debt restructuring and on the debt incurred to close the financing gap in 1987-88. The projection foresees a decline in debt service obligations to US\$575 million until 1988, followed by an

Table 7. Bolivia: Medium-Term Balance of Payments Projections

(In millions of U.S. dollars)

	1986	1987	1988	1989	1990	1991
<u>Current account</u>	<u>-354</u>	<u>-329</u>	<u>-311</u>	<u>-335</u>	<u>-377</u>	<u>-407</u>
Merchandise trade	-67	-14	19	41	58	62
Exports, f.o.b.	544	606	674	735	792	855
Imports, c.i.f.	-611	-620	-655	-694	-734	-793
Interest, net	-268 <u>1/</u>	-271	-281	-326	-382	-413
Other services and transfers	-19	-44	-49	-50	-53	-56
<u>Capital account</u>	<u>-26</u>	<u>29</u>	<u>81</u>	<u>160</u>	<u>224</u>	<u>366</u>
Direct investment	25	30	33	36	40	44
Long-term capital (public sector)	-66	-26	23	99	159	297
Disbursements	246	277	300	332	386	490
Amortization	-312 <u>2/</u>	-303	-277	-233	-227	-193
Short-term and other <u>3/</u>	15	25	25	25	25	25
<u>Overall balance</u>	<u>-380</u>	<u>-300</u>	<u>-230</u>	<u>-175</u>	<u>-153</u>	<u>-41</u>
Exceptional financing	328	270	230	175	163	61
<u>Net official reserves</u>	<u>51</u>	<u>30</u>	<u>—</u>	<u>—</u>	<u>-10</u>	<u>-20</u>
<u>Memorandum items:</u>						
As percent of GDP						
Current account	-7.9	-6.9	-6.1	-6.1	-6.4	-6.4
Exports, f.o.b.	12.1	12.7	13.1	13.3	13.4	13.5
Imports, c.i.f.	-13.6	-12.9	-12.7	-12.6	-12.5	-12.6
Principal assumptions (in percent)						
Real GDP growth	—	3.5	3.5	3.5	3.5	3.5
World inflation	3.5	3.2	3.7	3.7	3.7	3.7
LIBOR interest rate <u>4/</u>	7.5	7.5	7.5	7.5	7.5	7.5

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

1/ Includes unpaid interest.

2/ Includes unpaid amortization.

3/ Includes contributions to international organizations, gold monetization, and changes in commercial bank reserves.

4/ WEO projection.