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EBS/86/263

CONFIDENTIAL

November 26, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Bolivia - Staff Report for the 1986 Article IV Consultation, Review Under the Stand-By Arrangement, and Request for Arrangements Under the Structural Adjustment Facility

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with Bolivia, a review of the stand-by arrangement for Bolivia and Bolivia's request for arrangements under the structural adjustment facility. Draft decisions appear on pages 40-42.

This subject, together with Bolivia's request for a purchase under the compensatory financing facility (EBS/86/264, 11/26/86) 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)

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INTERNATIONAL MONETARY FUND

BOLIVIA

Staff Report for the 1986 Article IV Consultation, Review Under the Stand-by Arrangement, and Request for Arrangements Under the 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 E. Wiesner and Manuel Guitián

November 25, 1986

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I. Introduction

A staff mission consisting of Mr. Flickenschild (Head-WHD), Ms. Atkinson (ETR), Messrs. Fritz-Krockow, Kohnert, Sol Perez, and Mrs. de Berta (secretary-all WHD) visited La Paz during the period August 25-September 16, 1986 to conduct the 1986 Article IV consultation discussions and the mid-term review under the current stand-by arrangement. The mission also held discussions on an economic program for 1987 which--once set in a three-year framework--could give Bolivia access to a first-year disbursement under the Structural Adjustment Facility. The staffs of the Fund and the World Bank--the former represented by Messrs. Flickenschild and Sol Perez--met jointly with the Bolivian authorities in La Paz during the period October 28-30, 1986 to discuss a three-year policy framework and an economic program for 1987-89 that could give Bolivia access to the Structural Adjustment Facility.

The Bolivian team was headed by the Minister of Planning and Coordination and included the Minister of Finance and the President of the Central Bank. The consultation mission also met with the Ministers of Foreign Affairs and Culture; Industry, Commerce, and Tourism; Energy and Hydrocarbons; Mining and Metallurgy; and Labor; as well as with senior officials of these and a few other ministries and decentralized agencies and with the general managers of the two largest state enterprises. Both missions were assisted by Mr. Hoelscher, the Fund's resident representative in La Paz. Bolivia has accepted the obligations of Article VIII of the Articles of Agreement.

The 1985 Article IV consultation discussions were held in La Paz during the period June 17-July 5, 1985. In concluding the consultation on September 23, 1985, the Executive Directors commended the Bolivian authorities for the bold steps they had been taking to adjust and liberalize the economy (SUR/85/108, 9/25/85). While welcoming the adoption of a flexible exchange rate policy, the freeing of prices and interest rates, and the liberalization of the trade and payments regime, Directors emphasized the need to redress the fiscal imbalance by rebuilding the tax base and reducing the size of the public sector to a sustainable level. They urged the authorities to adopt measures to promote saving and lower inflation in order to create the conditions for economic growth. Directors also recognized the need for considerable financial assistance from Bolivia's foreign creditors, including in particular the multilateral development institutions.

The Fund approved a one-year stand-by arrangement for Bolivia on June 19, 1986 in an amount equivalent to SDR 50 million, or 55.1 percent of quota (EBS/86/120, 6/2/86). The balance available in the first credit tranche, amounting to the equivalent of SDR 15.4 million, was purchased upon approval of the arrangement (Table 1). The first of the remaining four quarterly purchases of SDR 8.65 million each was made on September 23, 1986, following Executive Board approval of a waiver for the nonobservance of the June 30, 1986 limit on external payments arrears (EBS/86/215, 9/12/86). All other performance criteria were observed, most of them with substantial margins (Table 2).

Table 1. Bolivia: Fund Position During the Period October 1986-December 1989

	Outstanding on 9-30-86	1986 October-December	1987 January-March	1987 April-June	1987 July-December	1988 January-December	1989 January-December
		(In millions of SDRs)					
Transactions under tranche policies (net) 1/		7.70	6.41	7.70	-0.89	--	-4.93
Purchases		8.65	8.65	8.65	--	--	--
Ordinary resources		8.65	8.65	8.65	--	--	--
Enlarged access resources		--	--	--	--	--	--
Repurchases		0.95	2.24	0.95	0.89	--	4.93
Ordinary resources		--	--	--	--	--	4.93
Enlarged access resources		0.95	2.24	0.95	0.89	--	--
Transactions under Compensatory Financing Facility (net)		61.86	-2.24	-2.24	-4.48	-2.24	--
Purchases		64.10	--	--	--	--	--
Repurchases		2.24	2.24	2.24	4.48	2.24	--
Transactions under Buffer Stock Facility (net)		-3.06	-3.06	-3.06	--	--	--
Purchases		--	--	--	--	--	--
Repurchases		3.06	3.06	3.06	--	--	--
Purchases under Structural Adjustment Facility		18.14	--	--	12.25	12.24	--
Total Fund credit outstanding (end of period)	51.68	136.32	137.43	139.83	146.71	156.71	151.78
Under tranche policies 1/	29.08	36.78	43.19	50.89	50.00	50.00	45.07
Under Compensatory Financing Facility	13.42	75.28	73.04	70.80	66.32	64.08	64.08
Under Buffer Stock Facility	9.18	6.12	3.06	--	--	--	--
Under Structural Adjustment Facility	--	18.14	18.14	18.14	30.39	42.63	42.63
		(In percent of quota)					
Total Fund credit outstanding (end of period)	57.0	150.3	151.5	154.2	161.8	172.8	167.3
Under tranche policies 1/	32.1	40.6	47.6	56.1	55.1	55.1	49.7
Under Compensatory Financing Facility	14.8	83.0	80.5	78.1	73.1	70.7	70.7
Under Buffer Stock Facility	10.1	6.7	3.4	--	--	--	--
Under Structural Adjustment Facility	--	20.0	20.0	20.0	33.5	47.0	47.0

Source: Fund staff projections.

