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January 21, 2009

The Acting Chair's Summing Up
Bolivia—2008 Article IV Consultation
Executive Board Meeting 09/4
January 14, 2009

Executive Directors agreed with the thrust of the staff appraisal. They noted that strong hydrocarbons and mining exports have continued to support Bolivia's growth and macroeconomic performance. In 2008, real GDP growth picked up, the external current account surplus remained large, and international reserves reached record levels. The combined public sector balance remained in surplus, benefiting from continued high export-based revenues. The currency strengthened, which contributed to a further significant reduction in deposit dollarization.

Directors noted that risks to Bolivia's outlook have increased because of the sharp deterioration of the global economic environment. Lower energy and mineral prices and an expected decline in remittances could slow GDP growth and push both the fiscal and external current accounts into deficits. Key policy challenges for the authorities will be to maintain sound fiscal and external positions, to consolidate the decline in inflation observed in recent months, and to reduce widespread poverty through increased investment.

Directors stressed that the increase in risks to the outlook requires a proactive fiscal response. They welcomed the authorities' fiscal strategy, which includes cuts in lower-priority capital expenditure while preserving social spending. To reduce dependency on volatile export-based revenue and ensure inter-generational sharing of hydrocarbon wealth, Directors saw a need to target a reduction in the non-hydrocarbons fiscal deficit over the medium term. They encouraged the authorities to seize the opportunity of declining oil prices to reduce gradually hydrocarbons subsidies, while using part of the resulting fiscal savings to protect vulnerable groups. Appropriate wage restraint, and a rigorous prioritization of investment projects will also be important.

Directors emphasized the importance of well-designed structural reforms for further strengthening Bolivia's fiscal position. They considered that the tax system could be simplified to improve its efficiency and equity, including through streamlining the value added tax framework and closing loopholes in the corporate income tax. They noted the need to better balance expenditure allocations and available resources at each level of government, and to improve the budget process.

While recognizing the role of supply shocks in raising inflationary pressures, most Directors saw merit in a more active monetary policy to help speed up the decline in inflation to single digits. In particular, they encouraged the central bank to conduct open market operations in a manner consistent with bringing about positive real interest rates on non-indexed bonds, and thereby eliminate the incentive for indexation. Higher real interest rates and lower inflation would also help consolidate the reduction in dollarization achieved in recent years. A few Directors cautioned against proposals that could affect the independence of the central bank.

Directors considered the real effective exchange rate level to be broadly appropriate. Many Directors believed that greater exchange rate flexibility, supported by an appropriate monetary policy framework, would help absorb possible negative external shocks stemming from adverse movements in commodity prices. A few Directors, however, noted that greater flexibility in the current environment could rekindle inflationary pressures and risk reversing the de-dollarization trend of recent years.

Directors noted that Bolivia's financial sector appears to be stable and highly liquid, and is unaffected by the global financial crisis. Nonetheless, efforts to reduce vulnerabilities need to continue. Directors welcomed plans to fully adopt international accounting standards and the ongoing efforts to improve risk management practices in banks. They encouraged the authorities to introduce prudential regulations that mitigate market risks and credit risks from dollarization. Other pending reforms to be addressed include the introduction of a deposit insurance scheme, the adoption of legislation governing corporate bankruptcy and restructuring. A few Directors called for the strengthening of the anti-money laundering regime. Directors supported the proposed FSAP update in 2010.

Directors stressed the importance of improving the investment climate—including constructive negotiations with investors in disputed contracts—as Bolivia's private investment rate remains significantly below the levels observed in the past decade and well below the regional average. This will be the key to fostering broad-based economic growth and reducing poverty.

The next Article IV consultation with Bolivia is expected to be held on the standard 12-month cycle.