FOR AGENDA

EBS/88/131

CONFIDENTIAL

July 11, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Bolivia - Staff Report for the 1988 Article IV Consultation and Request for Arrangements Under the Enhanced Structural Adjustment Facility

Attached for consideration by the Executive Directors is the staff report for the 1988 Article IV consultation with Bolivia and its request for arrangements under the enhanced structural adjustment facility (ESAF). Draft decisions appear on pages 26 and 27.

This subject, together with Bolivia's request for a purchase under the compensatory financing facility (EBS/88/132, 7/11/88), will be brought to the agenda for discussion on a date to be announced.

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

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

BOLIVIA

Staff Report for the 1988 Article IV Consultation and Request for Arrangements Under the Enhanced Structural Adjustment Facility

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

(In consultation with the Fiscal Affairs, Legal, Research, and Treasurer's Departments)

Approved by S. T. Beza and S. Kanesa-Thasan

July 8, 1988

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I. Introduction

Article IV consultation discussions and negotiations on an economic program that could give Bolivia access to Fund resources were held in La Paz during the periods December 8-23, 1987 and January 25-February 13, 1988 and in Washington, D.C. during May 2-20, 1988. The Bolivian representatives included the Ministers of Planning; Finance; Foreign Affairs; Tax Collection; Mining; Industry; Agriculture; Energy; and Labor; the President of the Central Bank, and other senior officials. 1/

On December 15, 1986 the Executive Board concluded the midyear review of the stand-by arrangement for SDR 50 million (55.1 percent of quota) that had been approved on June 19, 1986 (EBS/86/120, 6/2/86). The final purchase under that arrangement could not be made because certain performance criteria for March 1987 were not observed and the arrangement expired on July 20, 1987. In December 1986 the Board also approved Bolivia's requests for arrangements under the structural adjustment facility (EBS/86/263, 11/26/86) and for a purchase of SDR 64.1 million (70.7 percent of quota) under the compensatory financing facility (EBS/86/264, 11/26/86). Bolivia has received the first annual disbursement under the SAF of SDR 18.14 million (20 percent of quota). The financial benchmarks under the SAF were not observed after the first quarter of 1987 but progress in meeting the structural benchmarks was broadly satisfactory. The last Article IV consultation with Bolivia was concluded on December 15, 1986. On February 4, 1988 the Board was noti- fied that, as a result of continuing discussions on the use of Fund resources, conclusion of the 1988 Article IV consultation would be delayed beyond the normal cycle.

A policy framework paper for the period 1988-91, which updates and extends the PFP transmitted to the Fund in November 1986, has been distributed separately as EBD/88/173 (6/23/88). In the attached letter dated June 30, 1988 the Bolivian authorities request Fund support under the Enhanced Structural Adjustment Facility in an amount of SDR 136.05 million (150 percent of quota) and the first annual arrangement thereunder (Attachment II). The objectives and policies that the authorities intend to pursue in the three-year program period that began on April 1, 1988 and the targets and limits for 1988 are described in the Memorandum of Economic and Financial Policies of Bolivia (Attachment III). Disbursements under the proposed arrangement are shown in Table 1.

The Bolivian authorities also are expected to request a purchase of SDR 45.3 million (49.9 percent of quota) under the Compensatory Financing Facility. A paper in support of that request is being circulated

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1/ The staff representatives in the first two missions were Mr. Flickenschild (Head-WHD), Ms. Almuiña (EP-WHD), Messrs. Hoelscher, Rennhack, Sol Pérez (all WHD), Ms. Xafa (ETR), and Misses Edwards and Smith-Croxatto (secretaries-WHD). Mr. Gil Díaz, the Fund's resident representative in La Paz, assisted these missions.

separately (EBS/88/132, 7/11/88). Prior to Executive Board consideration of this request, Bolivia is expected to make a repurchase in respect of an overcompensation of SDR 34.1 million, which had been obtained in December 1986 on the basis of partly estimated data (see EBS/87/212). The requested purchase would raise Bolivia's holdings under the CFF to 83 percent of quota. Full use of the requested ESAF would increase Fund credit to Bolivia to SDR 218.05 million (240.4 percent of quota) at the end of the program period in March 1991 (Table 2).

Table 1. Bolivia: Schedule of Proposed Disbursements Under the Enhanced Structural Adjustment Facility, April 1988-March 1991

Amount (SDR millions)	Scheduled Availability	Conditions Necessary for Disbursement
22.675	Late July 1988	Executive Board approval of request for ESAF and first annual arrangement.
22.675	December 1988	Observance of performance criteria for September 30, 1988 and completion of Executive Board review.
22.675	June 1989	Executive Board approval of second annual arrangement.
22.675	December 1989	Observance of performance criteria for September 30, 1989 and completion of Executive Board review.
22.675	June 1990	Executive Board approval of third annual arrangement.
22.675	December 1990	Observance of performance criteria for September 30, 1990 and completion of Executive Board review.

Source: Bolivia--Enhanced Structural Adjustment Facility, Attachment I.

Bolivia has accepted the obligations of Article VIII of the Articles of Agreement. In January 1988 Bolivia began to incur arrears on its financial obligations to the Fund (see EBS/88/38, 2/22/88), but became current on April 21, 1988. 1/

1/ Bolivia's relations with the Fund and the World Bank group are summarized in Appendices I and II, respectively.

Table 2. Bolivia: Fund Position During the Period April 1988-March 1991

	Outstanding March 31, 1988	First Program Year 1/ QI	QII	QIII	QIV	Second Program Year 1/	Third Program Year 1/
		(In millions of SDRs)					
Transactions under tranche policies (net)		--	--	--	--	-9.02	-16.35
Purchases		--	--	--	--	--	--
Ordinary resources		--	--	--	--	--	--
Enlarged access		--	--	--	--	--	--
Repurchases		--	--	--	--	9.02	16.35
Ordinary resources		--	--	--	--	9.02	16.35
Enlarged access		--	--	--	--	--	--
Transactions under Compensatory Financing Facility (net)		-2.24	11.18	--	--	-3.75	-15.00
Purchases		--	45.28	--	--	--	--
Repurchases		2.24 2/	34.10	--	--	3.75	15.00
Disbursements under SAF/ESAF		--	22.67	22.68	--	45.35	45.35
Total Fund credit outstanding (end-of-period)	117.18	114.94	148.79	171.47	171.47	204.05	218.05
Under tranche policies	32.70	32.70	32.70	32.70	32.70	23.68	7.33
Under Compensatory Financing Facility	66.34	64.10	75.28	75.28	75.28	71.53	56.53
Under SAF/ESAF	18.14	18.14	40.81	63.49	63.49	108.84	154.19
		(In percent of quota) 3/					
Total Fund credit outstanding (end-of-period)	129.2	126.7	164.0	189.1	189.1	225.0	240.4
Under tranche policies	36.1	36.1	36.1	36.1	36.1	26.1	8.1
Under Compensatory Financing Facility	73.1	70.7	83.0	83.0	83.0	78.9	62.3
Under SAF/ESAF	20.0	20.0	45.0	70.0	70.0	120.0	170.0

Source: Fund staff projections.

1/ Program year April-March.
2/ Represents settlement of SDR 2.24 million of arrears in April 1988.
3/ Subtotals may not add to totals due to rounding.

II. Background and Recent Economic Developments

1. Developments until 1986

Following many years of inadequate economic policies, severe distortions, large public sector deficits and spiraling inflation, the new Government of Bolivia in late August 1985 embarked on a radical reorientation of economic policy. Prices in the product, labor, exchange and financial markets were freed and the Government reestablished effective control over the operations of the public sector. This action was followed by various structural reforms, including approval of a new tax system, reorganization of the state enterprises, and overhaul of the financial system. As a result, the scope of government intervention in economic matters was reduced to a few clearly defined productive activities, the provision of basic infrastructure and essential social services, and the establishment of a stable regulatory framework.

Notwithstanding a large deterioration of the terms of trade, the adjustment effort met with considerable success. The 12-month rate of inflation fell from 23,500 percent in September 1985 to 66 percent in December 1986 (Chart 1), and the net international reserves of the Central Bank increased in 1986. However, economic activity continued to contract in 1986 and unemployment rose, partly reflecting sizable layoffs in the public sector.

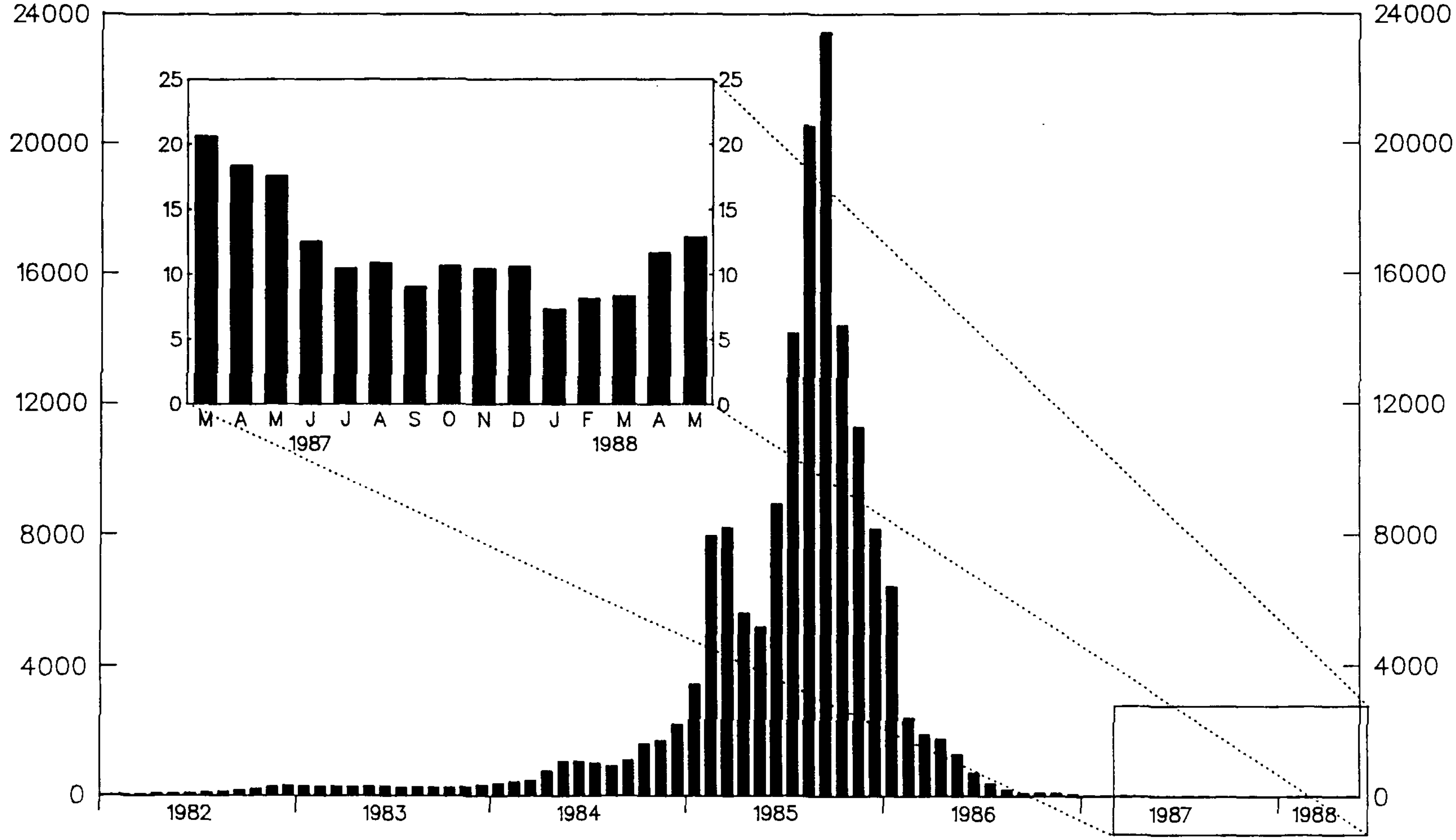
In concluding the 1986 Article IV consultation Executive Directors expressed satisfaction that the policies initiated in August 1985 had succeeded in stopping hyperinflation, restoring a flexible price system and a liberal exchange and trade system, achieving a relatively stable exchange rate, and reducing rapidly the public sector borrowing requirement (SUR/86/129). Directors noted that these favorable results had been achieved despite adverse shifts in Bolivia's terms of trade. They expressed concern about the continuing recession and the rise in unemployment, which were largely due to adverse external developments and delays in implementing foreign-financed investment projects, but stressed the need for sustained implementation of adjustment policies and timely adoption of measures to ensure that performance remained on track.

2. Developments in 1987 and early 1988 1/

After contracting in 1986, real GDP increased by 2 1/2 percent in 1987 (Table 3), led by construction, manufacturing, and related service activities. With the closure of the state mining company (COMIBOL) for

1/ The quality and timeliness of official statistics in Bolivia continue to pose problems (see Appendix III). The reorganization of the Central Bank in 1987 has affected particularly the preparation of external debt, balance of payments, and financial system data.

CHART 1
BOLIVIA
CONSUMER PRICE INCREASES
(Percent change over the corresponding month of preceding year)



Source: National Institute of Statistics.

Table 3. Bolivia: Selected Economic Indicators

	1985	1986	1987 Prog.	1987 Actual	Prog. 1988
(Annual rates of growth)					
Output					
Real GDP at market prices	-0.2	-2.9	3.2	2.4	2.5
Of which:					
Agriculture 1/	9.1	-4.7	3.0	-0.2	1.3
Mining and hydrocarbons 1/	-12.6	-15.6	6.0	-1.9	7.3
Manufacturing 1/	-9.3	2.1	0.4	7.2	2.5
Real GDP per capita	-2.9	-5.5	0.4	-0.4	-0.3
Prices					
GDP deflator	11,239.2	246.3	11.2	13.8	16.0
Consumer prices					
Average	11,749.6	276.3	13.9	14.6	11.6
End-of-period	8,163.4	66.0	9.2	10.6	12.5
(In percent of GDP)					
Consumption	84.1	96.9	91.5	97.9	95.6
Gross domestic investment	15.0	8.0	12.4	10.1	12.7
Exports of goods and nonfactor services	14.5	17.3	14.7	14.4	15.1
Imports of goods and nonfactor services	-13.6	-22.3	-18.6	-22.4	-23.4
External savings	6.1	10.4	9.4	11.3	11.4
National savings	8.9	-2.4	3.0	-1.2	1.3
Nonfinancial public sector	-9.4	-0.7	0.5	-2.5	0.1
Private sector	18.3	-1.7	2.5	1.3	1.2

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

1/ At producer prices.

reorganization, mining output contracted for the sixth consecutive year. Real domestic demand expanded by 3 1/2 percent, with total investment rising from 8 percent of GDP in 1986 to 10 percent of GDP.

Although employment increased at about the same pace as output, the unemployment rate rose slightly in 1987 to 20 1/2 percent, reflecting the rapid growth of the labor force. The 12-month rate of increase in consumer prices declined to 10 1/2 percent in December 1987, but accelerated to 13 percent in May 1988 after a sizable adjustment of prices of petroleum products.