1/ Ordinary and enlarged access resources.

Table 2. Bolivia: Performance Under the Stand-By Arrangement

	June 30 1986	September 30 1986
(In trillions of Bolivian pesos)		
Cumulative changes in net domestic assets of the Central Bank 1/		
Limit	94.7	198.9
Actual	24.7	-42.6
Margin	70.0	241.5
Cumulative changes in the net position of the nonfinancial public sector with the Central Bank 1/		
Limit	30.3	71.4
Actual	-46.1	-114.8
Margin	76.4	186.2
Borrowing requirement of the nonfinancial public sector 2/		
Limit	144.4	314.8
Actual	117.3	...
Margin	27.1	—
(In millions of U.S. dollars)		
Loss in net international reserves of the Central Bank		
Limit	-38.0	-70.9
Actual	9.5	48.9
Margin	47.5	119.8
Increase in public and publicly guaranteed external debt 3/		
Limit	25.0	55.0
Actual	-15.0	...
Margin	40.0	—
Payments arrears on public and publicly guaranteed external debt 4/		
Limit	11.1	6.1
Actual	21.5	6.4
Margin	-10.4 5/	-0.3
(In percent)		
Premium of parallel exchange rate 6/	0.4	-0.3

Source: Ministry of Finance and Central Bank of Bolivia.

1/ Tested continuously. For purposes of the program, foreign currency transactions are converted at $b 2,032,333=US$1 for the period March 31, 1986-June 30, 1986 and at $b 2,181,333=US$1 for the period March 31, 1986-September 30, 1986.
2/ For purposes of the program, foreign currency transactions are converted at the average exchange rate of the quarter in question.
3/ Disbursed debt outstanding in the 1-10 year maturity range.
4/ Excludes until December 30, 1986 amounts past due on debt service for which Bolivia has formally requested restructuring from (a) official bilateral lenders, (b) private lenders with official bilateral guarantee, and (c) private commercial banks.
5/ A waiver for the nonobservance of this performance criterion was granted on September 17, 1986 (EBS/86/215).
6/ Limit is 5 percent for the five-day moving average.

As envisaged in the arrangement, the discussions in connection with the mid-term review were comprehensive and covered the implementation of tax reform, collections from existing taxes, and the public sector investment program along with policies on the exchange rate, interest rates, wages, and public enterprise prices. In a letter dated October 30, 1986, the Bolivian authorities propose quantitative limits and targets for the period of the arrangement after September 30, 1986 on the basis of an economic program covering the period July 1, 1986-December 31, 1987 (Attachments I and II).

The present paper proposes the completion of the review contemplated in paragraph 4(d) of the stand-by arrangement, which will have the effect of waiving the nonobservance of the performance criterion on external payments arrears on September 30, 1986 and modifying that criterion for December 31, 1986 by excluding arrears to foreign commercial banks from the limit on arrears until March 30, 1987. The reasons for supporting the authorities' request for a waiver and modification of the performance criterion on external arrears are set out in the staff appraisal.

In a second letter, dated November 21, 1986, the Bolivian authorities request a structural adjustment arrangement in support of a structural adjustment program covering the three-year period 1987-89 (Attachments IV, V, and VI). On current indications, Bolivia's three-year access to the Structural Adjustment Facility would amount to SDR 42.629 million. The first-year disbursement of SDR 18.14 million, or 20 percent of quota, would be made on the basis of the economic policies outlined in the Memorandum of Understanding on Economic Policy Through the End of 1987 (Attachment II) and the benchmarks indicated in the Memorandum on Economic and Financial Policies in the Period January 1, 1987-December 31, 1989 (Attachment VI).

The Bolivian authorities also are expected to request shortly a purchase under the Compensatory Financing Facility. A paper in support of that request has been circulated separately (EBS/86/264). The requested purchase of SDR 64.1 million, or 70.7 percent of quota, would raise Bolivia's holdings under the Compensatory Financing Facility to the limit of 83 percent of quota. Use of the Fund's resources under the stand-by arrangement and the Compensatory Financing Facility would raise the Fund's holdings of Bolivian pesos to SDR 121.7 million, or 134.2 percent of quota, by the expiration of the stand-by arrangement in mid-1987. Total Fund credit outstanding (including the first disbursement under the Structural Adjustment Facility) would amount to SDR 139.8 million, or 154.2 percent of quota, in mid-1987.

The staffs of the Fund and the World Bank have collaborated closely in the preparation of the abovementioned three-year policy framework. The Fund staff also has benefited from the Bank staff's evaluation of the public sector investment program for 1986 and 1987, which was carried out in conjunction with preparatory work for a Consultative Group meeting that is scheduled to be held under the sponsorship of the

World Bank in early December 1986. Summaries on Bolivia's relations with the Fund and the World Bank and on statistical issues are presented in Appendices II, III, and IV. The economic program for July 1986-December 1987 is summarized in Appendix V.

II. Recent Economic Developments and Performance Under the Stand-by Arrangement

1. Overview

In August 1985, Bolivia was in the midst of a severe economic and financial crisis. Real GDP was contracting for the fifth consecutive year, and per capita GDP had dropped by almost 30 percent in real terms since 1980. Shortages were widespread and consumer prices had risen by almost 24,000 percent from August 1984 (Chart 1). The external payments situation was characterized by extreme currency overvaluation, the virtual depletion of usable international reserves, and the rapid accumulation of external payments arrears, which reached about US$1 billion or more than one fifth of GDP. The ratio between the exchange rates in the parallel and official markets increased to 20:1. The principal factor behind Bolivia's large financial imbalances was the rapidly rising deficit of the nonfinancial public sector. This deficit, which was financed by the Central Bank, rose to more than 28 percent of GDP in 1984 and continued to widen in 1985 (Chart 2).