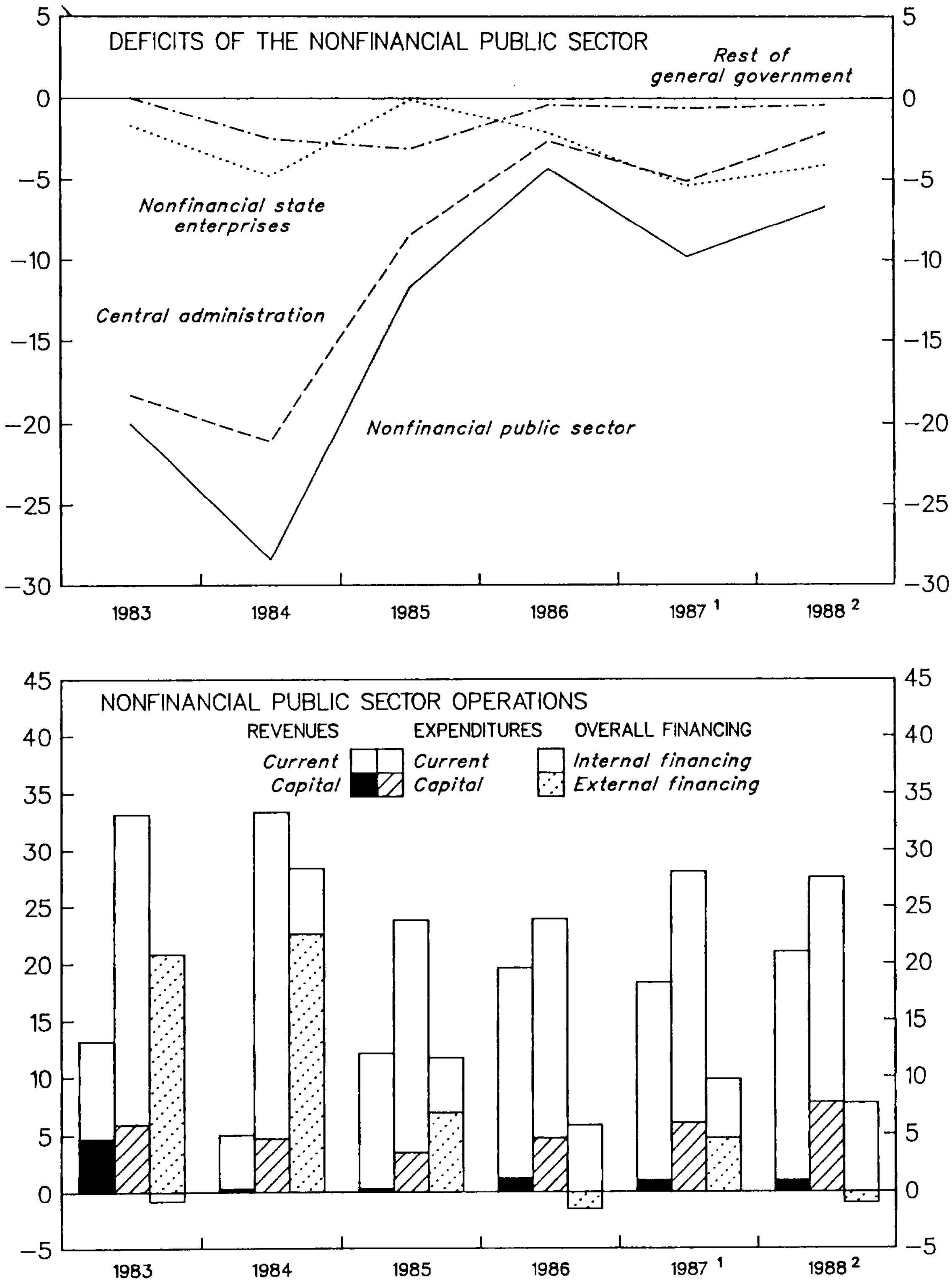
Fiscal performance weakened in 1987 as savings (with interest on a commitment basis and export receipts on an accrual basis) deteriorated from a negative 1 percent of GDP in 1986 to a negative 2 1/2 percent in 1987 (Chart 2 and Table 4). Since investment rose, the overall deficit widened from about 4 1/2 percent of GDP in 1986 to 7 1/2 percent of GDP in 1987. On a cash basis, the current and overall fiscal deficits were equivalent to about 5 percent of GDP and 10 percent of GDP, respectively, in 1987 because payment for a substantial part of Bolivia's gas exports to Argentina in that year was not received. 1/

As a result of the tax reform in April 1987, receipts of internal taxes and import duties rose from 4 percent of GDP in 1986 to 6 1/2 percent of GDP in 1987, mainly reflecting collections under the new value added tax. 2/ Cash receipts from the sale of hydrocarbon products--the most important source of fiscal revenue--declined from almost 16 percent of GDP in 1986 to 10 percent of GDP in 1987 because of lower export prices for gas, the delays in gas export receipts, and a freeze of a domestic prices of petroleum products.

1/ Natural gas is exported to Argentina under a 20-year contract through 1992 that sets the annual minimum volume of purchases by Argentina. In the past, prices and payment modalities were subject to periodic negotiations between the two countries. In September 1987 agreement was reached on the price of gas exported in 1987 and a schedule for payments falling due in 1987, including the elimination of all overdue payments by October 1988. The agreement also contained a price-setting formula and payment modalities until the expiration of the contract in 1992, and rescheduled Bolivia's debt to Argentina (US$109 million in arrears and US$580 million of unmatured principal) over 25 years, including 15 years' grace, at an interest rate of 8 percent a year. However, payments not made as originally scheduled increased by US$96 million (2.3 percent of GDP) in 1987 to a total of US$120 million.

2/ In addition to the value added tax, the new tax system included an income tax (from which value-added tax payments may be deducted) and taxes on transactions, consumption, corporate net worth, real estate, automobiles, power boats and airplanes. The tax system was described in SM/86/290 (12/2/86), Appendix II.

CHART 2
BOLIVIA
NONFINANCIAL PUBLIC SECTOR OPERATIONS
(In percent of GDP)



Sources: Ministry of Finance; Central Bank of Bolivia; and Fund staff estimates.
[1] Preliminary.
[2] Projected.

Table 4. Bolivia: Nonfinancial Public Sector Operations

(In percent of GDP)

	1985	1986	1987 Prog.	1987 Actual	Prog. 1988
Revenues	11.4	19.4	18.2	18.9	20.8
General Government	10.8	19.6	18.9	18.3	21.1
Operating surplus or deficit of the state enterprises	0.6	-0.2	-0.7	0.6	-0.3
Expenditures	24.1	23.7	24.3	26.4	27.5
Current	20.6	18.9	17.0	20.4	19.7
Capital	3.5	4.8	7.3	6.0	7.8
Overall surplus or deficit (-) 1/	-12.7	-4.3	-6.1	-7.5	-6.7
Financing	12.7	4.3	6.1	7.5	6.7
External	3.4	5.5	6.1	4.3	7.8
Internal	9.3	-1.2	--	3.2	-1.1
Memorandum items					
Savings 1/	-9.4	-0.7	0.5	-2.5	0.1
Tax revenues 2/	2.0	3.9	4.9	6.6	9.1
Hydrocarbon revenues	12.0	15.8	13.9	10.2	12.3
Wages and salaries	7.6	8.7	8.2	9.6	9.8
Interest due	5.2	7.4	5.2	5.2	4.9
Overall balance on a cash basis 1/	-12.0	-4.3	-6.1	-9.8	-3.9

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

1/ With interest on a commitment basis.
2/ Internal revenue and customs receipts.

Despite the reduction of public employment, the wage bill of the nonfinancial public sector rose from 8 1/2 percent of GDP in 1986 to 9 1/2 percent of GDP in 1987 because of a 15 percent general wage increase in April 1987 and special increases in the second half of 1987 to teachers, petroleum and health workers, and the armed forces.

Real money and quasi-money increased by 33 percent in 1987, compared with 67 percent in 1986, as the process of rapid remonetization of the economy tapered off. The share of U.S. dollar denominated deposits increased from 37 percent of money and quasi-money at the end of 1986 to 44 percent at the end of 1987 (Chart 3).

The net domestic assets of the banking system rose more slowly in 1987 (in relation to private sector liabilities at the beginning of the year) than in 1986. While net credit to the nonfinancial public sector shifted from a contraction of 59 percent in 1986 to an expansion of 17 percent in 1987, the growth of private sector credit decelerated from 108 percent to 32 percent (Table 5). During the year the Central Bank provided substantial financing for the public sector and emergency assistance to several banks. The rise in credit exceeded the growth of resources by more than had been projected, and there was a larger loss of net international reserves than had been expected in 1987. This trend continued during the first quarter of 1988. As of March 31, 1988 gross official reserves amounted to US$374 million, equivalent to slightly less than six months of merchandise imports. However, freely usable liquid reserves had fallen below the equivalent of one month of imports because the bulk of reserves were in the form of nonconvertible balances in the Central Bank of Argentina, nonmonetary gold, and funds in escrow accounts.

Interest rates continued to be market determined, with rates on time deposits in local currency falling from 39 percent in December 1986 to 27 percent in May 1988, which was still high in real terms. Over the same period, lending rates for local currency loans declined from 88 percent to 42 percent.

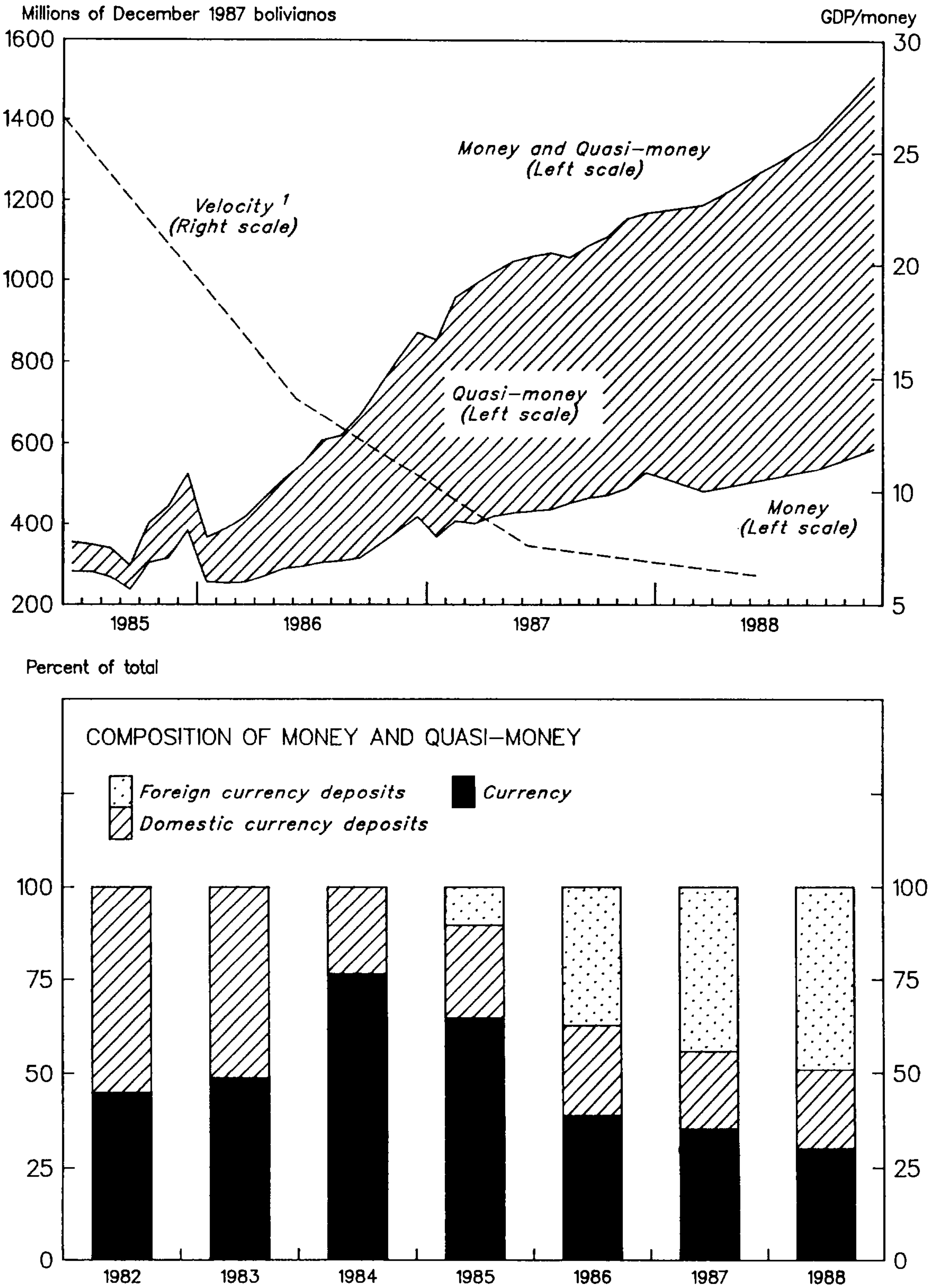
The current account deficit of the balance of payments widened from 6 percent of GDP in 1985 to about 11 1/2 percent of GDP in 1987 (Chart 4 and Table 6), reflecting a rise of imports and steep declines of the prices of tin and natural gas, which together accounted for about four fifths of merchandise exports. The value of exports fell by 14 percent (in U.S. dollar terms) in 1987, as gas exports declined because of lower prices and volume, while mining exports stagnated because of the closure of COMIBOL for reorganization. Nontraditional exports, which had risen strongly in 1986, also stagnated in 1987, which may have reflected delays in expectation of the implementation of a system of customs duty rebates that was announced in July. The capital account weakened in 1987 because of lower net private capital inflows and the accumulation of unpaid gas exports to Argentina.

The stock of public and publicly guaranteed external debt rose by more than 7 percentage points of GDP to US$4.1 billion (or 99 percent of GDP) in 1987. Net disbursements accounted for less than half of this increase, with the remainder reflecting the capitalization of interest and valuation changes. Total arrears at the end of 1987 amounted to about US$1.1 billion, most of which represented unpaid debt service to foreign commercial banks.

CHART 3

BOLIVIA

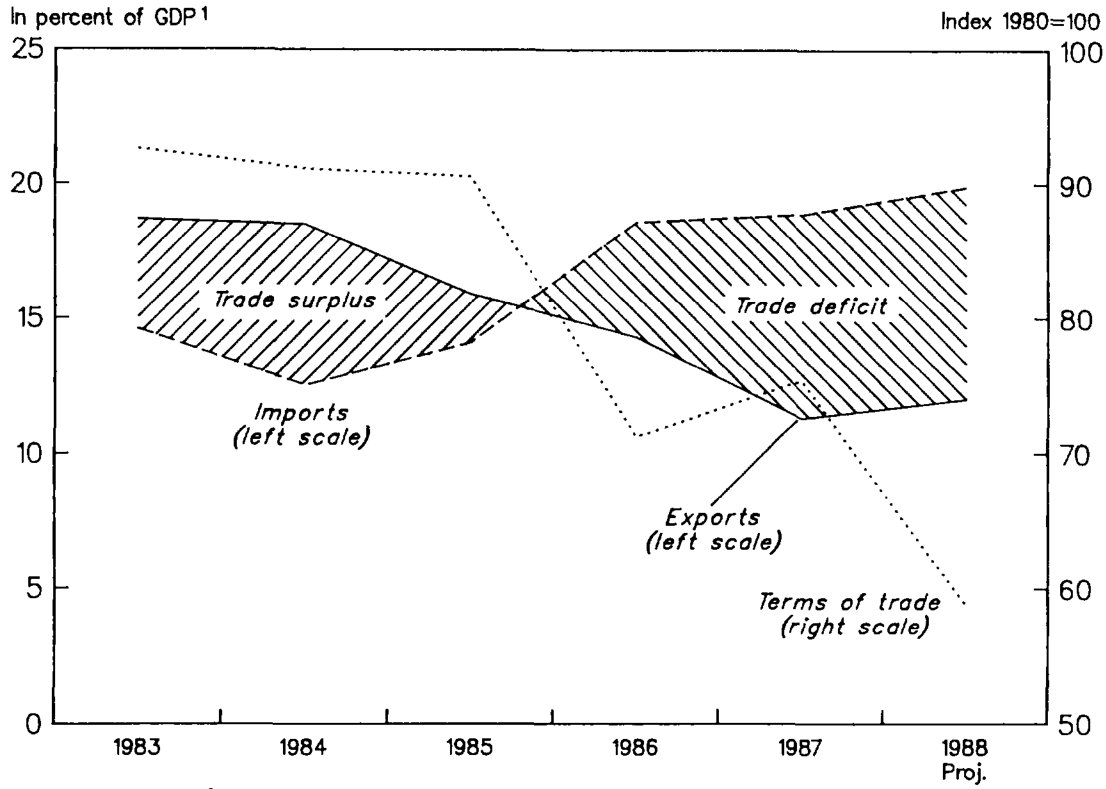
FINANCIAL ASSETS AND VELOCITY

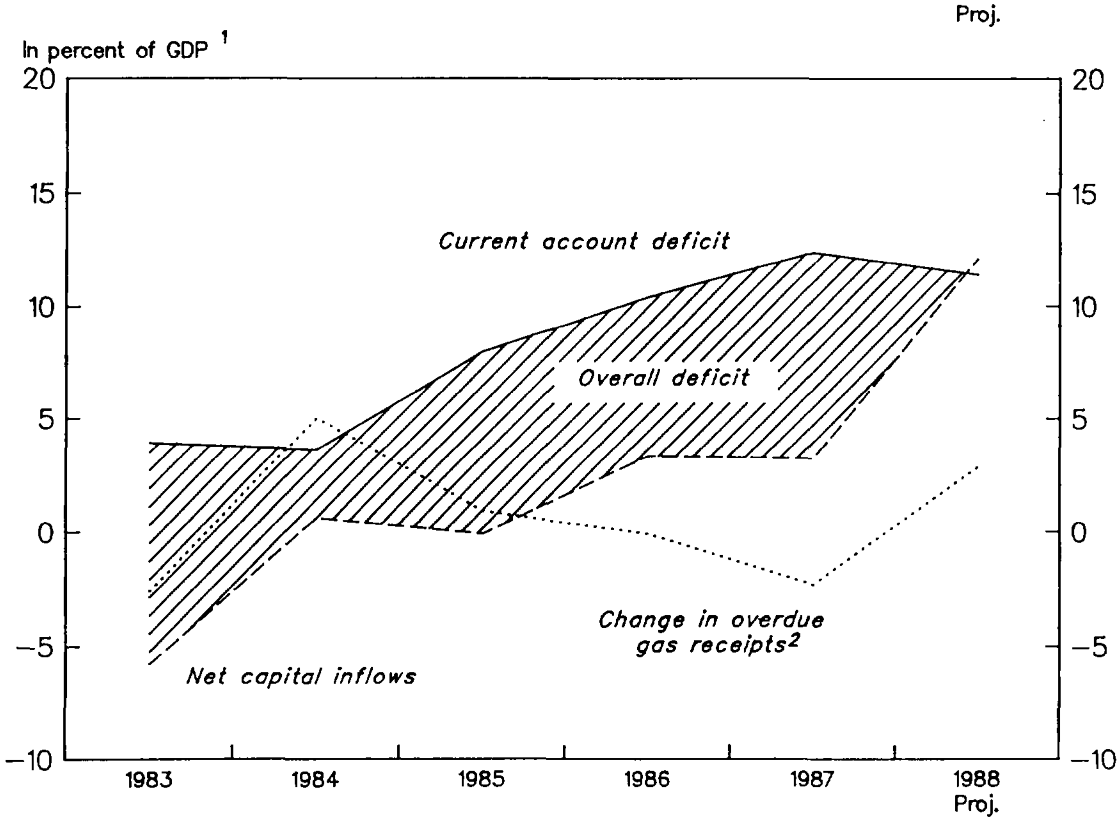


Sources: Central Bank of Bolivia; and Fund staff estimates.