In late August 1985 a new Government, which had been inaugurated for a four-year term earlier that month, embarked upon a fundamental reorientation of economic policy. The exchange rate was freed, leading to an immediate depreciation of 93.5 percent in foreign currency terms and the virtual disappearance of the premium in the parallel market; the prices of goods and services provided by the public sector were raised substantially; all other prices and interest rates were freed; the external trade and payments system was liberalized; employers in the public and private sectors were permitted to dismiss workers; and, in the public sector, a hiring freeze was imposed; wages, subsidies and bonuses were consolidated into a basic annual salary; and subsidized stores in state enterprises were abolished. 1/ In late November 1985, the authorities introduced a restrained public sector wage policy that granted an increase retroactive to August 1985 but froze wages until June 1986.

The immediate response of the economy to the change in policy orientation and the early policy measures was favorable. Goods became available again, and retail prices began to fall. After the initial depreciation, the exchange rate stabilized in a narrow band and the Central Bank was able to buy foreign exchange on a net basis while currency issue and bank deposits expanded as the public began to recon-

1/ The measures announced or taken in late August 1985 are described more fully in the supplement to the staff report on the 1985 Article IV consultation (SM/85/233, Sup. 1, 9/18/85) and in the forthcoming report on recent economic developments.

stitute its depleted cash balances. Meanwhile, the above-mentioned measures curtailed the domestic financing requirements of the nonfinancial public sector and the monetary authorities exercised restraint in their domestic credit policy.

2. Developments in 1986

A number of adverse exogenous events and a temporary relaxation of demand management in late 1985 endangered the stabilization effort and made the adjustment task of the authorities more difficult in 1986. The international prices of tin and hydrocarbons, two products which accounted for 83 percent of Bolivia's exports and 55 percent of public sector revenue in 1985, collapsed in late 1985 and early 1986, imparting a real income loss of about 3 percent of GDP to the Bolivian economy in 1986. In addition, heavy rains and flooding in early 1986 caused output losses in agriculture and necessitated emergency public expenditure. Further income, output and employment losses of undetermined magnitude were the result of operations initiated in July 1986 to suppress the production and processing of coca leaf. The authorities responded to these challenges by tightening demand management while continuing to pursue their efforts to put in place measures to strengthen their market-oriented adjustment model; at the same time, they intensified their efforts to obtain external assistance.

a. Output, employment, and prices 1/

The Bolivian economy, partly because of these adverse exogenous events and partly as a result of the exigencies of adjusting the large fiscal imbalance, will continue in deep recession in 1986, and the authorities now expect real GDP to contract for the sixth consecutive year (Table 3). Although signs of a revival have begun to emerge in manufacturing, especially in the consumer goods sector, and in some tertiary activities, real GDP is expected to decline by about 3 percent in 1986, mainly because of large output losses in mining and a reduced level of government services, which are expected to contract by one fifth and one sixth, respectively.

The closure of both private and public mines, layoffs of civil servants, and the operations to disrupt the production and processing of coca leaf have depressed employment in 1986. Officially measured unemployment rose from an annual average of 18 percent in 1985 to 20 percent in March 1986. Since about one-half of the work force is mostly self-employed in agriculture, unemployment outside that sector is probably in a range of 30-40 percent.

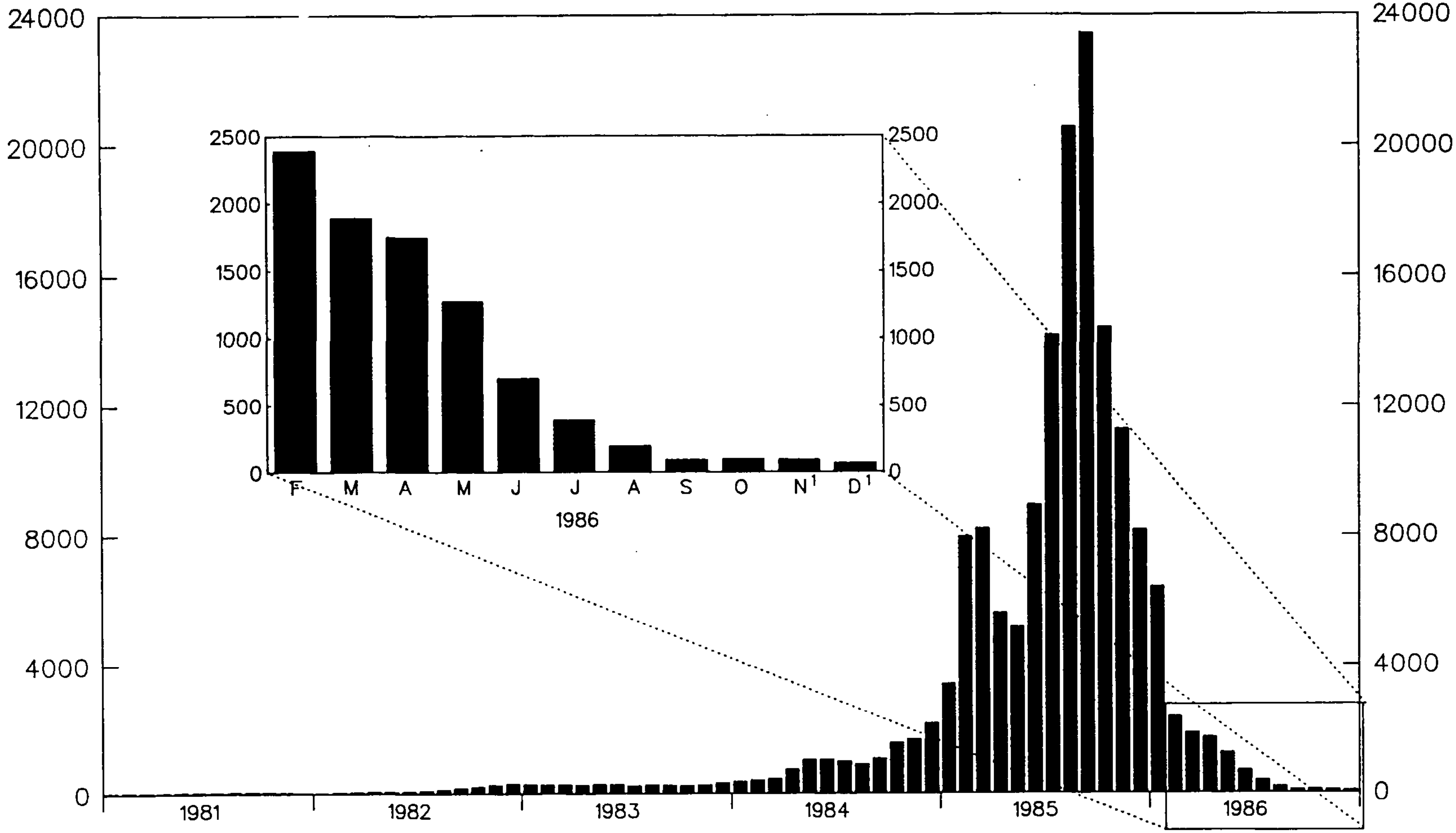
1/ The quality and timeliness of official statistics in Bolivia remain poor (see Appendix IV). Moreover, the coverage of these statistics excludes informal and illegal activities, which have expanded considerably in recent year.