[1] Annual average calculated as the ratio of nominal GDP and the period average of liabilities to the private sector.

CHART 4
BOLIVIA
SELECTED BALANCE OF PAYMENTS TRENDS





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

[1] GDP in U.S. dollar terms was constructed using real growth and the U.S. GDP deflator during the hyper-inflation period 1983–85 to avoid distortions caused by currency overvaluation during this period.

[2] Overdue gas receipts are included in the capital account as an involuntary credit extended by Bolivia. A positive figure indicates repayment of overdue gas receipts.

Table 5. Bolivia: Selected Monetary Indicators

(Percentage change) 1/

	1985	1986	1987 Prog.	1987 Actual	Prog. 1988
		I. Central Bank			
Net international reserves	559.0	114.6	-16.7	-51.2 2/	17.0
Medium- and long-term foreign liabilities	210.4	-32.7	-55.9	-39.9	-55.6
Net domestic assets	4,542.6	-15.2	90.2	125.7	48.4
Nonfinancial public sector	6,207.1	-136.3	--	45.6 2/	-16.4
Banking system	3,930.0	89.2	90.4	39.8	43.1
Other 3/	-5,594.5	31.9	-0.2	40.3	21.7
Liabilities to the private sector	5,312.0	66.7	17.6	34.6	9.9
		II. Financial System			
Net international reserves	491.6	51.5	-6.1	-11.7 2/	4.7
Medium- and long-term foreign liabilities	396.2	-12.2	-20.6	-12.8	-15.2
Net domestic assets	8,448.4	91.9	48.4	65.9	28.5
Nonfinancial public sector	3,891.3	-59.2	--	14.2 2/	-4.5
Private sector	4,248.1	108.1	49.0	32.2	27.1
Other 3/	309.0	43.0	-0.6	19.5	5.9
Liabilities to the private sector	9,336.2	131.2	21.7	41.4	18.0
Memorandum items					
		(Stocks at end of period)			
Money and quasi-money					
In millions of bolivianos	284.1	787.8	718.2	1,170.8	1,510.0
In millions of December 1987 bolivianos	527.6	881.5	795.0	1,170.8	1,342.2
		(Period average)			
Velocity	26.5	14.9	11.4	8.6	6.3

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

1/ With respect to liabilities to the private sector at the beginning of the period.
2/ Includes the impact of the rescheduling of US$61 million of short-term obligations to medium-term obligations of the nonfinancial public sector.
3/ Includes official capital and surplus; blocked accounts; allocation of SDRs; valuation accounts; and other net unclassified assets.

Table 6. Bolivia: Balance of Payments

(In millions of U.S. dollars)

	1985	1986	1987 Prog.	1987 Actual	Prog. 1988
Current account	-300	-400	-375	-469	-489
Exports, f.o.b.	623	547	474	472	514
Imports, c.i.f.	-553	-712	-618	-775	-850
Interest (net)	-324	-269	-268	-260	-260
Other services and transfers (net)	-46	34	36	94 1/	107 1/
Capital account	1	127	43	-12	390
Nonfinancial public sector 2/	-176	-139	-56	-118	94
Disbursements	85	144	237	145	243
Amortization	-261	-283	-293	-263	-149
Private sector 3/	143	269	99	202	176
Overdue gas export receipts	34	-3	--	-96	120
Overall balance	-299	-273	-332	-481	-99
Debt service in arrears	328	-13	...	-11	...
Rescheduling of debt	--	397 4/	...	414 5/	...
Net official reserves (increase -)	-29	-110	19	78	-30
Memorandum items					
Current account deficit (as percent of GDP)	6.1	10.4	9.4	11.3	11.4
Debt service paid (as percent of GDP) 6/	5.7	5.1	5.2	4.0	5.6
Gross official reserves (in months of imports, c.i.f.)	5.8	8.5	9.2	6.4	7.2
Terms of trade (percentage change)	-0.7	-20.7	-12.9	-8.8	-10.1
External payments arrears (end of period, in millions of U.S. dollars)	1,063	877	...	1,074 7/	--

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

1/ Excludes receipt of grants for the buyback of commercial bank debt.
2/ Includes short-term debt and excludes financing implied by unpaid gas exports to Argentina.
3/ Includes contributions to international nonmonetary organizations, errors and omissions, and a US$10 million allocation of Andean pesos from the Andean Reserve Fund in 1985.
4/ Includes rescheduled arrears of US$333 million due to Paris Club creditors.
5/ Includes the rescheduling of US$71 million of current maturities and US$109 million of arrears due to Argentina, as well as US$65 million of current maturities covered by the 1986 Paris Club rescheduling, and US$107.5 million of debt relief from commercial banks; excludes the rescheduling of US$509 million of unmatured principal due to Argentina; and includes the rescheduling of US$61 million of reserve liabilities to Argentina as long-term debt of the Central Government.
6/ Public sector, medium- and long-term.
7/ Excludes rescheduled arrears of $333 million due to Paris Club creditors as well as arrears due to Argentina, which had agreed in advance to abide by the Paris Club terms.

The Bolivian currency depreciated by 14 1/2 percent in real effective terms in the fifteen months ended March 1988, all but reversing the appreciation that had taken place in 1986 (Chart 5). As a result, the real effective exchange rate was about 23 percent more depreciated in March 1988 than in September 1985, immediately after the adoption of the exchange auction system.

III. The Medium-Term Framework

1. Objectives and policies for 1988-91

The program for the four years ending 1991 aims at economic growth of 3-4 percent a year, annual price increases in the single digit range, external current account deficits that decline gradually relative to GDP, and a small gain of net international reserves after receipt of US$120 million of unpaid gas bills from Argentina and payment of US$160 million of arrears to foreign-owned oil companies.

The growth objective is expected to require an increase in investment from 10 percent of GDP in 1987 to about 15 percent of GDP in 1991 (Table 7) and modest improvements in efficiency. The program therefore calls for a major effort to mobilize national savings through market-determined interest rates, a continued real depreciation of the currency, and a fiscal policy that would raise public sector savings and contain the overall public sector deficit below the anticipated level of net foreign financing.

Public savings are expected to increase from a negative 2.5 percent of GDP in 1987 to a positive 2.2 percent of GDP in 1991. This objective is based on an increase in current revenues by about 8 percentage points to 33 percent of GDP in 1991, reflecting the increase in petroleum product prices in early 1988, taxes to be implemented in the remainder of 1988, the resumption of operations by COMIBOL and normal payment for gas exports. The planned increase in revenues includes also the effect of exchange rate policy, improved tax administration, and pricing measures by other state enterprises. With the assistance of a comprehensive financial control system that is in the process of implementation, the growth of current expenditures is projected to be restrained to 3 percentage points of GDP during the program period to reach about 31 percent of GDP in 1991. Wage and employment policy will be restrained, although selective real wage increases will be needed to improve the efficiency of the public sector. Public investment is expected to rise from 6 percent of GDP in 1987 to about 8 percent of GDP in 1988. Thereafter it is projected at about 7 percent of GDP, thus limiting the over- all deficits of the nonfinancial public sector to about 4 1/2 percent of GDP. Identified net foreign financing is projected to decline from around 5 percent of GDP in 1988-89 to about 3 1/2 percent of GDP in 1990-91 because of the expiration of the grace period on arrears refinanced under the 1986 Paris Club rescheduling agreement. Additional foreign financing (ranging between 2 percent and

Table 7. Bolivia: Macroeconomic Flows

(In percent of GDP)

	Actual	Program			
	1987	1988	1989	1990	1991
I. Balance of Payments					
Current account balance	-11.3	-11.4	-11.5	-10.3	-10.6
Trade balance	-7.3	-7.9	-7.3	-6.8	-6.9
Factor payments (net) 1/	-6.6	-6.3	-7.5	-6.9	-7.2
Other services and transfers	2.6	2.8	3.3	3.4	3.5
Capital account	9.4	12.1	10.0	11.0	11.8
Nonfinancial public sector	4.3	7.8 2/	5.1	3.4	3.4
Additional financing	--	--	--	1.9	2.5
Other capital 3/	5.1	4.3	4.9	5.7	5.9
Changes in official net international reserves (increase -)	1.9	-0.7	1.5	-0.7	-1.2
II. Nonfinancial Public Sector					
Current revenue	25.2 4/	29.3	31.3	32.6	33.0
Current expenditure	27.7	29.2	30.5	30.8	30.8
Nonfinancial public sector savings	-2.5	0.1	0.8	1.8	2.2
Capital revenue	1.0	1.0	1.0	1.0	1.0
Capital expenditure	6.0	7.8	6.2	7.3	7.9
Overall deficit	-7.5	-6.7	-4.4	-4.5	-4.7
Net foreign financing	4.3 4/	7.8 2/	5.1	3.4	3.4
Net domestic financing	3.2	-1.1	-0.7	-0.8	-1.2
Additional financing	--	--	--	1.9	2.5
III. Savings and Investment					
Investment	10.1	12.7	12.7	13.8	14.7
Nonfinancial public sector	6.0	7.8	6.2	7.3	7.9
Private sector	4.1	4.9	6.5	6.5	6.8
Savings	10.1	12.7	12.7	13.8	14.7
External savings	11.3	11.4	11.5	10.3	10.6
National savings	-1.2	1.3	1.2	3.5	4.1
Nonfinancial public sector	-2.5	0.1	0.8	1.8	2.2
Private sector	1.3	1.2	0.4	1.7	1.9
Memorandum items					
Nominal GDP (in millions of bolivianos)	8,558	10,180	11,535	13,052	14,770
Consumer price increase (annual average in percent)	14.6	11.6	9.7	8.9	8.6

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

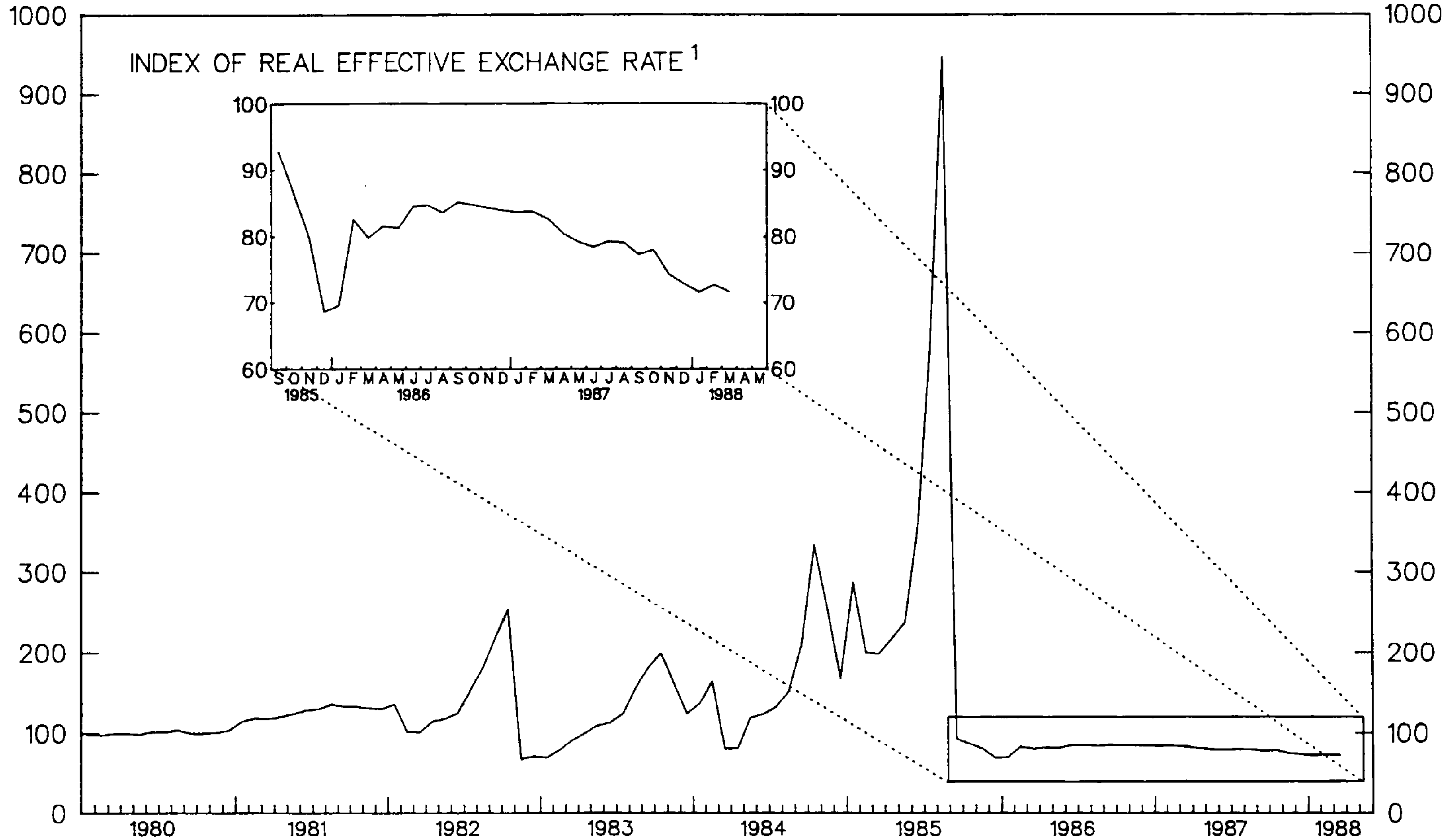
1/ Includes interest on a commitment basis.
2/ Includes receipt of delayed gas payments from Argentina (2.8 percent of GDP).
3/ Includes net borrowing by the financial public sector, nonofficial reserve movements, and net errors and omissions.
4/ Includes unpaid gas exports to Argentina (2.3 percent of GDP).

CHART 5

BOLIVIA

REAL EFFECTIVE EXCHANGE RATE

(1980=100)



Source: Information Notice System.

[1] Trade weighted index of nominal effective exchange rate deflated by consumer prices; increase means appreciation.

2 1/2 percent of GDP in 1990-91) is expected to be committed during the forthcoming Consultative Group meeting sponsored by the World Bank. The authorities' fiscal plan envisages domestic financing surpluses of about 1 percent of GDP a year during 1988-91, which should help to provide sufficient financing to the private sector during the program period.

A balance of payments scenario prepared by the staff (see Appendix IV) and incorporating the authorities' program for 1988-91, is presented in Table 8. The scenario assumes that exports recover rapidly over the next two years and continue to grow at around 5 percent a year in the following years, and that Bolivia continues to export gas after the expiration of its long-term contract with Argentina in 1992 on the same basis as before. The Bolivian authorities intend to request from the Paris Club the rescheduling of previously unrescheduled debt service to bilateral official creditors on terms at least as favorable as those obtained under the 1986 Paris Club agreement but maintaining the cutoff date of that agreement, thus assuring full financing for the 1988-89 balance of payments. The financing needs for the remaining projection period are expected to be covered by rescheduling of debts to bilateral creditors and by assistance (in the form of grants and concessional loans) to be committed as a result of the Consultative Group meeting sponsored by the IBRD.

Reflecting the expectation that additional financing will be provided in the form of grants or concessional loans, the debt service ratios after debt relief would decline from 46 percent of exports of goods and nonfactor services in 1988 to 35 percent in 1997.

Despite difficulties in meeting external debt service in recent years, Bolivia has almost always remained current in its financial obligations to the Fund and other multilateral lenders. With the virtual depletion of its liquid international reserves in late 1987, Bolivia began to fall behind on payments to multilateral lenders. Overdue financial obligations to the Fund were settled in April 1988 and arrears to other multilateral lenders are to be eliminated by the end of 1988.

After taking account of repurchase obligations, the use of Fund resources requested under the ESAF and the CFF would increase Fund credit outstanding to Bolivia at the end of the third program year in March 1991 to 240.4 percent of quota (see Table 2). At that time, Fund credit would represent 30 percent of exports of goods and nonfactor services, 7 percent of GDP or 6.2 percent of total external public debt. Debt service obligations to the Fund are projected to rise from less than 2 percent of exports of goods and nonfactor services in 1988 to 6 percent in 1990 before declining to 2.7 percent in 1993.

The authorities' program over the period 1988-1991 aims at a net international reserve gain of US$45 million. However, the Central Bank's gross liquid reserves are expected to increase by about US$360 million, because US$210 million of nonconvertible balances with the Central Bank of Argentina would be used to service Bolivia's debt to

Table 8. Bolivia: Medium-Term Balance of Payments Projection

	1987	1988	1989	1990	1991	1992	1993	1997
		Projections						
I. Summary of Main Assumptions								
(In percent)								
Export volume growth	-10.0	12.6	14.2	14.3	5.5	5.5	5.5	5.0
Import volume growth	3.5	2.0	4.1	6.6	4.1	4.2	4.2	2.5
Real GDP growth	2.4	2.5	3.3	4.0	4.2	4.5	4.8	4.0
Terms of trade	-8.8	-10.1	1.0	0.5	0.8	0.8	0.2	0.2
Real effective exchange rate	-3.7	-13.3	...	...	...	...	...	...
Import prices 1/	5.3	7.5	4.9	3.7	3.5	3.6	3.6	3.6
LIBOR	7.0	7.0	7.5	7.5	7.5	7.5	7.5	7.5
II. Summary of Main Projections								
(In millions of U.S. dollars)								
Current account	-469	-489	-487	-434	-449	-457	-477	-455
Trade balance	-303	-336	-307	-286	-292	-297	-308	-263
Exports, f.o.b.	472	514	621	740	814	897	982	1,385
Imports, c.i.f.	-775	-850	-928	-1,026	-1,106	-1,194	-1,290	-1,648
Investment income (net) 2/	-274	-271	-318	-293	-306	-316	-333	-401
Other services and transfers (net)	108	118	138	145	149	156	164	209
Capital account	-12	390	311	278	317	305	346	455
Medium- and long-term capital	-68	179	192	119	149	128	162	245
Multilateral lenders (net)	101	214	187	198	214	221	236	312
Disbursements	149	270	238	251	268	286	303	367
Amortization	-48	-56	-51	-52	-53	-64	-66	-55
Bilateral creditors (net)	-108	-30	7	-75	-61	-89	-70	-63
Disbursements	63	70	83	61	60	58	62	60
Amortization	-171	-100	-76	-136	-121	-147	-132	-123
Commercial banks (net)	-59	-4	-1	--	--	--	--	--
Other (net)	-2	-0	-1	-4	-4	-4	-4	-4
Direct investment	15	30	35	40	44	48	52	68
Overdue receipts for gas	-96	120	--	--	--	--	--	--
Short term and other	137	61	84	119	124	129	132	142
Overall balance	-481	-99	-176	-156	-132	-152	-131	--
Financing	481	99	176	156	132	152	131	--
Agreed debt relief	414	--	--	--	--	--	--	--
Change in arrears	-11	-13	--	--	--	--	--	--
Potential debt relief 3/	--	142	111	105	76	63	47	--
Additional aid (including grants)	--	--	--	81	106	89	84	--
Net international reserves (increase -)	78	-30	65 4/	-30	-50	--	--	--
Gross reserves (stock)	415	513	498	547	553	518	490	359
In months of imports	6.4	7.2	6.4	6.4	6.0	5.2	4.6	2.6
Excluding Argentina account	3.2	5.3	6.4	6.4	6.0	5.2	4.6	2.6
IMF (net) 5/	-166	-236	-286	-305	-262	-226	-198	-67
External public debt (including IMF)	4,106	3,786 6/	4,088	4,393	4,724	4,959	5,222	6,299
(In percent of GDP)								
Current account	-11.3	-11.4	-11.5	-10.3	-10.6	-10.0	-10.6	-6.8
Exports	11.4	12.0	14.7	17.5	19.2	19.6	19.8	20.8
Imports	18.7	19.9	21.9	24.3	26.1	26.1	26.0	24.7
(In percent of exports of goods and nonfactor services)								
External public debt	682	587 6/	533	491	482	462	446	386
Debt service								
Before debt relief	93	70	50	53	52	49	45	35
After debt relief	38	48	36	41	44	43	41	35

Source: Fund staff estimates.

1/ Import-weighted average of trading partners' import prices.
2/ Includes interest on the financing gap and on exit bonds. It is assumed that bank claims that remain outstanding after the buyback are rescheduled on terms similar to the buyback.
3/ On debt not previously rescheduled and assuming terms similar to those of the 1986 Paris Club rescheduling.
4/ After payment of US$120 million of arrears to foreign owned petroleum companies.
5/ Includes SAF and ESAF; excludes Trust Fund.
6/ Reflects reduction of US$632 million as a result of buyback aid conversion of bank debt.

Argentina and to pay arrears to foreign-owned petroleum companies, and the Fund would make net disbursements of about US$103 million. Thus, while gross foreign assets would remain roughly constant in terms of merchandise imports, freely disposable liquid reserves would increase from 1 1/4 months of imports to 4 1/2 months during the period. 1/ On this basis, Bolivia should have no difficulty in servicing its obligations to the Fund.

2. Structural reforms

The program rests on a set of structural reforms, most of which have been initiated already in the last few years. In taking some of these measures, the authorities were aware that their short-term impact could be negative in terms of output, employment, and the fiscal and external positions. Nevertheless, they considered that sustained growth could be achieved only by introducting certain fundamental changes in the economy.

In the fiscal area, the two key elements are the dismantling and restructuring of highly inefficient state enterprises and the adoption of a comprehensive tax reform. In the process the authorities were faced with adverse initial developments, such as a temporary drop in mining output and exports because of the closure of state-owned mines, and large outlays for the lay-off of excess personnel. However, the improvement in efficiency of the public sector is a basic element of the medium-term strategy for growth.

Additional far-reaching structural changes are the almost complete liberalization of domestic prices, private sector wages, interest rates, and exchange and trade transactions, and the adoption of a unified auction-determined exchange rate. In the past, these areas have been sources of heavy fiscal and quasi-fiscal losses (through subsidies and exchange rate differentials) and misallocation of resources. In addition Bolivia has simplified its tariff structure, which now consists of a rate of 10 percent for imports of capital goods and a rate for other imports, currently at 19 percent, that is being gradually reduced to achieve a uniform 10 percent tariff by 1990. By letting market forces operate freely, by adopting a low tariff and by pursuing a flexible exchange rate policy, the authorities are providing a strong incentive to domestic production and investment. At the same time, in the key hydrocarbon sector (where Bolivia has considerable potential), the authorities recently reached agreement with two foreign oil companies, whereby Bolivia will settle the equivalent of some US$160 million of arrears with the understanding that a substantial portion of these resources will be reinvested in the country.

1/ These calculations value the Central Bank's 0.9 million ounces of nonmonetary gold at US$42.22 per ounce and exclude it from liquid reserves.

To complement these various structural changes during the program period, the program envisages the final phases of the tax reform, improvements in tax and customs administration, reorganization of the state petroleum company (YPFB), divestment of selected state enterprises, introduction of a comprehensive financial control system for the public sector, upgrading of transportation infrastructure (especially along the export corridors), rehabilitation of the state banks, and the enforcement of improved banking regulations and supervision. 1/

IV. Summary of the Discussions and the Program for April 1988-March 1989

The discussions on the first program year under the requested ESAF, which covers the period April 1988-March 1989, focused on a financial program for calendar year 1988, which is the budget year in Bolivia. The program targets for 1988 reflect the weak performance in the first quarter and project a substantial improvement thereafter, particularly in the fiscal area (Table 9). Structural benchmarks were established through the end of the first program year in March 1989 (see Table 6 of Attachment III), but financial benchmarks for March 1989 will be established at the time of the midyear review.

Consistent with the medium-term objectives described earlier, the 1988 program aims at achieving a real GDP growth of 2.5 percent. To achieve this objective, total investment is projected to increase from 10 percent of GDP in 1987 to about 12 1/2 percent on 1988, with most of the increase to come from the public sector. (Private sector investment is not expected to respond immediately to the structural changes being implemented by the authorities.) The 1988 program also envisages a net international reserves gain of US$30 million, and is consistent with a moderate domestic inflation.

1. Fiscal policy

The authorities are adopting measures aimed at strengthening public savings through price adjustments (e.g., of domestic petroleum products), improved tax collections and restraint on current expenditure, including a freeze of public sector wages for the remainder of 1988. These policies are designed to achieve an improvement of the public savings performance from a negative 2.5 percent of GDP in 1987 and a provisionally estimated negative 0.5 percent of GDP in the first quarter of 1988 to a positive 0.6 percent of GDP in the remainder of 1988. Public investment is projected to increase from 6 percent of GDP in 1987 to 7.8 percent of GDP in 1988, and the overall deficit would decline from 7.5 percent of GDP in 1987 to 6.7 percent of GDP in 1988. The projected deficit would be more than financed by net use of foreign

1/ For a fuller specification of structural measures and the time frame for their implementation see the policy matrix attached to the PFP (EBD/88/173, 6/23/88).

Table 9. Bolivia: Impact of the Adjustment Program

	1987	Prog. 1988 January March 1/	April-Dec.	Year
		(In percent of annual GDP)		
Nonfinancial public sector				
Tax revenue 2/	6.6	1.6	7.5	9.1
Public savings	-2.5	-0.5	0.6	0.1
Public investment	6.0	1.2	6.6	7.8
Overall balance	-7.5	-1.7	-5.0	-6.7
		(In millions of U.S. dollars)		
Balance of payments				
Current account	-469.0	-102.1	-386.7	-488.8
Of which: Trade balance	-303.0	-58.1	-278.1	-336.2
Change in net international reserves (-increase)	78.2	33.9	-63.5	-29.6
		(In percent) 3/		
Financial system				
Credit to the nonfinancial public sector	17.1	4.8	-9.3	-4.5
Credit to the private sector	32.2	2.5	24.6	27.1
Liabilities to the private sector	41.4	0.3	17.6	18.0

Sources: Data provided by the Bolivian authorities; and Fund staff estimates.

1/ Preliminary.

2/ Includes customs duties.

3/ Change in terms of liabilities to the private sector at the end of previous year; calculated at accounting exchange rates.

loans and the expected settlement of arrears on gas exports by Argentina, thus allowing for a net reduction of public sector debt with the Central Bank. Quarterly limits on the increase in public sector indebtedness have been established in accordance with these targets.

a. Revenue policies

Revenue from internal taxes and import duties is projected to increase from 6.6 percent of GDP in 1987 to 9.1 percent of GDP in 1988. Revenue from internal taxes is expected to benefit from the full-year effect of last year's tax reforms, the reorganization of the internal revenue and customs administrations and improved enforcement, including close monitoring of large taxpayers. A 15 percent tax on consumer durables has been submitted to Congress for approval and is expected to be implemented in the second half of 1988 together with the tax on rural land holdings, the last as yet unenforced tax of the 1986 tax reform package. In March 1988 the authorities reduced the customs tariff from 20 percent (with the option of a three-year deferment of duty payment) to 10 percent (without that option) for specified capital goods and the tariff on all other imports by one percentage point from 20 percent to 19 percent. The authorities intend to continue reducing the latter rate by 1 percentage point each quarter until a uniform tariff is re-established in 1990 at a level of 10 percent. Notwithstanding the tariff reductions, the effective rate of duty collection is expected to remain unchanged, in part as a result of a reduction of exemptions.

Domestic prices of petroleum products were raised by 29 percent on average to the equivalent of US$45 per barrel in March 1988. The authorities intend to maintain the average price of petroleum products constant in U.S. dollar terms by small, frequent adjustments and have followed this policy since March. The adjustment in petroleum product prices is expected to yield 2 percent of GDP on an annual basis.

The average price for natural gas exports is expected to drop from US$3.32 per thousand cubic feet in 1987 to US$2.89 in 1988, in line with world market developments for energy prices. However, the decline in prices should be partly offset by a recovery in volume.

The revenue projections also assume that most mines of COMIBOL will be fully operational by mid-1988 and that the company's exports in 1988 will amount to US$45 million (1.1 percent of GDP), net of refining costs incurred abroad.

b. Expenditure policies

An integrated system of financial administration and governmental control (SAFCO) is being established with financial and technical assistance from the World Bank and UNDP. SAFCO will monitor the operations of the largest state enterprises, decentralized agencies, regional development corporations and municipalities, and the social security system.

Effective March 1988, public sector wages were increased by 15.7 percent on average, and no further increases are envisaged for 1988. As a result, wages in the nonfinancial public sector are projected to increase slightly in relation to GDP. The ongoing rationalization of state enterprises, including YPFB, is expected to result in further employment reductions in the public sector.

The authorities are confident that the projected increase in public investment can be achieved as a result of recent measures to overcome difficulties in the implementation of projects, including the appointment of an undersecretary in charge of public investment, technical assistance in the areas of project preparation and execution from the Federal Republic of Germany, the UNDP, and the World Bank, and the use of foreign procurement agents.

2. Social policy

Bolivia's protracted economic difficulties have had serious adverse effects on the welfare of the population. A resumption of broad-based economic growth should increase employment and income for all groups, but the relatively fast population growth and the need to increase domestic savings are not likely to permit an early improvement of per capita consumption.

To alleviate social pressures, the authorities created the Emergency Social Fund (FSE), which is responsible for short-term employment generating projects (such as road improvements, erosion control and urban upgrading) and health and nutritional assistance. Over its envisaged three-year lifespan through the end of 1989, the FSE will have funds equivalent to US$130 million, most of which have already been committed under concessional loan or grant arrangements from multilateral development banks and bilateral official sources. The FSE is not consolidated with the nonfinancial public sector and requires only small transfers from the Treasury (which are included in the authorities' fiscal program for 1988). The FSE is expected to provide short-term employment for about 38,000 persons (1.8 percent of the labor force) at its peak level of operation some time in 1988.

The authorities are relying on the recently established Social Housing Institute to develop a national housing plan with emphasis on low-income housing to be financed from a new housing fund (FONVI) that is funded principally by contributions from employers and workers. The authorities plan to transfer responsibility for education and health services to the regional and local bodies, but this will not take place in 1988. The eventual transfer is expected to achieve greater efficiency and focus in the delivery of these services.

3. Monetary and credit policies

The monetary program for 1988 is intended to be consistent with a domestic price increase of 12 1/2 percent and an increase in net international reserves (after settlement of arrears on gas exports to Argentina and payment of arrears to foreign-owned petroleum companies) of US$30 million (0.7 percent of GDP). The authorities have established quarterly limits on the expansion of the Central Bank's net domestic assets and sublimits on the quarterly variations of the nonfinancial public sector's indebtedness to the Central Bank that are consistent with these assumptions.

With banking system liabilities to the private sector assumed to rise broadly in line with the projected growth of nominal GDP, and taking into account projected net disbursements of US$90 million of foreign loans, banking system credit to the private sector is projected to increase by some 27 percent in terms of liabilities to the private sector at the end of 1987.

Except for intermediated development loans in foreign currency, which carry an interest rate of LIBOR plus 5 percentage points, interest rates will continue to reflect market forces. The authorities expect that interest rates will decline from their currently high real levels as a result of the implementation of their economic program and of financial sector reforms. Spreads between lending and deposit rates are expected to narrow as a result of improved efficiency in the banking system, growth in the deposit base and the remuneration of a portion of banks' legal reserve deposits.

A number of regulatory and institutional reforms are being implemented during the remainder of 1988 to strengthen the institutional structure and financial soundness of the banking system. These efforts, which benefit from financial assistance from the World Bank, include the enforcement through the newly established Superintendency of Banks of tightened regulations with respect to the treatment of interest on nonperforming loans, loan loss provisions, loan concentration, banks' real estate holdings, and minimum capital requirements. Procedures for rehabilitating ailing banks are being developed and the three remaining state banks (Banco del Estado, Banco Agrícola, and Banco Minero) are being reorganized.

4. Exchange and trade system policies

The authorities intend to conduct their credit and exchange rate policies during the program period in such a way as to achieve, as a minimum, the quarterly targets for the Central Bank's net international reserves. The Central Bank will continue to sell foreign exchange in daily auctions with unrestricted access for all bidders. A gradual improvement in international competitiveness--by moving the exchange rate of the boliviano against the U.S. dollar faster than the rate of domestic inflation--would help achieve the reserve target and would ensure progress toward diversification and the sustained expansion of output and exports.

Bolivia's exchange and trade system is essentially free of restrictions. Arrears on debt service payments to foreign banks are expected to be eliminated by the end of 1988 as a result of an agreement with the banks. Unpaid debt service to bilateral official creditors is expected to be rescheduled in bilateral negotiations as soon as a new Paris Club agreement has been reached. Arrears to other creditors (mostly international organizations) are to be eliminated by the end of 1988 in accordance with a quarterly schedule.

The authorities intend to grant import tariff rebates of 10 percent of the f.o.b. value of nontraditional exports on the basis of exchange surrender. They believe that this measure is needed to ensure a rapid increase in nontraditional exports and have made allowance in their fiscal program for its estimated cost. As noted above, the tariff on imports other than specified capital goods will be reduced by 1 percentage point a quarter during the remainder of 1988, continuing a process designed to achieve a uniform 10 percent tariff by 1990, and the scope of tariff exemptions will be reduced further, inter alia, by letting the tariff exemption for wheat lapse in October 1988.

5. External debt policy

Bolivia's balance of payments situation is not strong enough to sustain borrowing on commercial terms. Therefore the authorities are seeking to mobilize external resources at concessional terms, relying principally on the Consultative Group process. They will not seek foreign bank financing, except (possibly) some short-term import credits. Under the proposed program, the increase in public and publicly guaranteed external debt outstanding in the 1-10 year maturity range will not be permitted to exceed US$40 million in 1988.