CHART 1

BOLIVIA

CONSUMER PRICE INCREASES

(Percentage increases)



Source: National Institute of Statistics.

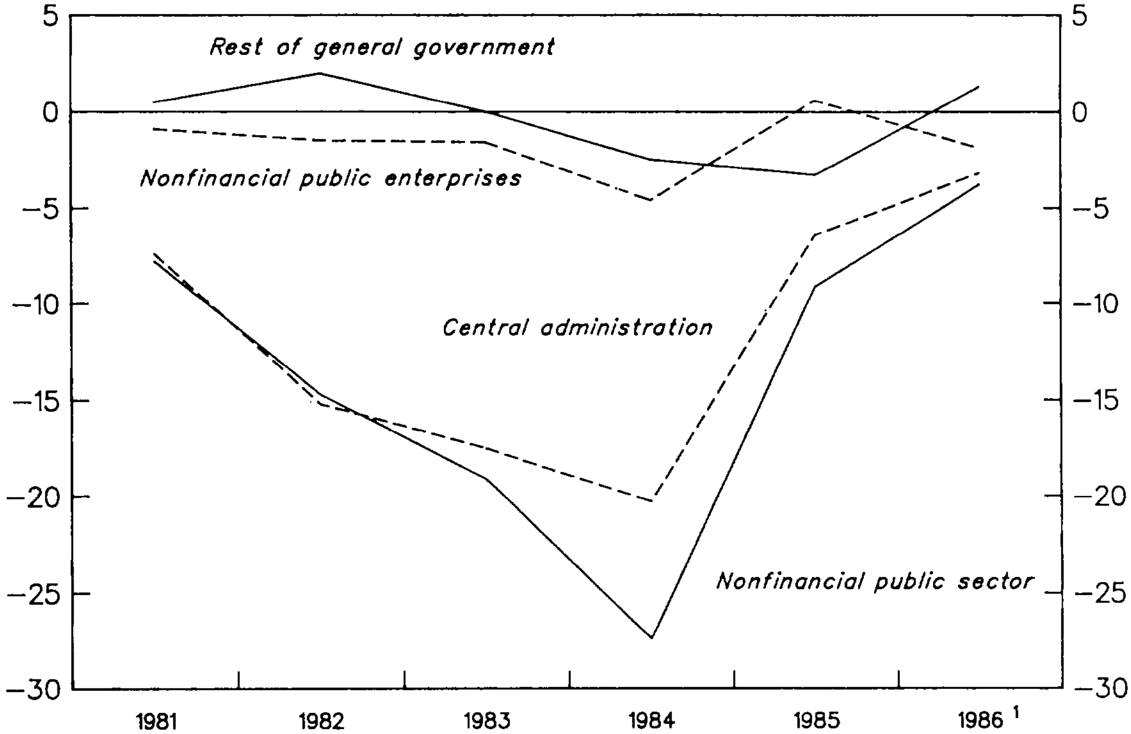
1 Projected.