The authorities are hoping to obtain favorable terms in the rescheduling of existing debt, and intend to request from the Paris Club a rescheduling of maturities falling due after mid-1987, including concessions on moratorium interest rates. Using donations received from other countries, in January 1988 Bolivia offered to redeem its debt to commercial banks at 11 U.S. cents per U.S. dollar of principal. By mid-April 1988 almost half of Bolivia's bank debt principal (and attendant interest claims) had been offered for redemption. 1/ Payments out of

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1/ Banks had tendered claims equivalent to US$256 million; one country had donated principal claims with a face value of US$16 million; and US$53 million was offered for conversion into fully collateralized zero-coupon bonds. These exit bonds can be converted into investment in Bolivia with a premium (paid by the Central Bank) that declines over time from 50 percent initially to zero when the bonds mature in 25 years.

the Voluntary Contribution Account, which is administered by the Fund to receive and disburse donations for the buyback (EBD/87/251, 10/5/87), will be made soon. Subsequently, the authorities plan to negotiate a long-term restructuring of the remaining bank debt.

6. Benchmarks and performance criteria

The economic and financial program for 1988 is summarized in Appendix V. To monitor the implementation of their program, the authorities have established the following quarterly financial and structural benchmarks (Attachment III, Tables 1-6): (i) targets for the minimum gain or maximum loss of the Central Bank's net international reserves; (ii) limits on the increase in the indebtedness of the nonfinancial public sector; (iii) limits on the change of net domestic assets of the Central Bank; (iv) sublimits on the change in the net position of the nonfinancial public sector with the Central Bank; (v) limits on payments arrears on public and publicly guaranteed external debt; (vi) limits on the increase in public and publicly guaranteed external debt with original maturities of more than one year and up to 10 years; (vii) reorganization of YPFB; (viii) establishment of SAFCO; (ix) improvement of tax and customs administration; and (x) reorganization of the external debt department of the Central Bank.

Benchmarks (i) through (iv) have been made performance criteria for September 30, 1988, together with the customary provisions on the exchange and trade system and the completion of a mid-term review with the Fund. The review will assess progress in achieving the program's objectives and establish financial benchmarks for the quarter ending March 31, 1989.

If Argentina reduces its arrears by less than US$120 million or if Bolivia reduces its arrears to foreign-owned petroleum companies by less than US$40 million during 1988, benchmarks (i), (iii), and (iv) will be adjusted by the shortfall in relation to program assumptions.

V. Staff Appraisal

Since the major reorientation of economic policies in August 1985 Bolivia has made considerable progress in adjusting its economy. The 12-month rate of inflation dropped from 23,500 percent in September 1985 to around 10 percent in the first five months of 1988 and, following an initial steep depreciation, the real effective exchange rate depreciated by a further 23 percent over the same period. Economic growth resumed in 1987 after five years of decline.

Notwithstanding these achievements, Bolivia's external position remains very fragile. Steep declines in the prices of tin and natural gas, along with rising imports, resulted in a widening of the current account deficit since 1985. Large private capital inflows and debt rescheduling helped finance this deficit, but the accumulation by

Argentina of arrears on natural gas payments in 1987, together with a relaxation of fiscal and monetary policies compared with the program, resulted in a sharp reduction of liquid reserves by the end of the year and the emergence of arrears to multilateral lenders. In these circumstances, the authorities' decision to adopt a new economic program that aims at reversing these adverse trends within a medium-term framework is to be welcomed.

Notwithstanding the initial adverse impact on output, employment and the fiscal and external positions, the authorities embarked upon major structural reforms at the outset of their adjustment program. The current program envisages the continuation of these efforts, with emphasis on the completion of the tax reform, further improvements in tax and customs administration, reorganization of the state enterprises, introduction of a comprehensive financial control system for the public sector, the upgrading of transportation infrastructure, the rehabilitation of the state banks, and the enforcement of improved banking regulations and supervision. The staff supports these efforts as indispensable for the achievement of sustained economic growth.

Achievement of the authorities' growth, price, and external payments objectives calls for higher levels of national savings and investment, aided by the deepening of structural reforms and the pursuit of cautious financial policies. A key element of the authorities' strategy is a fiscal plan that entails steadily growing public savings and small domestic financing surpluses under the assumption that Argentina makes its overdue payments in 1988 and that financing gaps of 2-2 1/2 percent of GDP in 1990-91 can be closed with additional external resources on suitable terms. Savings and investment also should be encouraged by a stable regulatory framework, market-determined prices and interest rates, and a flexible exchange rate policy that aims at securing an improvement in international competitiveness. The recent agreements to settle arrears with foreign-owned petroleum companies can also be expected to contribute to a revival of private investment.

The program that has been adopted counts on the attainment of a substantial improvement in fiscal revenue. In the short run this calls for strong efforts to broaden compliance with the value added and other existing taxes. Beyond this, it will be necessary to move without delay to the implementation of the taxes on rural land holdings and on the sale of consumer durables. Given their importance for public sector revenue, the program provides for frequent adjustments of domestic petroleum product prices so as to avoid their erosion in U.S. dollar terms. Prices of goods and services sold by other state enterprises also need to be kept under close review.

The reduction of the import tariff planned by the authorities is a positive step for resource allocation, but it also is essential to avoid that such reductions have adverse effects on the fiscal situation. Repealing tariff exemptions and enforcing tariffs more rigorously could provide compensatory effects. In the light of developments, however, it also may prove advisable to delay implementation of the export rebate for nontraditional exports and to delay or reduce the planned import tariff cuts.

On the side of expenditures, the program assumes that there will be no further wage increases in the remainder of 1988. It is particularly important that this policy intention be adhered to, not only because of the fiscal requirements but also to avoid signals to the private sector that could encourage settlements that would undermine Bolivia's competitiveness.

After many years of compression there is a clear need to increase public investment in infrastructure and in the state enterprises. Given the scarcity of domestic resources, however, the authorities will need to confine the execution of projects to those with assured foreign financing at concessional terms. High-priority projects without such financing should be referred to the Consultative Group for Bolivia.

The projections of the growth of the banking system's liabilities to the private sector and net disbursements of foreign lines of credit indicate that the program leaves adequate room for the credit needs of the private sector. Adherence to the credit program and implementation of the regulatory and institutional reforms in the banking system should strengthen confidence and may be expected to result in the reduction of interest rates and banking spreads. Of course, pressures to reduce interest rates through administrative measures will need to be resisted.

Notwithstanding the sizable real effective depreciation of the currency since the initiation of the adjustment effort, the deterioration of the terms of trade, the slow growth of nontraditional exports in the recent past, and the need to diversify the economy all suggest that Bolivia needs to improve its international competitiveness further. The proposed exchange rate policy is designed to achieve this in a gradual fashion so as to minimize pressure on domestic prices and interest rates.

The program for 1988-91 requires a substantial amount of concessional external financing, which the authorities hope to arrange through the continuing negotiation of debt relief and the mobilization of loans and grants from bilateral and multilateral sources. Residual financing gaps in 1990-91 will require additional support from the international community, and it is important that Bolivia secure this assistance on concessional terms. In view of the heavy external debt burden, the staff supports the authorities' decision to avoid financing at commercial terms or maturities of up to one year and to limit the net incurrence of debt with maturities of up to 10 years.

The staff commends the authorities for the maintenance of a liberal external trade and payments system, which will enhance Bolivia's growth prospects. Arrears to bilateral official creditors and foreign banks--which evidences the presence of an exchange restriction subject to Fund approval--are to be eliminated in the course of 1988 as a result of negotiations that are expected to proceed shortly. Arrears to other creditors are expected to be eliminated by the end of 1988 according to a quarterly schedule. On the basis of these prospects and intentions, the staff supports the approval until the intended elimination date of the restriction evidenced by these arrears.

A multiple currency practice subject to approval under Article VIII, Section 3 would arise if the authorities proceed with their intention to issue customs duty rebate certificates to exporters of nontraditional products on the basis of exchange surrender. It is preferable not to resort to measures of this kind, but rather to provide incentives to exports through the exchange rate. However, the authorities feel that this measure can provide an immediate boost to exports, and the staff is prepared to go along with temporary approval of this measure in the expectation that it will be phased out as soon as Bolivia's external competitiveness improves sufficiently.

To conclude, the Bolivian authorities have made considerable headway since 1985 in adjusting their economy, including through substantial structural reform. However, the economic situation remains fragile, especially in the areas of the balance of payments and the public finances. In these circumstances, the staff believes that the proposed program with its emphasis on fiscal restraint, structural reforms and market-oriented policies offers the best hope for the sustained growth of exports and income that is required to attain long-term viability.

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

Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board.

I. 1988 Consultation

1. The Fund takes this decision relating to Bolivia's exchange measures subject to Article VIII, Sections 2 and 3, in the light of the 1988 Article IV consultation with Bolivia conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended ("Surveillance over Exchange Rate Policies").

2. Bolivia maintains an exchange restriction evidenced by external payments arrears that is subject to approval under Article VIII, Section 2(a). In addition, the decision to grant import duty rebates for nontraditional exports on the basis of exchange surrender will give rise to a multiple currency practice once it is implemented. The Fund welcomes Bolivia's intention to eliminate its external arrears in 1988 and urges the early elimination of the import duty rebate scheme. In the meantime, the Fund grants approval of the exchange restriction until December 30, 1988 and the multiple currency practice until July 15, 1989 or the next Article IV consultation with Bolivia, whichever is earlier.

II. Enhanced Structural Adjustment Facility: Three-Year and First Annual Arrangement

1. The Government of Bolivia has requested a three-year structural adjustment arrangement under the enhanced structural adjustment facility, and the first annual arrangement thereunder.

2. The Fund notes the policy framework paper for Bolivia set forth in EBD/88/173.

3. The Fund approves the arrangement set forth in EBS/88/131.

Bolivia--Fund Relations
(As of June 30, 1988)

I. Membership Status

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

A. Financial Relations

II. General Department (amounts in millions of SDRs)

(a) Quota: 90.70
(b) Total Fund holdings of bolivianos:
187.5 (206.7 percent of quota)
(c) Fund credit: 96.8 (106.7 percent of quota)
Of which:
General resources account:
Credit tranches: 32.7 (36.1 percent of quota)
Compensatory financing facility: 64.1 (70.7 percent of quota)

Special disbursement account:
Structural adjustment facility: 18.1 (20.0 percent of quota)

(d) Reserve tranche position: 1/

III. Stand-by Arrangements and Special Facilities in the Last Ten Years

(a) Stand-by arrangements:

(i) Duration: June 1986 to July 1987
(ii) Amount: SDR 50 million
(iii) Utilization: SDR 32.7 million

(i) Duration: February 1980 to January 1981
(ii) Amount: SDR 66.38 million
(iii) Utilization: SDR 53.38 million

(b) Compensatory financing facility:

(i) Approval: December 1986
(ii) Amount: SDR 64.1 million 2/

(i) Approval: January 1983
(ii) Amount: SDR 17.9 million

(i) Approval: July 1978
(ii) Amount: SDR 15.0 million

1/ SDR 4,394.
2/ Of which SDR 34.1 million is expected to be repurchased before the Executive Board discussion of this staff report.

(c) Buffer stock financing facility (Tin):

(i) Approval: June 1982
(ii) Amount: SDR 24.5 million

IV. Structural Adjustment Facility

(i) Duration: December 1986 to December 1989
(ii) Committed under three-year arrangement: SDR 57.6 million
(iii) Disbursed: SDR 18.1 million
(iv) Remaining amount: SDR 39.5 million

V. Administered Accounts

(a) Trust Fund loans:

(i) Disbursed: SDR 36.2 million
(ii) Outstanding: SDR 10.1 million

(b) SFF subsidy account:

Payments by the Fund: SDR 3.9 million

VI. SDR Department

(a) Net cumulative allocation: SDR 26.7 million

(b) Holdings: Nil

VII. Financial Obligations Due to the Fund 1/

Type of Obligation	1988 2/	1989	1990	1991	1992	1993	Total Through 1993 3/
Principal	37.7	9.0	33.6	32.2	26.2	20.6	159.3
Repurchases	34.1	4.9	31.4	32.1	22.6	17.0	142.1
SAF and Trust Fund repayments	3.6	4.1	2.2	0.1	3.6	3.6	17.2
Charges and interest	3.9	9.2	8.3	5.6	2.8	1.3	31.1
Total 3/	41.6	18.2	41.9	37.8	29.0	21.9	190.4

1/ On the basis of Bolivia's present use of Fund credit, Trust Fund loans outstanding, position in the SDR Department and of disbursements under the proposed ESAF and the requested CFF. Charges are projected on the basis of current rates of charge. Special charges are not projected.

2/ Due after May 31, 1988. Includes prompt repurchase of SDR 34.1 million under the CFF.

3/ Totals may not add due to rounding.

B. Nonfinancial Relations

VIII. Exchange Rate Arrangement: The Bolivian currency is the boliviano, which replaced the peso on January 1, 1987 at a rate of Bs 1 = $b 1,000,000. The Central Bank sells foreign exchange daily by auction, accepting all bids that are at least equal to the Central Bank's minimum price, which is not announced until after each auction. Successful bidders pay the price submitted in their bids (Dutch auction system). If acceptable bids exceed the amount offered for auction, the lowest acceptable bids are prorated so as to exhaust the amount offered. The minimum price, which constitutes the official exchange rate for all exchange surrenders and debt service payments by the public sector, is adjusted from time to time. Since early 1987, these adjustments have led to a depreciation of the currency that slightly exceeded the domestic rate of inflation. On May 31, 1988 the official exchange rate and the buying rate in the parallel market both were Bs 2.35 = US$1.

IX. Last Consultation: The 1986 Article IV consultation was concluded on December 15, 1986 with the adoption of the following decision:

1. The Fund takes this decision relating to Bolivia's exchange measures subject to Article VIII, Sections 2 and 3, in the light of the 1986 Article IV consultation with Bolivia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Bolivia maintains an exchange restriction evidenced by external payments arrears. In addition, a multiple currency practice may arise from the operation of Bolivia's exchange markets, as described in EBS/86/263. The Fund approves the exchange restriction until March 31, 1987, and the multiple currency practice until December 15, 1987 or the next Article IV consultation with Bolivia, whichever is earlier.

X. Technical Assistance: Bolivia has received a substantial amount of technical assistance in the recent past. Since the implementation of the stabilization program in late August 1985 technical assistance has consisted of the following:

(a) Bureau of Statistics: A staff member of the Bureau provided technical assistance in balance of payments statistics in March 1986, July 1986, and February 1988.

(b) Central Banking Department: An expert in external debt statistics completed a ten-month assignment in November 1985 and returned for a follow-up visit in July 1986. Another expert was posted as a research advisor from February 1986 to February 1987. A successor took up his duties (with particular emphasis on financial programming) in February 1988 for an initial period of one year. A third expert began a one-year assignment to revamp the Central Bank's accounting system in June 1986. His assignment has been extended until June 1989. A two-man mission provided advice on banking legislation and the Central Bank reorganization in March 1987.

(c) Fiscal Affairs Department: A three-man mission assisted the authorities in November 1985 in preparing, executing, and controlling the budget for 1986. A staff member of the Department and an outside expert returned in January 1986 to continue that work. Another expert returned for three months in March 1986 and for another six months in December 1986 to continue that work and to assist with the preparation of the 1987 budget. His assignment has been extended twice until early 1989. A staff member of the Department returned in July 1986, November 1986, and March 1988 to assess the progress of this project. In June 1987, a consultant to the department visited La Paz to examine progress in implementing the tax reform and made recommendations in tax administration. The consultant returned to La Paz in April 1988.

(d) Western Hemisphere Department: A staff member of the Department provided advice on the operational aspects of an auction-based exchange rate system in August-September 1985.

XI. Resident Representative: Mr. José Gil Díaz has been posted as resident representative in La Paz since June 1987.

XII. Statistical Data: Generally not adequate because of conceptual and methodological problems in all areas (see Appendix III). These problems have been aggravated in recent years because of the high turnover and the deteriorating quality of supervisory and technical staff. The Central Bank was fundamentally reorganized in the period February-March 1987 and its operations had not returned to normal by May 1988.

Bolivia--Status of World Bank Group Operations

1. Statement of World Bank loans and IDA credits (as of April 30, 1988)

Loan or Credit Number	Fiscal Year	Borrower	Purpose	Amount (less cancellations) Disbursed Bank	IDA	Undis-bursed	Total
				(In millions of U.S. dollars)			
Thirteen loans and fourteen credits fully disbursed				250.0	100.9	--	350.9
940	1979	Bolivia	National Mineral Exploration Fund	--	3.1	4.4	7.5
1587	1978	Bolivia	Highway Maintenance	24.9	--	0.1	25.0
1703	1986	Bolivia	Reconstruction Import Credit I	--	35.5	28.0	63.5 1/
1719	1986	Bolivia	Vuelta Grande Gas Recycling Project	--	6.6	10.5	17.0 1/
1809	1987	Bolivia	Public Financial Management	--	3.5	8.9	12.4 1/
1818	1987	Bolivia	Power Sector Rehabilitation	--	--	7.3	7.3 1/
1828	1987	Bolivia	Reconstruction Import Credit II	--	--	50.0	50.0 1/
1829	1987	Bolivia	Emergency Social Fund I	--	5.4	5.4	10.8 1/
1842	1988	Bolivia	La Paz Municipality Development	--	3.0	13.3	16.3 1/
1882	1988	Bolivia	Emergency Social Fund II	--	--	26.3	26.3
Total				274.9	158.0	154.1	587.0
Of which: has been repaid				96.2	6.5	--	102.7
Total now outstanding				178.7	151.5	154.1	484.3
Amount sold				0.5	--	--	0.5
Of which: has been repaid				(0.5)	--	--	(0.5)
Total now held by Bank and IDA				178.7	305.6 2/	--	484.3
Total undisbursed						154.1	154.1

1/ Because of variations in SDR exchange rate, present amount is different from original amount.