CHART 2
BOLIVIA

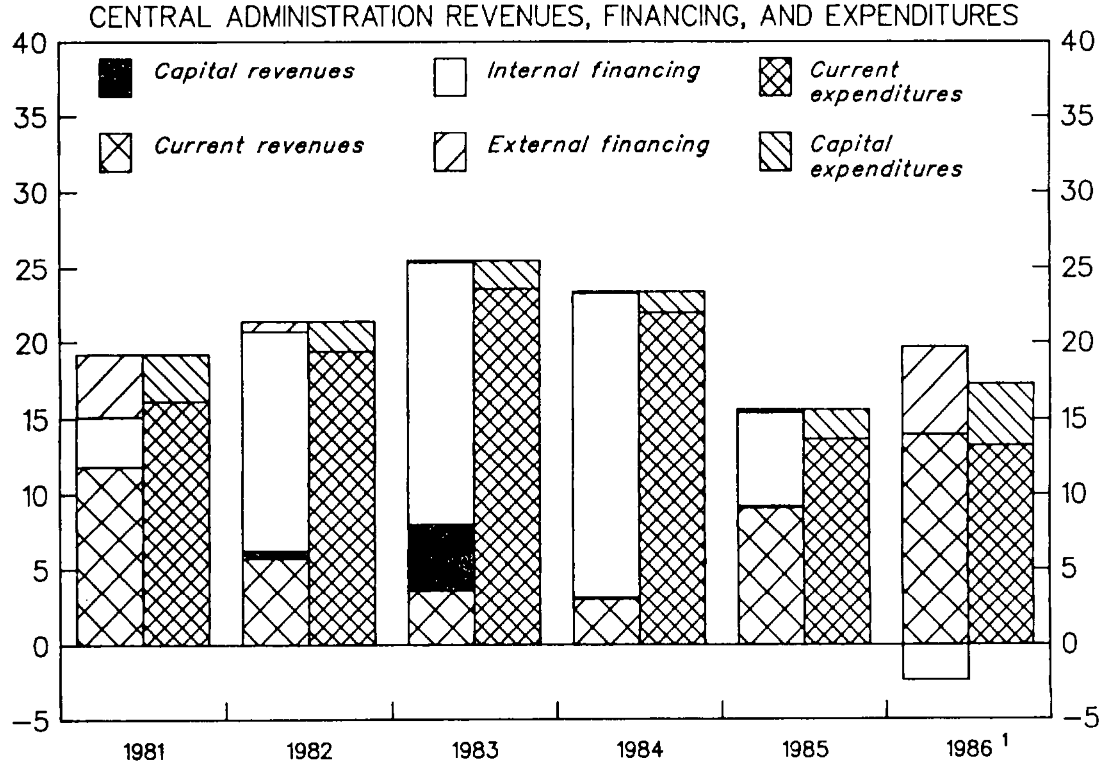
NONFINANCIAL PUBLIC SECTOR OPERATIONS

(In percent of GDP)

DEFICITS OF THE NONFINANCIAL PUBLIC SECTOR



CENTRAL ADMINISTRATION REVENUES, FINANCING, AND EXPENDITURES



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

[1] Projected.

Table 3. Bolivia: Selected Economic Indicators

	Average						Program 1986		Prog.	Prog.	Prog.
	1976-78	1979-81	1982	1983	1984	1985	Original	Revised	1987	1988	1989
				(Annual Rates of Growth)							
Real GDP (at factor cost)	4.6	0.8	-4.8	-7.3	-3.2	-4.1	—	-2.9	3.2	3.4	4.2
Of which: agriculture	2.1	2.4	10.4	-27.6	15.8	2.5	--	-1.5	3.0	4.0	4.0
mining and hydrocarbons	-2.5	-3.6	-3.9	-1.0	-13.9	-12.3	-0.7	-11.7	6.0	2.8	6.4
manufacturing	6.6	-1.6	-12.8	-3.4	-15.2	-11.6	-5.0	4.2	2.0	3.0	5.0
GDP per capita	1.7	-1.9	-7.4	-9.8	-5.8	-6.7	-2.7	-5.5	0.4	0.6	1.4
Prices											
GDP deflator	10.1	27.5	169.2	275.7	1,343.8	11,407.9	290.0	253.9	11.2	7.8	5.5
Consumer prices											
Average	7.7	12.7	123.5	275.7	1,281.2	11,741.0	291.6	275.0	13.9	7.0	5.0
End-of-period	9.8	31.5	296.5	328.5	2,177.2	8,163.4	84.3	65.8	9.2	5.4	5.0
				(As percent of GDP)							
Consumption	82.0	86.6	86.4	93.6	90.3	94.8	91.3	92.6	91.5	89.2	87.4
Gross domestic investment	20.8	14.9	9.8	3.6	6.4	4.2	10.5	9.5	12.4	14.3	15.6
Exports of goods and nonfactor services	21.0	18.6	15.6	14.4	12.4	15.1	14.6	16.2	14.7	14.8	15.0
Imports of goods and nonfactor services	-23.6	-19.8	-11.7	-11.6	-9.1	-14.0	-16.4	-18.3	-18.6	-18.3	-18.1
External saving	4.6	7.5	3.8	3.9	3.6	8.0	7.9	8.6	9.4	8.6	7.9
National saving	16.2	7.4	6.0	-0.3	2.8	-3.8	2.6	0.9	3.0	5.7	7.7
Nonfinancial public sector	3.1	-0.5	-9.0	-17.9	-23.8	-8.9	-0.4	1.7	0.5	1.5	2.0
Private sector	13.1	7.9	15.0	17.6	26.6	5.1	3.0	-0.8	2.5	4.2	5.7

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

With the exception of the period December 1985-February 1986, when a temporary relaxation of demand management led to a price surge of almost 70 percent, inflation has been kept under strict control in 1986. In the period March-October 1986 consumer prices increased at an annual rate of 23.5 percent, and the authorities expect that, with continued tight demand management, the twelve-month rate of price increase will continue to decline from just below 100 percent in October 1986 to about 65 percent in December 1986 (see Chart 1).

b. Fiscal management

The management of the public finances in 1986 was much tighter than originally envisaged. In the first quarter of 1986, the nonfinancial public sector recorded a surplus in excess of 2 percent of projected annual GDP in 1986 as a result of the freezing of the deposits of the Treasury and the state enterprises with the Central Bank that was a part of the authorities' effort to regain control over the public finances. Also in the first quarter, the state petroleum company was required to transfer a high proportion of its sales proceeds (65 percent of domestic sales and 59 percent of exports) to the Treasury. The authorities intend to retain this regime, which supersedes the existing taxes on the production, domestic sale, and export of hydrocarbons.

The authorities do not permit the Treasury and the petroleum company to spend their share of the proceeds of natural gas exports which are settled in the form of inconvertible balances in the Central Bank of Argentina until these balances are used by Bolivia for payments to Argentina. 1/ This policy and the deposit freeze in early 1986 have tightened the liquidity position of the nonfinancial public sector, and its floating debt increased in the first half of 1986. Thus, while the total domestic indebtedness of the nonfinancial public sector is expected to be reduced by about 2 percent of GDP in 1986, there will be a reduction in the sector's indebtedness to the domestic financial system of above 3 percent that is in part offset by a net increase in the sector's floating debt of about 1 percent of GDP. As the net availability of external financing is estimated to remain at about 5 1/2 percent of GDP, as originally envisaged, it is expected that the overall deficit of the nonfinancial public sector will be 3.8 percent of GDP in 1986, compared with the figure of 6.4 percent of GDP envisaged earlier (Table 4).