2/ Because of SDR exchange rate, the amount is different from Statement of Credit (US$309.7 million).

2. Statement of IFC investment (as of March 31, 1988)

	Loan	Equity	Total
	(In millions of U.S. dollars)		
Total gross commitments	19.6	0.9	20.5
Less cancellations, terminations, repayments, and sales	8.3	0.3	8.6
Total commitments now held by IFC	11.3	0.6	11.9
Total undisbursed	8.9	--	8.9

3. Recent and prospective IDA institutional development support

The IDA is financing specific institutional development components in some of its ongoing development projects. It has previously assisted in the improvement of investment planning and programming as well as external debt reporting. Assistance in the area of institutional reorganization and development was given to the state petroleum company (YPFB) and the state mining company (COMIBOL). A project is now underway to improve financial administration and control of public expenditures, support the Government's tax reform program, and provide technical assistance to efforts to reorganize the Central Bank and to restructure major public banks. In addition, appraisal will soon take place of a project designed to improve economic management, including assistance to the Ministry of Agriculture's reorganization program, strengthening of the public investment program, and support to decentralization efforts.

4. IBRD views on the investment program

This year's investment program marks a significant advance on previous efforts, as the Government is now preparing sectoral strategies, which were discussed with the Bank staff at a seminar in April 1988. The investment budget in past years was largely determined by past commitments. This year, however, the program will be determined by an overall development program, including significant new directions in agriculture and industry.

5. Enhanced structural adjustment facility

The Fund and World Bank staffs assisted the Bolivian authorities in the preparation of a policy framework paper that is to be discussed on July 21, 1988 by the Committee of the Whole of the World Bank's Executive Board.

6. Resident representative

A resident representative was posted to La Paz in October 1986.

7. Recent economic and sector missions

(a) Mission to prepare draft of 1987 Updating Economic Memorandum on Bolivia - October 1987

(b) Mission to review draft of Policy Framework Paper (jointly with IMF) - December 1987

(c) Mission to discuss arrangements for the Emergency Social Fund - November/December 1987

(d) Mission to discuss with Government officials the proposed water supply and sewerage project - November/December 1987

(e) Mission to pre-appraise project to strengthen economic management - February 1988

(f) Mission to prepare project on development of the private sector - February 1988

(g) Mission to prepare projects in the social sector and to prepare public health and nutrition sector review - March 1988

(h) Mission to prepare agricultural development projects and discuss the Agricultural Sector Study Paper - March 1988

(i) Mission to identify Environmental Study Action Plan and discuss Updating Economic Memorandum with the Government - March/April 1988

(j) Mission to appraise project to strengthen economic management - April 1988

(k) Mission to supervise Public Financial Management Operation - April 1988

(l) Mission to prepare a project to rehabilitate the mining sector - April 1988

(m) Mission to supervise loan to support the Emergency Social Fund - April 1988

(n) Mission to supervise implementation of the Second Reconstruction Import Credit - May 1988

Bolivia--Statistical Issues

1. Outstanding Statistical Issues

a. Real sector

The present consumer price index (CPI), based on a 1966 survey of lower- and middle-income households in La Paz, is no longer representative, although the National Statistical Office has updated the food component and given it a lower weight in the index.

b. Government finance

Monthly data are reported for IFS based on the Boletín Estadístico of the Central Bank. However, monthly and quarterly data do not add to annual data because the latter include, in addition to Treasury Accounts, extrabudgetary accounts. Monthly data updated through December 1987 have been received. These data, which reflect the effects of inflation, are being reviewed and processed for publication in IFS. Annual data in IFS do not correspond to annual data in the 1987 Government Finance Statistics Yearbook (GFSY) because the GFSY data cover in addition operations of the social security funds and some extrabudgetary units with own budget. Data for 1985 and 1986 were received too late for inclusion in the 1987 GFSY. Data on domestic debt need to be reported for Central Government, as well as domestic and foreign debt for state and local governments.

c. Monetary accounts

A technical assistance mission has been scheduled for later this year to review the new Central Accounting and Monetary Accounting Systems being established by the Central Bank with a view to improve the quality and currentness of money and banking statistics.

d. Balance of payments

A technical assistance mission visited Bolivia in February 1988. The mission report, which will be transmitted to the authorities shortly, notes that there was no progress concerning the recommendations made by a previous mission (July 1986). The area that requires immediate attention is the collection of basic data needed for the compilation of balance of payments statistics, in particular with respect to services and some of the capital account items. The trade data obtained from the customs are available but only with considerable delays. The request for data through questionnaires has been discontinued since 1983. Furthermore, statements of the External Debt Office do not provide all the information needed for recording the relevant flows in the balance of payments. The mission made recommendations on the sources and methods of compilation to improve the coverage and quality of the balance of payments data. Balance of payments statements for 1986 and 1987 were compiled by the mission.

e. International banking statistics

The data prepared in U.S dollars on banks' external positions differ significantly from the equivalent data reported in bolivianos. The mission on money and banking statistics, scheduled for later this year, will deal with this issue.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for Bolivia in the June 1988 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Bolivia, which during the past year have been provided on an irregular basis.

Status of IFS Data

		Latest Data in June 1988 IFS
Real Sector	- National Accounts	1986
	- Prices	January 1988
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	Q2 1986
	- Financing	Q2 1986
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	November 1987
	- Deposit Money Banks	November 1987
	- Other Financial Institutions	November 1987
Interest Rates	- Discount Rate	Q4 1984
	- Bank Lending/Deposit Rates	Q4 1984
	- Bond Yields	n.a.
External Sector	- Merchandise Trade: Values	December 1987 1/
	Prices	December 1987
	- Balance of Payments	1987
	- International Reserves	September 1986
	- Exchange Rates	January 1988

1/ Imports through November 1987.

Bolivia: Medium-Term Scenario

The Government's macroeconomic objectives over the medium term are real GDP growth of 3-4 percent a year while maintaining domestic inflation in the single-digit range. The market-oriented reforms undertaken since 1985 have strengthened the basis for a resumption of growth of output and per capita income. Sustaining growth over the medium term will necessitate an increase in investment from the low levels in the first half of the 1980s, particularly in transportation infrastructure. The resources required to finance this investment effort will need to come from increased national savings and concessional external assistance. The scenario assumes national savings equivalent to about 2.5 percent of GDP a year on average, 1/ about one half of which would be generated in the public sector as a result of tax collection efforts and tight control over current expenditure. There would be small domestic financing surpluses in the public sector, thus providing room for the credit needs of the private sector.

The staff's illustrative medium-term scenario is based on (i) the authorities' program for 1988-91 and maintenance of the level of net international reserves thereafter; (ii) World Economic Outlook projections on the external environment; and (iii) indications from creditors and donors on the level and terms of their prospective financial support for Bolivia. The main assumptions include (i) repayment by Argentina in 1988 of US$120 million of arrears on gas exports; (ii) repayment by Bolivia in 1988-89 of US$160 million of arrears to foreign petroleum companies operating in Bolivia, using Bolivia's nonconvertible deposit with the Central Bank of Argentina; (iii) reinvestment in Bolivia of three quarters of the arrears paid to the companies, thereby raising imports of capital goods in 1988-90; (iv) the continued export of gas by Bolivia after the expiration of the long-term contract in 1992 (US$273 million or 5.5 percent of GDP in 1993); (v) maintenance of financial restraint and market-oriented policies; (vi) depreciation of the exchange rate in real terms; and (vii) rescheduling of the unredeemed bank debt in late 1988 on terms similar to those obtained for the buy-back and debt conversion.

Export volume is expected to rebound in 1988 as COMIBOL fully resumes production, nontraditional exports expand, and the volume of natural gas exports returns to normal (see Table 8). The real depreciation of the currency is assumed to contribute to export volume growth averaging 8.5 percent a year in 1988-93 (including average annual growth of the volume of nontraditional exports by 10 percent, which would raise such exports to one-third of total exports by 1993) and 5 percent a year in the period 1994-97. The reinvestment in Bolivia of the arrears

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1/ The Bolivian savings effort is more impressive if net factor income and net short-term inflows, much of which are thought to represent illegal exports, are considered. Domestic savings would then represent 11-12 percent of GDP on average.

payments received by foreign petroleum companies for exploration and development of new oil fields is expected to contribute to export growth. If Argentina does not continue to buy gas after the expiration of the long-term contract in 1992, Bolivia might begin exporting gas to Brazil at around that time if negotiations between the two countries can be concluded soon. However, the scenario does not make allowance for a possible Brazilian pipeline project.

Import volume is projected to grow by 2 percent in 1988, as a result of real exchange rate depreciation and tight demand management. Thereafter, import volume is projected to increase by about 4 1/2 percent a year in 1989-93, and by 4 percent a year in 1994-97. This growth is consistent with the authorities' GDP growth objective on the assumption of improved efficiency in the use of imports and some import substitution. Improvements in the design and implementation of the investment program should contribute to this end.

Gross disbursements from multilateral lenders are projected to increase by 80 percent to US$270 million in 1988, reflecting a considerable speedup in the project pipeline. The World Bank accounts for 45 percent of gross disbursements from multilateral lenders in 1988, with the Inter-American Development Bank (IDB) and the Andean Development Corporation (CAF) accounting for the bulk of the remainder. After declining somewhat in 1989 from the exceptionally high level projected for 1988, such disbursements are expected to rise gradually to some US$300 million by 1993 and to some US$370 million by 1997.

Based on present indications, financial support from bilateral official sources would increase modestly in 1988 and subsequent years. Reflecting the switching of assistance from loans to grants by some countries, official transfers are projected to grow by about 6 percent a year to US$180 million in 1993 and to US$220 million by 1997. However, gross disbursements of official bilateral loans are projected to stabilize at their 1987 level of about US$60 million by 1993, after a temporary increase to US$70-83 million in 1988-89 on account of the cofinancing of an IDA credit by Japan. While total amortization due to bilateral creditors is projected to average about US$120 million a year in 1988-97, there will be a step increase in amortization payments when the 15 year grace period under the 1987 agreement with Argentina expires in 2003.

Foreign commercial banks are not projected to extend new loans to Bolivia during 1988-97 and the scenario does not explicitly assume a resumption of trade financing. Private capital inflows, which increased substantially in 1986-87 following the introduction of the stabilization program, are estimated to decline to about US$100-110 million a year. This estimate may be conservative with the continued pursuit of tight financial policies. Direct investment flows are assumed to recover gradually, exceeding by 1997 the annual level of US$60 million reached at the beginning of the decade. This assumption also may prove conservative if Bolivia settles its arrears to the foreign petroleum companies.

The current account deficit is projected to remain around 10-11 percent of GDP in 1988-93 and then to decline to an average of 8 percent in 1994-97. Exports are projected to increase substantially more rapidly than imports, but the initial magnitude of the trade deficit, together with increasing scheduled interest payments, prevent a more substantial improvement in the current account to GDP ratio over the projection period.

After allowing for an accumulation of reserves of US$45 million during the program period, annual financing needs emerge that rise from US$142 million in 1988 and peak at US$180-185 million in 1990-91 before disappearing gradually by 1997. For 1988-89 these needs are expected to be fully covered by debt rescheduling from official bilateral creditors on terms similar to those obtained under the 1986 Paris Club rescheduling, assuming an unchanged cutoff date, and by the rescheduling of the unredeemed portion of commercial bank debt on terms similar to those obtained for the recent buyback and debt conversion. However, debt relief from bilateral official creditors would not be sufficient to cover the financing needs for 1990 and beyond. Even if the annual repayments of principal under the 1986 Paris Club agreement (US$55 million in 1990-91 and US$83 million in 1992-93) could be rescheduled, there would be residual gaps of US$26 million in 1990 and US$51 million in 1991. Thereafter, the residual gaps are about equal to the scheduled principal repayments under the 1986 Paris Club rescheduling.

The assumed net reserve gain of US$45 million and scheduled repayments to the Fund would imply that the stock of gross reserves would gradually decline to about 4 1/2 months of imports by 1993 and to 2 1/2 months of imports by 1997. However, the composition of gross reserves would improve as deposits in the Central Bank of Argentina will be used to pay moratorium interest to Argentina and arrears to the foreign petroleum companies, while freely usable foreign exchange increases. During 1988-90 Fund disbursements will contribute to improving the level of gross international reserves.

As a result of the debt buyback and debt conversion and valuing unredeemed bank debt at the buyback price, Bolivia's medium- and long-term external public debt would decline from 682 percent of exports of goods and nonfactor servives at the end of 1987 to 587 percent at the end of 1988. Thereafter, it would decline further to 446 percent in 1993 and to 386 percent in 1997, including borrowing to fill the projected residual financing gaps (see Table 8). The medium- and long-term public debt service ratio after debt relief is projected to decline from 46 percent of exports of goods and nonfactor services in 1988 to 41 percent in 1993 and to 35 percent in 1997, including interest on the financing gap but assuming that the bulk of loan disbursements is received on concessional terms.

Variations in world interest rates would not significantly affect Bolivia's public debt service obligations because the bulk of Bolivia's debt was contracted at fixed rates. The main impact of such variations would be on moratorium interest due on US$458 million of debt rescheduled in accordance with the 1986 Paris Club agreement, about two thirds of which was linked to LIBOR or other market-determined benchmark rates, on moratorium interest on future debt reschedulings, and possibly on interest on the residual financing gaps in 1990-96. A one percentage point change in market interest rates would affect debt service obligations by 0.2 percent of GDP, and increase the financing gap by US$9 million a year, on average during 1989-93.

A variation of 10 percent in the prices of natural gas and tin would lead to variations of export receipts of US$25.0 million (0.6 percent of GDP) and US$14.2 million (0.3 percent of GDP) a year on average during 1988-93. A variation of 1 percent in export and import prices would lead to variations of US$7.4 million (0.2 percent of GDP) and US$10.7 million (0.2 percent of GDP) a year on average during 1988-93.

Bolivia: Summary of the Program for 1988

I. Major Assumptions

1. Real GDP: After an increase of 2.4 percent in 1987, real GDP is expected to increase by 2.5 percent in 1988 (Table 10). The growth in 1988 reflects a recovery of agriculture (which is expected to grow by 1.3 percent after a decline of 0.2 percent in 1987) and a strong increase in mining and hydrocarbons (7.3 percent after a fall of 1.9 percent in 1987).

2. Export volume: Export volume is assumed to increase by 12.6 percent in 1988 following a reduction of 10.0 percent in 1987. Tin exports are expected to grow by 26 percent after having fallen by 40.5 percent in 1987. The volume of all other metals is also expected to increase except for antimony, which is expected to fall by 8 percent. Natural gas exports, under the contract with Argentina, are expected to rise back to their historical level of 78.3 million cubic feet in 1988.

3. Export and import prices: The price of tin is forecast at US$3.15 per pound in 1988, compared with US$3.11 per pound in 1987. The price of natural gas is expected to fall by 13 percent reflecting developments in international petroleum markets. Import prices are projected to increase by 7.5 percent in 1988. As the weighted average of export prices is expected to fall by 3.4 percent, the terms of trade would deteriorate by 10.1 percent.

4. Financial sector: Real money and quasi-money are projected to grow by 14.6 percent, implying a further decline in velocity.

II. Targets

1. Inflation: The rate of increase in consumer prices is projected to fall from 14.6 percent to 11.6 percent on an average basis but to increase from 10.6 percent to 12.5 percent on an end-of-period basis. The GDP deflator would increase by 16.0 percent, compared with 13.8 percent in 1987.

2. Net international reserves: The Central Bank will aim at increasing its net international reserves by US$29.6 million in 1988, compared with a loss in net international reserves of US$78.2 million (after the long-term rescheduling of US$61 million of reserve liabilities) in 1987. The target assumes the payment of US$119.6 million by Argentina on account of gas bills that had not been settled in 1987 as originally envisaged and the payment by Bolivia of US$40.0 million of arrears to foreign-owned petroleum companies. (A further payment of US$120 million of such arrears is foreseen for 1989.)

3. External current account: Because of the deterioration of the trade account, the external current account is projected to widen from US$469 million in 1987 to US$489 million in 1988. Relative to GDP the deficit would remain virtually unchanged at 11.4 percent.

III. Principal Policy Instruments

1. Exchange rate policy: The Central Bank will conduct frequent foreign exchange auctions to maintain a flexible exchange rate with unrestricted access to the auction market. It is expected that the auctions will be conducted in such a way as to result not only in meeting the net international reserves targets but also to achieve a real depreciation of the currency.

2. Fiscal policy: The overall deficit of the nonfinancial public sector will be limited to 6.7 percent of GDP. Under the assumption that Argentina eliminates its arrears to Bolivia, the nonfinancial public sector will reduce its domestic indebtedness by 1.1 percent of GDP.

Tax revenues of the General Government are expected to increase from 6.6 percent of GDP in 1987 to 9.1 percent of GDP in 1988. The increase reflects the full-year effect of the tax reform, the implementation of two new taxes, and improvements in tax and customs administration and is expected to occur notwithstanding a reduction in customs duties.