1/ Natural gas is exported to Argentina under a long-term contract. While the annual minimum volume of purchases by Argentina is fixed until 1992, the price and payment modalities are negotiated periodically between both countries. In 1986, about 40 percent of gas exports are settled in cash and the remaining balance is credited to an account in the Central Bank of Argentina that can be used only for the payment of imports from, or debt service to, Argentina.

Table 4. Bolivia: Summary of Nonfinancial Public Sector Operations 1/

(In percent of GDP)

	1982	1983	1984	1985	Program 1986 Orig.	Program 1986 Rev.	Program 1987	Program 1988	Program 1989
Total nonfinancial public sector revenue	14.4	12.7	4.9	12.8	17.7	19.2	18.9	19.8	21.0
General Government (total)	11.5	11.3	4.8	11.3	17.3	19.2	18.8	19.3	20.0
Current revenue	10.9	6.9	4.6	11.1	16.3	19.2	18.2	18.8	19.5
Of which: transfers from state enterprises	4.1	2.3	2.4	7.7	10.5	12.2	10.7	10.4	10.1
Capital revenue and foreign grants	0.6	4.4	0.1	0.2	1.0	--	0.6	0.5	0.5
Nonfinancial state enterprises (total)	2.9	1.4	0.2	1.5	0.4	--	--	0.5	1.0
Operating surplus	2.8	1.2	--	1.4	--	--	--	0.5	1.0
Capital revenue and grants	0.1	0.2	0.2	0.1	0.4	--	--	--	--
Total nonfinancial public sector expenditure	30.4	31.9	33.0	25.1	24.1	23.0	25.0	25.3	26.5
General Government (total)	25.7	28.9	28.1	23.7	19.4	21.1	21.7	22.0	22.5
Current expenditure	22.6	26.1	25.9	21.5	15.4	17.1	17.0	17.8	18.5
Capital expenditure	2.9	2.8	2.2	2.2	4.0	3.9	4.7	4.2	4.0
Net lending	0.2	--	--	--	--	--	--	--	--
Nonfinancial state enterprises (total)	4.6	3.0	4.9	1.4	4.6	1.9	3.3	3.3	4.0
Operating deficit	--	--	2.5	--	1.4	0.4	0.7	--	--
Capital expenditure	4.6	3.0	2.4	1.4	3.3	1.5	2.6	3.3	4.0
Net lending	--	--	--	--	--	--	--	--	--
Consolidated nonfinancial public sector overall surplus or deficit (-)	-16.0	-19.2	-28.1	-12.4	-6.4	-3.8	-6.1	-5.5	-5.5
Financing	-16.0	-19.2	-28.1	-12.4	6.4	3.8	6.1	5.5	5.5
External financing (net) 2/	0.1	-0.8	5.8	4.8	5.4	5.6	6.1	5.8	5.8
Internal financing (net)	15.9	20.0	22.3	7.6	1.0	-1.9	--	-0.3	-0.3
Memorandum items									
Consolidated nonfinancial public sector savings	-8.9	-18.0	-23.8	-9.0	-0.4	1.7	0.5	1.5	2.0
Consolidated nonfinancial public sector deficit on a cash basis	-14.7	-19.1	-27.4	-9.1	-3.3	-0.2	-4.5	-4.1	-4.4

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

1/ Includes unpaid interest and net of intrasectoral transfers; details may not add up to totals because of rounding.

2/ Includes exceptional financing.

Revenue of the Central Administration was in line with projections. In the first nine months of 1986, revenue collections of the Treasury--including funds temporarily blocked by the authorities--amounted to about 10.8 percent of projected 1986 GDP. Transfers from the petroleum company were 7.7 percent of GDP, including 2.1 percent of GDP that was frozen until the corresponding export proceeds are spent in Argentina. Collections of customs duties and internal revenue taxes were slightly above projected levels. For all of 1986, revenue of the Central Administration is expected to increase by almost 5 percentage points of GDP, to 14 percent of GDP, from the level in 1985 (Table 5).

For the first time in many years a budget for the nonfinancial public sector was approved by the Congress, and its execution remained well within established limits. Cash operations for the first nine months show that spending by the Treasury was apparently as projected. A major factor in restraining expenditure in the nonfinancial public sector was the authorities' ability to adhere to their tight wage policy. Except for an increase for the teachers in April 1986, the wage freeze in the public sector was maintained until June 1986 when a tapered increase was granted that raised the monthly public sector wage bill (including retirees) by 15.5 percent, or 1.1 percent of GDP on an annual basis. The monthly wage bills of public sector entities and enterprises were increased in inverse proportion to the average wage paid by each entity or enterprise, with no increase to those paying more than $b 300 million (some US$150) a month per employee. The national minimum wage, which also applies to the private sector, was raised by one third to $b 40 million (some US$20) a month. Despite mounting pressures, the authorities have excluded the possibility of any further wage increases in 1986, relying instead on the provision that allows public sector employers to distribute wage bill savings from layoffs and retirements (limited to 50 percent of such savings in the case of enterprises) to the remaining employees.

While difficulties persist in exercising control over some of the state enterprises, the centralized wage policy, the freezing of enterprise deposits, and the refusal to give the enterprises access to central bank credit have reduced the margin for deviations from established plans. At the same time, the enterprises generally have followed a realistic pricing policy. This applies in particular to the petroleum company, which has maintained the domestic retail prices of its products at the equivalent of US$0.23 per liter on average. As in the General Government, investment spending by the enterprises remained depressed in the first half of 1986, reflecting weaknesses in the implementation of projects, cumbersome public approval procedures, and delays in the disbursement of external loans. Cash flow data for the first six months of 1986 show an overall surplus of the enterprises of 0.8 percent of projected 1986 GDP, compared with a deficit of 0.2 percent in the corresponding 1985 period.

Table 5. Bolivia: Summary of Central Administration Operations 1/

(As percent of GDP)

					Program 1986		Program		
	1982	1983	1984	1985	Orig.	Rev.	1987	1988	1989
Total revenue	6.2	7.9	3.1	9.3	13.5	14.0	14.1	14.6	15.3
Current revenue	5.7	3.6	3.0	9.1	12.5	14.0	13.5	14.1	14.8
Tax revenue	4.9	2.8	2.8	8.8	11.9	13.8	13.5	14.1	14.8
Internal revenue	2.0	1.5	0.8	1.1	1.4	1.9	2.0	2.0	2.0
Property taxes	--	--	--	--	--	--	--	--	--
Taxes on goods and services	1.3	0.5	0.3	6.3	8.7	10.0	8.8	8.5	8.3
YPFB (petroleum and gas)	1.2	0.4	0.3	6.3	8.7	10.0	8.8	8.5	8.3
Production tax	1.1	0.3	0.3	5.8	3.3	4.8	4.6	4.5	4.5
Sales tax on refined petroleum	0.1	0.1	--	0.5	1.1	5.2	4.1	4.0	3.8
Monopoly tax	0.1	--	--	--	4.2	--	--	--	--
Taxes on banking credits	--	0.1	--	--	--	1.3	--	--	--
Taxes on international trade and transactions	1.7	0.8	1.7	1.5	1.1	1.3	1.7	1.9	1.9
Import duties	1.1	0.5	0.7	1.1	1.1	1.3	1.7	1.9	1.9
Customs duties	1.0	0.4	0.6	1.1	1.0	1.3	1.7	1.9	1.9
Consular fees	0.1	0.1	0.1	0.1	--	--	--	--	--
Tax on mining exports	0.5	0.1	0.6	0.3	--	--	--	--	--
On state mining	0.4	--	0.4	--	--	--	--	--	--
COMIBOL	--	--	--	--	--	--	--	--	--
ENAF	0.4	--	0.4	--	--	--	--	--	--
On other mining	0.1	0.1	0.3	0.3	--	--	--	--	--
Foreign exchange tax	0.1	0.2	0.3	0.3	--	--	--	--	--
Tax reform impact (May 1986)	--	--	--	--	0.7	0.6	1.1	1.7	2.6
Nontax revenue	0.8	0.8	0.2	0.3	0.6	0.3	--	--	--
Postal and communication fees	--	--	--	--	--	0.1	--	--	--
Other revenue	0.8	0.8	0.2	0.3	0.6	0.1	--	--	--
Capital revenue and grants	0.5	4.4	0.1	0.1	1.0	--	0.6	0.5	0.5
Total expenditure	22.4	25.4	24.0	18.4	16.5	17.3	17.2	17.5	18.0
Current expenditure	20.5	23.6	22.6	16.4	12.4	13.3	12.5	13.3	14.0
Wages and salaries	5.6	5.4	7.7	5.1	2.5	4.2	4.4	4.3	4.3
Purchase of goods and services	0.9	1.2	1.3	1.4	3.0	1.7	1.5	1.5	1.5
Interest payments	2.8	2.1	2.2	4.1	4.2	6.3	5.0	4.9	4.7
Internal debt	--	--	0.1	--	0.1	1.3	0.5	0.6	0.6
External debt	2.8	2.1	2.1	4.1	4.1	5.0	4.5	4.3	4.1
Current transfers	2.4	3.3	5.3	2.7	1.0	1.3	1.2	1.2	1.2
Private sector	1.1	1.7	2.2	0.9	0.5	0.6	0.6	0.6	0.6
To international organizations	--	--	--	--	--	--	--	--	--
To specialized banks	0.1	--	--	--	--	--	--	--	--
To social security entities	0.4	0.5	1.8	0.5	0.5	0.6	0.6	0.6	0.6
To rest of nonfinancial public sector	0.9	1.1	1.3	1.3	--	--	--	--	--
Other expenditure	8.7	11.6	6.1	3.2	1.8	--	0.4	1.4	2.3
Capital expenditure	1.9	1.8	1.4	2.0	4.0	3.9	4.7	4.2	4.0
Capital formation	1.8	1.6	1.2	2.0	4.0	3.9	4.7	4.2	4.0
Capital transfers	0.1	0.1	0.2	--	--	--	--	--	--
Overall surplus or deficit (-)	-16.2	-17.5	-20.9	-9.1	-3.0	-3.3	-3.1	-2.9	-2.7
Financing	16.2	17.5	20.9	9.1	3.0	-3.3	3.1	2.9	2.7
External (net) 2/	1.7	0.1	0.7	2.9	3.6	5.7	4.8	4.6	4.5
Internal (net)	14.5	17.4	20.2	6.2	-0.6	-2.4	-1.7	-1.7	-1.8
Memorandum items									
Central administration savings	-13.7	-20.0	-19.0	-4.5	--	0.7	1.0	0.8	0.8
Overall deficit (cash)	-15.2	-17.5	-20.3	-6.4	-1.4	0.3	-1.5	-1.5	-1.6

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

1/ Includes unpaid interest, numbers may not add-up because of rounding.
2/ Includes exceptional financing.

c. Financial sector trends

Money and quasi-money continued to grow in real terms in 1986 (Chart 3). While seasonal factors held the expansion of currency issue to 22 percent in the first nine months of the year, bank deposits almost quadrupled to the equivalent of US$210 million (Table 6). The Central Bank restrained the expansion of credit to the private sector and, as mentioned, the nonfinancial public sector reduced its indebtedness to the domestic financial system. In effect, the growth of money and quasi-money has reflected mainly the increase in net international reserves of the financial system, which increased by about US$115 million in the first nine months of the year. This, together with developments on the price front, would suggest that the increase in private sector holdings of domestic financial assets was demand determined.