Expenditure in the Central Administration and the state enterprises will be strictly controlled. An important element is a tight wage policy, which foresees no further wage increases in 1988 following an increase of 15.7 percent on average in March 1988. Investment spending is expected to increase from 6.0 percent of GDP in 1987 to 7.8 percent of GDP in 1988. Tight control will be maintained over the finances of the state enterprises; their pricing policy will remain under close review and their efficiency will be improved.

3. Monetary policy: Credit to the private sector is programmed to expand in 1988 by 27.1 percent of liabilities to the private sector at the beginning of the period, including net use of external lines of credit of US$90 million. However, higher net use of external credit lines can be accommodated under the monetary program.

Interest rates will remain market determined. They are projected to decline in real terms as confidence strengthens with the implementation of the economic program.

4. External debt policy: The program calls for stepped-up disbursements from multilateral development banks and from official bilateral creditors. It also assumes the conversion into exit bonds of bank debt that remains outstanding after the buyback and rescheduling from official bilateral creditors under the aegis of the Paris Club. No bank financing is being sought except for short-term import financing.

5. External trade and payments policy: The trade system will remain open. Import duties were reduced from 20 percent to 10 percent on capital goods in March 1988; duties on all other imports are being reduced from 20 percent by one percentage point per quarter. The authorities will not introduce or intensify restrictive exchange practices or restrict imports for balance of payments purposes.

Table 10. Bolivia: Principal Objectives and Targets of the Program for 1988

	1986	1987	Prog. 1988
(Annual percentage change)			
Output and prices			
Real GDP	-2.9	2.4	2.5
Consumer prices (end-of-period)	66.0	10.6	12.5
(In millions of U.S. dollars)			
External sector			
Current account balance	-399.8	-469.0	-488.8
In percent of GDP	-10.4	-11.3	-11.4
Change in net international reserves	110.4	-78.2	29.6
Gross loan disbursements to nonfinancial public sector	144.0	144.8	243.1
(In percent of GDP)			
Nonfinancial public sector			
Tax revenue	3.9	6.6	9.1
Overall deficit	4.3	7.5	6.7
Domestic financing	-1.2	3.2	-1.1
(Annual percentage change) 1/			
Financial system			
Credit to the private sector	108.1	32.2	27.1
Liabilities to the private sector	131.2	41.4	18.0
(In percent of GDP)			
Savings and investment			
Gross domestic investment	8.0	10.1	12.7
National savings	-2.4	-1.2	1.3

Sources: Data provided by the Bolivian authorities; and Fund staff estimates.

1/ With respect to liabilities to the private sector at the beginning of the period and measured at an accounting exchange rate.

BOLIVIA--Basic Data

Area (square kilometers)	1,098,600
Population and vital statistics (1986)	
Population (1987)	6.75 million
Annual rate of population increase	2.78 percent
Density per sq. km. of agricultural land	20
Labor force in agriculture	48 percent
Life expectancy at birth	53 years
Infant mortality (aged under 1)	118 per thousand
Child death rate (aged 1-4)	20 per thousand
Population between 0-14 years	44 percent
Unemployment (1987)	20.5 percent
Food and nutrition (1986)	
Per capita food production index (1979-81 = 100)	91
Per capita supply of calories per day	2,146
Per capita protein intake (grams per day)	50
Health (1986)	
Population per physician	4,800
Population per hospital bed	2,500
Access to services	
Safe water (1986)	
Percent of urban population	69 percent
Percent of rural population	10 percent
Electricity (1973)	
Percent of urban population	76 percent
Percent of rural population	6 percent
Education (1986)	
Primary school enrollment	87 percent
Pupil-teacher ratio	25
Income distribution (1973)	
Percentage of private income received by:	
Highest 20 percent of households	59 percent
Lowest 20 percent of households	4 percent
Lowest 40 percent of households	13 percent
GDP (1987)	SDR 3,212 million

	1983	1984	1985	1986	1987 Prog.	1987 Actual	Proj. 1988
GDP per capita, SDR	590	596	591	484	504	476	469
Origin of real GDP				(In percent)			
Agriculture	18.1	22.3	24.5	24.1	22.0	23.5	23.3
Mining	16.8	14.8	13.0	11.3	13.3	10.9	11.4
Manufacturing	12.5	10.8	9.8	10.4	11.6	10.9	10.9
Construction	3.4	3.2	3.0	2.7	3.8	2.8	2.9
Transport and communications	6.4	6.5	6.7	7.1	5.9	7.4	7.4
Government	13.4	13.7	14.3	13.8	12.3	13.5	13.5
Other services	29.4	28.7	28.7	30.6	31.1	31.0	30.6
Ratios to GDP							
Exports of goods and nonfactor services	15.1	12.5	14.6	17.3	14.7	14.5	15.1
Imports of goods and nonfactor services	12.1	9.2	13.6	22.3	18.6	22.2	23.3
External public debt (end of year)	56.4	49.6	66.8	96.5	101.9	98.8	88.4
Central Administration revenues	8.3	3.1	8.8	14.8	14.1	14.3	16.5
Central Administration expenditures	26.6	23.7	17.7	17.8	17.2	19.3	18.7
Nonfinancial public sector savings	-17.0	-26.3	-9.4	-0.7	0.5	-2.5	0.1
Nonfinancial public sector surplus or deficit (-)	-18.3	-30.6	-12.7	-4.3	6.1	-7.5	-6.7
National saving	6.2	5.2	4.3	-2.4	3.0	-1.2	1.3
Gross domestic investment	8.9	7.3	10.4	8.0	12.4	10.1	12.7
Balance of payments current account	-2.7	-2.1	-6.1	-10.4	-9.4	-11.3	-11.4
Money and quasi-money (stock) 1/	21.3	21.6	12.6	10.7	8.4	13.7	14.8

	1983	1984	1985	1986	1987 Prog.	1987 Actual	Proj. 1988
Annual changes in selected economic indicators				(In percent)			
Real GDP per capita (in U.S. dollars)	-9.0	-3.0	-2.9	-5.5	0.4	-0.4	-0.3
Real GDP	-6.5	-0.3	-0.2	-2.9	3.2	2.4	2.5
GDP at current prices	254.0	1,400.9	12,392.4	236.5	14.7	16.5	18.9
Domestic expenditures (at current prices)	258.2	1,380.9	11,501.6	256.2	16.8	19.8	16.6
Investment	122.4	1,132.2	23,971.4	74.8	50.9	37.9	138.9
Consumption	281.6	1,405.8	10,872.1	276.3	13.3	18.3	4.8
GDP deflator	278.7	1,391.0	11,239.2	246.3	11.2	13.8	16.0
Cost of living (annual averages)	275.6	1,281.3	11,749.6	276.3	13.9	14.6	11.6
Central Administration total revenues	347.9	461.1	32,226.7	455.2	15.6	12.2	37.8
Central Administration total expenditures	296.5	1,225.3	8,384.3	235.0	14.4	27.4	14.8
Money and quasi-money	188.6	1,418.4	7,209.0	177.3	23.1	48.6	29.0
Money	212.5	1,777.1	6,105.4	81.6	17.7	39.0	15.7
Quasi-money	156.7	584.4	14,245.4	441.3	26.2	57.5	39.8
Net domestic bank assets 2/	203.6	994.0	8,448.4	91.9	53.1	65.9	13.3
Credit to nonfinancial public sector (net)	255.5	1,477.1	3,891.3	-59.2	--	14.2	-4.5
Credit to private sector	104.2	463.0	4,248.1	108.1	49.0	32.2	27.1
Central administration finances			(In millions of bolivianos)				
Total revenues	0.108	0.606	195.9	1,087.6	1,178.8	1,220.6	1,682.2
Total expenditures	0.345	4.572	387.9	1,299.3	1,434.1	1,654.8	1,899.5
Current account surplus or deficit (-)	-0.272	-3.702	-151.6	-131.3	-84.6	-376.2	-194.1
Overall deficit (-)	-0.238	-3.970	-191.9	-211.7	-255.3	-434.1	-217.3
External financing (net)	0.002	0.027	60.0	383.6	400.6	174.8	280.0
Internal financing (net)	0.236	3.943	131.9	-171.9	-145.3	259.3	-62.7
Balance of payments			(In millions of U.S. dollars)				
Merchandise exports (f.o.b.)	755	724	623	547	474	472	514
Merchandise imports (c.i.f.)	-589	-492	-552	-712	-618	-775	-850
Factor income (net)	-428	-441	-429	-309	-335	-274	-271
Other services and transfers (net)	107	71	57	74	103	108	118
Current account balance	-155	-138	-300	-400	-375	-469	-489
Nonfinancial public sector 3/	4	17	-12	70	179	76	185
Unpaid amortization 4/	-167	-202	-165	-239	-245	-204	-96
Banking system n.i.e. (net)	-141	-2	91	44	69	60	91
Private capital (net) 5/	178	21	47	254	38	152	90
Arrears on gas exports	-98	188	35	-3	--	-96	120
Allocation of SDRs and gold monetization	1	1	10	2	--	--	--
Overall balance	-379	-115	-300	-273	-332	-481	-99
Exceptional financing 6/	667	262	328	383	313	403	129
Change in official NIR (increase -)	-289	-148	-29	-110	19	78	-30
International reserve position			(In millions of SDRs)				
Central Bank (gross)	168.8	292.1	244.8	413.1	415.1	291.6	...
Central Bank (net)	-38.2	109.7	124.0	201.6	163.7	118.7	...
Rest of banking system (net)	-57.1	-59.1	-41.8	-45.1	...	-25.2	...

1/ Average of end-of-month stocks.
2/ In relation to the stock of liabilities to the private sector at the beginning of the period.
3/ Includes regular disbursements, assumption of restructured debt, and amortization paid.
4/ Public sector.
5/ Includes net errors and omissions.
6/ Includes unpaid debt service (arrears, deferments, and restructuring).

Three-Year and First Annual Arrangements Under the Enhanced Structural Adjustment Facility

Attached hereto is a letter with an attached Memorandum on Economic and Financial Policies of Bolivia (''the memorandum") dated June 30, 1988, from the Minister of Planning and Cooperation, the Minister of Finance, and the President of the Central Bank of Bolivia, requesting from the International Monetary Fund a three-year arrangement under the enhanced structural adjustment facility, and the first annual arrangement thereunder, and setting forth

(i) the objectives and policies of the program to be supported by the three-year arrangement;

and

(ii) the objectives and policies of the program to be supported by the first annual arrangement.

To support these objectives and policies, the Fund grants the requested arrangements in accordance with the following provisions, and subject to the Regulations for the administration of the structural adjustment facility and the Instrument to Establish the Enhanced Structural Adjustment Facility Trust:

1. (a) For a period of three years from August ___, 1988, Bolivia will have the right to obtain loans from the Fund under the enhanced structural adjustment facility, in a total amount equivalent to SDR 136.05 million. Of this amount, the equivalent of SDR 39.4545 million shall be provided from the structural adjustment facility within the Special Disbursement Account, and the equivalent of SDR 96.5955 million shall be provided from the Enhanced Structural Adjustment Facility Trust, subject to any changes in the amount of access to the structural adjustment facility.

(b) The amount of each annual arrangement will be the equivalent of SDR 43.35 million for the first annual arrangement; the equivalent of SDR 43.35 million for the second annual arrangement; and the equivalent of SDR 43.35 million for the third annual arrangement.

(c) Under the first annual arrangement:

(i) the first loan, in an amount equivalent to SDR 22.675 million, will be available on August ___, 1988 at the request of Bolivia and

(ii) the second loan, in an amount equivalent to SDR 22.675 million, will be available on December 15, 1988 at the request of Bolivia subject to paragraph 2 below.

2. Bolivia will not request disbursement of the second loan specified in paragraph 1(c)(ii) above -

(a) if the Managing Director finds that the data at the end of September 1988 indicate that -

(i) the limit on changes in net domestic bank assets of the Central Bank of Bolivia or the sublimit on changes in the net position of the nonfinancial public sector with the Central Bank of Bolivia, described in paragraph 10 and Table 3 of the memorandum was not observed; or

(ii) the limit on increase in the indebtedness of the nonfinancial public sector described in paragraph 5 and Table 2 of the memorandum was not observed; or

(iii) the target for changes in net international reserves for the Central Bank of Bolivia, described in paragraph 4 and Table 1 of the memorandum was not observed; or

(b) If Bolivia

(i) imposed or intensified restrictions on payments and transfers for current international transactions; or

(ii) introduced or modified multiple currency practices, except to reduce or eliminate import duty rebates; or

(iii) concluded bilateral payments agreements which are inconsistent with Article VIII; or

(iv) imposed or intensified import restrictions for balance of payments reasons; or

(c) Until the Fund has determined that the mid-term review of Bolivia's program referred to in paragraph 4 of the attached letter, has been completed.

If the Managing Director finds that any of the performance clauses that have been established in or under this paragraph 2 have not been met, the second loan specified in paragraph 1(c)(ii) above may be made available only after consultation has taken place between the Fund and Bolivia, and understandings have been reached regarding the circumstances in which Bolivia may request that second loan.

3. Before approving the second annual arrangement, the Fund will appraise the progress of Bolivia in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, taking into account primarily:

(a) the indicators described in paragraphs 4, 5, 10, 14, 16 and 18, and Tables 1 - 6 of the memorandum;

(b) imposition or intensification of restrictions on payments and transfers for current international transactions;

(c) introduction or modification of multiple currency practices except to reduce or eliminate import duty rebates;

(d) conclusion of bilateral payments agreements which are inconsistent with Article VIII; and

(e) imposition or intensification of import restrictions for balance of payments reasons.

4. In accordance with paragraph 3 of the attached letter, Bolivia will provide the Fund with such information as the Fund requests in connection with the progress of Bolivia in implementing the policies and reaching the objectives supported by these arrangements.

5. In accordance with paragraph 4 of the attached letter, during the period of the first annual arrangement, Bolivia will consult with the Managing Director on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests such a consultation. Moreover, after the period of the first annual arrangement and while Bolivia has outstanding financial obligations to the Fund arising from loans under that arrangement, Bolivia will consult with the Fund from time to time, at the initiative of the Government or whenever the Managing Director requests consultation on Bolivia's economic and financial policies. These consultations may include correspondence and visits of officials of the Fund to Bolivia or of representatives of Bolivia to the Fund.

La Paz, Bolivia
June 30, 1988

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus:

1. The objectives of a new four-year program to strengthen substantially and in a sustainable manner Bolivia's balance of payments position and to foster economic growth were set out in the Economic Policy Framework for 1988-91 ("the Policy Framework Paper"), which was prepared in collaboration with the staffs of the Fund and the World Bank and which was transmitted to you on June 17, 1988. The Policy Framework Paper updates and extends by two years the Medium-Term Economic and Policy Framework, 1987-89 that was transmitted to the Fund in November 1986.

2. The annexed Memorandum on the Economic and Financial Policies of Bolivia ("the Memorandum"), pursuant to the policy framework referred to above, sets out the objectives and policies that the Government of Bolivia intends to pursue in the three-year period starting from April 1, 1988 and the objectives, policies and measures for the first annual program thereunder. In support of these objectives, policies and measures, Bolivia hereby requests a three-year enhanced structural adjustment arrangement in an amount equivalent to SDR 136.05 million, and the first annual arrangement thereunder in an amount equivalent to SDR 45.35 million, subject to the availability of resources to the Enhanced Structural Adjustment Facility Trust, and subject to such adjustment as may be made for the second and third years in accordance with Section II of the Instrument to Establish the Trust.

3. Bolivia will provide the Fund with such information as the Fund requests in connection with its progress in implementing the policies and measures and achieving the objectives of the program.

4. The Government believes that the policies and measures set forth in the annexed Memorandum are adequate to achieve the objectives of its program, but will take any further measures that may become appropriate for this purpose. Bolivia will consult with the Managing Director on the adoption of any measures that may be appropriate, at the initiative of Bolivia or whenever the Managing Director requests such consultations. In addition, Bolivia will conduct with the Fund a mid-

term review of its first annual program by the end of 1988. As part of this review, suitable benchmarks will be established for the quarter ending March 31, 1989.

Sincerely yours,

Gonzalo Sanchez de Lozada
Minister of Planning and Coordination

Juan Cariaga
Minister of Finance

Javier Nogales
President
Central Bank of Bolivia

Attachment: Memorandum on the Economic and Financial Policies of Bolivia

Memorandum on the Economic and Financial Policies of Bolivia

1. Since August 1985 the Government of Bolivia has been implementing an economic program aimed at overcoming hyperinflation and restoring growth on a sustainable basis. Prices in the product, labor, financial, and foreign exchange markets were freed, the exchange and trade system was liberalized, and major steps were taken to reform the tax system, reorganize the state enterprises, and strengthen the financial system. The new economic strategy was successful in reducing the 12-month rate of inflation from a peak of 23,500 percent in September 1985 to less than 10 percent in March 1988. Over the same period, the real effective exchange rate depreciated by 23 percent. Output rose in 1987 for the first time since 1981. These results were achieved even though Bolivia was faced with adverse external developments, including steep declines in the prices for Bolivia's major exports (tin and natural gas) and delays in payments by Argentina for Bolivia's gas exports.

2. The program for 1987 sought to achieve a resumption of economic growth while consolidating the progress toward price stability and furthering the implementation of structural reforms. The program called for cautious fiscal and credit policies which, together with a flexible exchange rate policy, were to protect the balance of payments; in particular, the overall public sector deficit was to be limited to 6.1 percent of GDP and the net official international reserves were not to decline by more than US$18.5 million. There were difficulties in the implementation of these policies, which were exacerbated by the above mentioned failure of Argentina to make timely payments for its purchases of Bolivia's gas, and the public sector deficit expanded from 4.3 percent of GDP in 1986 to 9.8 percent of GDP in 1987 while the net international reserves of the Central Bank declined by US$139 million. 1/ After taking into account the delay in payments by Argentina, the overall deficit and reserve loss still would have been 7.5 percent of GDP and US$43 million, respectively.

3. To bring the adjustment program back on track, the Government has developed a set of policies for 1988 in the framework of a long-term adjustment program that aims at achieving a sustained increase in real per capita income, maintaining reasonable price stability, promoting the diversification of the economy, and strengthening the balance of payments on a lasting basis. Further structural reforms will be implemented with the aim of (i) promoting private sector activity, particularly in exports and efficient import substitution, (ii) improving the

1/ The reserve loss recorded in the acounts of the Central Bank was US$78 million because US$61 million of the Central Bank's reserve liabilities were assumed by the Central Government as long-term obligations as part of a comprehensive debt restructuring agreement with Argentina.

efficiency of the state enterprises, (iii) strengthening the Central Government administration, (iv) reducing the size of the public sector by divesting selected manufacturing enterprises, and (v) strengthening the financial system. These reforms are being pursued within a stable regulatory framework which includes a unified exchange rate system, a liberal trade and payments regime, a low and uniform import tariff, absence of price controls, and market-determined interest rates.

4. The program through 1991 aims at achieving rates of output growth of 3-4 percent a year, consolidating the progress in reducing inflation, raising domestic savings and investment, and strengthening the balance of payments. The Government believes that the financial program for 1988 is compatible with output growth of 2-3 percent, inflation of no more than 12 percent, and an improvement in the net international reserves of US$29.6 million, as set out in Table 1. The quarterly targets in Table 1 shall be adjusted in accordance with the provisions of paragraph 17 below.

5. The Government's program aims at improving the public sector's savings performance; the current account position of the nonfinancial public sector would shift from a deficit of 4.8 percent of GDP (2.5 percent after adjustment for Argentina's arrears) in 1987 to a small surplus in 1988 and to a surplus of 2.2 percent of GDP in 1991. The overall deficit would be reduced from 9.8 percent of GDP (7.5 percent after adjustment for Argentina's arrears) last year to 6.7 percent of GDP in 1988 and further to 4.7 percent of GDP by 1991. The limits on the quarterly overall deficit of the nonfinancial public sector for the remainder of 1988 are set out in Table 2. The Government's financing plan for the nonfinancial public sector does not envisage any increase in the domestic floating debt after March 31, 1988 nor any recourse to domestic bank financing except to finance part of the large arrears reduction to two foreign-owned petroleum companies in 1989, as described in paragraph 9 below. The progress in raising public sector savings and reducing the overall fiscal deficit is constrained by the heavy burden represented by interest payments on the external debt, mostly to official creditors; such obligations are projected to average 5 percent of GDP (or one sixth of current expenditure) in 1988-91. The Government will be seeking ways of reducing this burden through negotiations with its creditors, and any reduction in interest obligations that may result from these efforts will be used to strengthen the public sector's savings performance, with a view to raising fixed capital formation by either the public or the private sector.

6. Revenues from domestic taxes are expected to rise sharply in 1988 as a result of the tax reform that began to be implemented in April 1987. Tax administration will be strengthened further, in particular with respect to large taxpayers subject to the value added and specific consumption taxes and through the reorganization of the directorate in

charge of internal revenue collections. The tax on rural land holdings--the only measure not yet implemented of the 1986 tax reform law--will begin to be collected in the second half of 1988 on the basis of guidelines that are to be issued shortly. In addition, a new tax on the sale of consumer durables has been submitted for congressional approval together with the budget. Reflecting tax administration efforts as well as seasonal factors, domestic tax collections are projected to increase from Bs 35.9 million in April 1988 to Bs 53.1 million in May 1988 and Bs 74.0 million in June 1988. Notwithstanding the reduction of the customs tariff, duty collections are expected to rise in 1988, reflecting the growth of imports, the curtailment of exemptions, and a planned reform of the customs administration. Collections from domestic taxes and import duties are expected to increase from 6.6 percent of GDP in 1987 to 9.1 percent of GDP in 1988 and to more than 10 percent of GDP in 1991.

Domestic prices of petroleum products were raised by 29 percent to US$1.07 a gallon on average in March 1988. The price of gasoline, which accounts for 45 percent of domestic sales of petroleum products, was raised by 40 percent. The Government intends to maintain the average of petroleum product prices constant in U.S. dollar terms, adjusting these prices whenever the exchange rate has moved enough to justify an increase of Bs 0.01 per liter. The first such adjustment was made in early May 1988. With regard to revenues from exports of gas to Argentina, which under a September 1987 agreement with that country is exported at prices that are adjusted quarterly on the basis of developments in world market prices for imported substitute energy, the Government's program assumes a decline of 13 percent from US$3.32 per one thousand cubic feet in 1987 to US$2.89 in 1988.

Following the recent reorganization of the state mining company (COMIBOL), most mines of the enterprise are expected to become fully operational in mid-1988. The resulting resumption of exports is assumed to contribute about 1 percent of GDP to public revenues in 1988.

Revenue collections in 1989-91 will benefit from the full-year effect of the recent price increase for petroleum products and the resumption of operations by COMIBOL, the exchange rate policy outlined in paragraph 13 below, further tax administration measures, and the pursuit of realistic pricing policies in the state enterprises. The Government expects current revenue of the nonfinancial public sector (including the sales proceeds of the state enterprises on a gross basis) to increase from 29.3 percent of GDP in 1988 to 33.0 percent of GDP in 1991.

7. Public sector wages were increased by 15.7 percent on average in March 1988 and no further increases are planned until early 1989. With the completion of severance payments for laid-off workers, wage costs in COMIBOL have now been reduced substantially. The Government has begun to implement, with the financial and technical assistance from the World Bank and the UNDP, a comprehensive system of financial management and

control (SAFCO) in 13 key ministries, state enterprises, and other public sector entities covering about 60 percent of public sector financial flows. Taking into account the need to raise real wages on a selective basis over time and the impact of exchange rate policy on interest obligations on the external debt, the Government intends to limit current expenditure of the nonfinancial public sector (including the expenditures of the state enterprises on a gross basis) to 29.2 percent of GDP in 1988 and 30.8 percent of GDP in 1991.

8. The improvement in public sector savings and higher project loan disbursements are expected to make possible an increase in the level of public investment during the program period. This increase is expected to be facilitated by improved administration and execution of projects and streamlined procurement procedures. Public investment is expected to increase from 6 percent of GDP in 1987 to 7.8 percent of GDP in 1988 and remain at 7 percent of GDP in 1989-91.

9. The Government of Bolivia attaches major importance to clearing arrears to foreign-owned petroleum companies operating in Bolivia. Given the importance of a resolution of this issue from the viewpoint of promoting the exploration and development of Bolivia's oil potential and creating an exportable surplus, the program provides for a reduction of arrears of US$40 million in 1988 and US$120 million in 1989. The oil companies, for their part, have agreed to reinvest the bulk of these resources to expand their operations in Bolivia.

10. Credit policy will be managed with a view to achieving the price and balance of payments objectives of the program. The credit program for 1988 has been designed on the basis of a projected growth of 18 percent in the financial system's liabilities to the private sector. Accordingly, the authorities have established limits on the expansion of the net domestic assets of the Central Bank of Bolivia for the remainder of 1988, with sublimits on central bank credit to the nonfinancial public sector, as set out in Table 3. These limits shall be adjusted in accordance with the provisions of paragraph 17 below. Together with expected large net onlending of foreign loans through the banking system, the program makes room for a private sector credit expansion equivalent to 4 percent of GDP in 1988.

11. Interest rates in Bolivia will continue to be market determined during the program period. The Government expects that, with the implementation of its economic program and the financial sector reforms that are supported by an adjustment credit from the World Bank, interest rates will decline from their currently high real levels. If this expectation is not fulfilled by the end of 1989, the interest rate of development loans will be raised from its current level of LIBOR plus 5 percentage points to the average of after-tax deposit rates of the commercial banks. Also, the Central Bank will remunerate a portion of banks' legal reserve requirements irrespective of whether the banks observe the reference interest rates recommended by the bankers' association. The Central Bank is encouraging the consolidation and

recapitalization of the banking system, with the support of the above mentioned credit from the World Bank. As part of this process, bank supervision is being strengthened and the newly created Superintendency of Banking is expected to take over the functions of bank supervision from the banking control department of the Central Bank in 1988.

12. Wages in the private sector are determined by collective bargaining within the framework of the general labor law, which guarantees the right to unionize and strike but allows employers considerable flexibility in hiring and firing. The Government establishes by law a national minimum wage, which in March 1988 was increased by 20 percent from Bs 50 to Bs 60 (equivalent to US$26.67 at the time of the increase) a month. Apart from the benchmark provided by the minimum wage, the Government will not interfere with the free determination of wages in the program period.

13. In order to promote the diversification of the economy and a sustained expansion of output and exports, the Government intends to manage exchange rate policy in the period of the program in such a way as to strengthen the competitive position of Bolivian producers. The Government believes that this objective can be achieved by moving the Central Bank's minimum price for foreign exchange sales faster than the rate of domestic inflation. Foreign exchange will continue to be sold by the Central Bank in daily auctions with unrestricted access for all bidders. The net foreign exchange operations of the Central Bank will be consistent, at a minimum, with achievement of the quarterly targets for the net official international reserves that have been established in the program. However, net central bank purchases of foreign exchange would be increased beyond the amounts consistent with the program's international reserve target, if needed to ensure that the exchange rate adjusts in accordance with the objective of strengthening Bolivia's competitive position. Export diversification is also expected to be boosted by implementation of a 10 percent tax rebate for nontraditional exports and by the reduction of the import tariff for capital goods from 20 percent to 10 percent. The import tariff on all other goods is being reduced at a rate of 1 percentage point a quarter until 1990, by which time all goods will be subject again to a uniform duty rate of 10 percent. The preferential import tariff treatment for certain imports by the two foreign-owned petroleum companies was abolished as part of the recent agreements on the settlement of arrears to the companies. The tariff exemption for wheat will lapse in October 1988.

14. Bolivia will continue to maintain an external trade and payments system that is essentially free of restrictions. Arrears on debt service to multilateral lenders will be eliminated in the course of 1988 in accordance with the schedule set out in Table 4. Arrears with other lenders will be settled through debt renegotiations, as described in paragraph 15 below. The Government does not intend to introduce any new trade or payments restrictions or multiple currency practices other than the export rebate system during the program period.

15. The Government's economic program will require substantial foreign support through concessional loans and grants and restructuring of debt service. The Government intends to approach the Paris Club soon with a request to reschedule the maturities falling due after mid-1987. Bolivia's outstanding debt obligations to commercial banks are being addressed through a buyback arrangement and debt conversion. With donations that were channelled through a voluntary contribution account administered by the Fund and through debt conversion, Bolivia has retired or converted almost one half of its commercial bank debt (plus attendant unpaid interest) at an average price of US$0.11 to the U.S. dollar. The Government has initiated discussions with the banks with a view to renegotiating the remaining part of that debt. In these negotiations, the Government will seek to obtain highly concessional terms. The Government expects to have eliminated all arrears to the banks by the end of 1988.

16. To promote a steady improvement in the country's debt service profile, the Government will avoid borrowing at commercial terms and short maturities during the program period. To the latter effect, the Government has established quarterly limits on the increase in the public sector's external indebtedness (including guarantees) with an original maturity of more than one year and up to ten years, as set out in Table 5. Short-term external public debt will not be increased during 1988.

17. As Bolivia had to draw down its international reserves to finance Argentina's arrears on Bolivia's gas exports, the Government intends to use gas payments by Argentina that had not been paid as originally scheduled as of the end of 1987 (US$119.6 million) to rebuild the Central Bank's reserves. However, to the extent that Argentina were to delay further the payment of these obligations, the targets and limits in paragraphs 4 and 10 and Tables 1 and 3 will be adjusted. The targets and limits in paragraphs 4 and 10 and Tables 1 and 3 will also be adjusted to the extent that Bolivia pays less than US$40 million to reduce its arrears to the petroleum companies operating in Bolivia.

18. Structural policies for 1988-91 are spelled out in the updated policy framework paper and the benchmarks for monitoring structural policy implementation through March 31, 1989 and set out in Table 6.

Table 1. Bolivia: Minimum Gain or Maximum Loss of Net International Reserves of the Central Bank of Bolivia 1/

(Cumulative amounts in millions of U.S. dollars from December 31, 1987)

Date	Targets
March 31, 1988-33.9 2/	
June 30, 198861.0 3/	
September 30, 198842.6 3/4/	
December 31, 198829.6 3/	

1/ Defined as central bank foreign assets less liabilities with a maturity of up to one year but including liabilities to the Andean Reserve Fund and to the International Monetary Fund, excluding those arising from loans from the IMF's Trust Fund.
2/ Actual.
3/ Target subject to adjustment in accordance with the provisions in paragraph 17.
4/ Performance criterion; other targets are benchmarks.

Table 2. Bolivia: Limits on the Increase in the Indebtedness of the Nonfinancial Public Sector 1/

(Cumulative amounts in millions of bolivianos from December 31, 1987)

Date	Limits
March 31, 1988	175.9 2/
June 30, 1988	320.6
September 30, 1988	482.5 3/
December 31, 1988	681.2

1/ The nonfinancial public sector is defined as the Central Administration, the social security institutions, other decentralized agencies, the regional development corporations, prefectures, municipalities, and the state enterprises (excluding the Central Bank of Bolivia and other state-owned financial institutions).
2/ Actual.
3/ Performance criterion; other limits are benchmarks.

Table 3. Bolivia: Limits on the Changes in Net Domestic Assets of the Central Bank of Bolivia and Sublimits on the Changes in the Net Position of the Nonfinancial Public Sector with the Central Bank of Bolivia

(Cumulative amounts in millions of bolivianos from December 31, 1987)

Time Period	Limits or Sublimits
Cumulative changes in net domestic assets of the Central Bank of Bolivia 1/	
March 31, 1988	27.2 2/
June 30, 1988	-175.5 3/
September 30, 1988	-111.1 3/4/
December 31, 1988	-29.6 3/
Cumulative changes in net position of the nonfinancial public sector with the Central Bank of Bolivia	
March 31, 1988	72.6 2/
June 30, 1988	-190.2 3/
September 30, 1988	-147.9 3/4/
December 31, 1988	-67.9 3/

1/ Defined as the difference between changes in currency issue and changes in net international reserves.
2/ Actual.
3/ Limit or sublimit subject to adjustment in accordance with the provisions in paragraph 17.
4/ Performance criterion; other limits are benchmarks.

Table 4. Bolivia: Limits on Payments Arrears on Public and Publicly Guaranteed External Debt 1/

(In millions of U.S. dollars)

Date	Limits 2/
March 31, 1988	50.3 3/
June 30, 1988	22.7
September 30, 1988	6.5
December 31, 1988	--

1/ Excluding amounts due on loans for which Bolivia has formally requested rescheduling from (a) official bilateral lenders, (b) private lenders with official bilateral guarantee, and (c) foreign commercial banks.

2/ Benchmarks.

3/ Actual.

Table 5. Bolivia: Limits on the Increase of Public and Publicly Guaranteed External Debt with Original Maturities of More than One Year and Up to Ten Years 1/

(Cumulative amounts in millions of U.S. dollars from December 31, 1987)

Date	Limits 2/
June 30, 1988	20.0
September 30, 1988	30.0
December 31, 1988	40.0

1/ Includes debt with unknown original maturity. Excludes (i) changes in those central bank liabilities defined in Table 1 as part of the net international reserves, (ii) the refinancing of reserve liabilities as medium- and long-term debt, (iii) the reduction of debt covered by the limits through its repurchase by Bolivia or through its exchange for exit bonds, and (iv) the restructuring of debt service obligations of the public sector.

2/ Benchmarks.

Table 6. Bolivia: Benchmarks for the Implementation of Certain Structural Policy Measures

Policy Measures	Time Frame for Measures
1. Reorganization of the State Petroleum Company (YPFB)	
a. Creation of profit centers	September 1988
b. Centralization of the administration of pipelines and drilling operations	December 1988
c. Reduction of staff by 550	March 1989
2. Establishment of a Comprehensive System of Financial Management and Control (SAFCO)	
a. Preparation of norms for the public sector budget	September 1988
b. Preparation of a public sector budget for 1989	December 1988
3. Improvement of the Tax and Customs Administration	
a. Implementation of a new computerized tax collection system	September 1988
b. Adoption and start of implementation of an action plan to strengthen customs administration	December 1988
c. Creation of special directorates to control large taxpayers subject to value added and special consumption taxes in La Paz, Cochabamba, and Santa Cruz	March 1989
4. Reorganization of the External Debt Department of the Central Bank	
a. Compilation of a comprehensive inventory of external public debt	September 1988
b. Creation of a system to produce comprehensive quarterly statistics on external public debt flows	March 1989