With the abatement of inflation, both interest rates and the spread between lending and deposit rates have declined. The banks' average monthly lending rate fell from 20 percent at the beginning of 1986 to 5 3/4 percent in early October 1986, and the average monthly interest rate on time deposits fell from 10 1/2 percent to 3 percent. In real terms, interest rates remain very high but the authorities expect that they will decline further as confidence strengthens in the light of inflation and exchange rate experience.

With the increase in the floating debt of the nonfinancial public sector in the first half of 1986, liquidity conditions tightened in the private sector. The additional financing requirement of the private sector sustained the high interest rates. To satisfy the private sector's loan demand in the face of the authorities' tight domestic credit policy, the banks began to evade minimum reserve requirements. The authorities responded in September 1986 by tightening the reserve requirement system and by increasing penalties for reserve deficiencies.

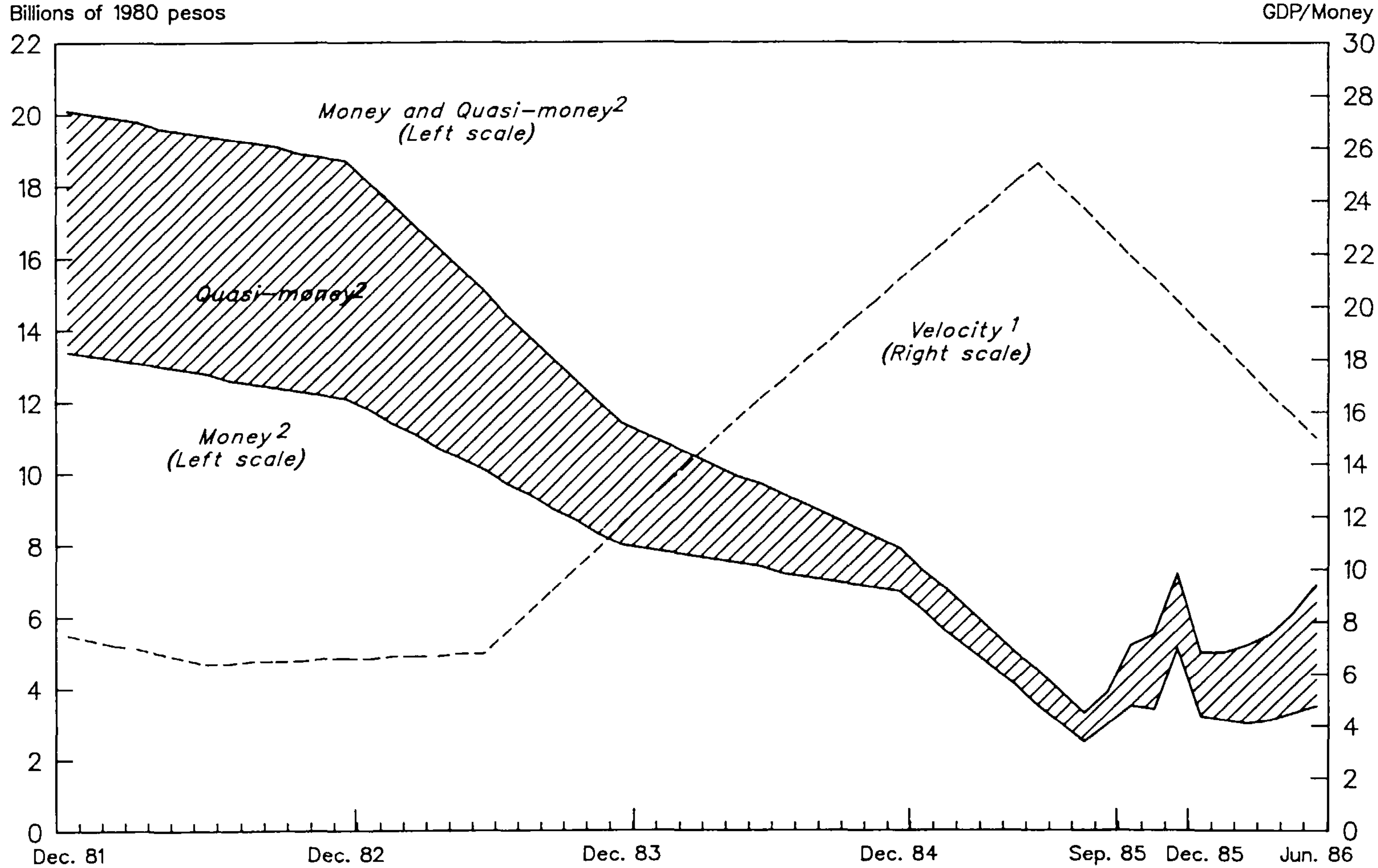
d. External sector developments

The substantial gain of net international reserves has been taking place in the context of exchange rate stability in recent months. Intervention and the tightening of domestic policies resulted in the appreciation of the official exchange rate from $b 2.5 million per US$1 in mid-January 1986 to $b 1.8 million per US$1 at the end of the month. Since mid-March 1986 the official exchange rate in the auction market has remained at $b 1.9 million per US$1 and the premium of the parallel exchange rate has virtually disappeared, after reaching a peak of 2.9 percent in mid-May 1986; occasionally, the peso in the parallel market has been more appreciated than in the official market. In real trade weighted terms, the peso appreciated by 23.7 percent during the first eight months of 1986 (Chart 4). However, it remains at about the level of competitiveness established immediately after the large depreciation in September 1985.

CHART 3

BOLIVIA

TRENDS IN REAL MONEY AND QUASI-MONEY AND VELOCITY



Source: Central Bank of Bolivia.

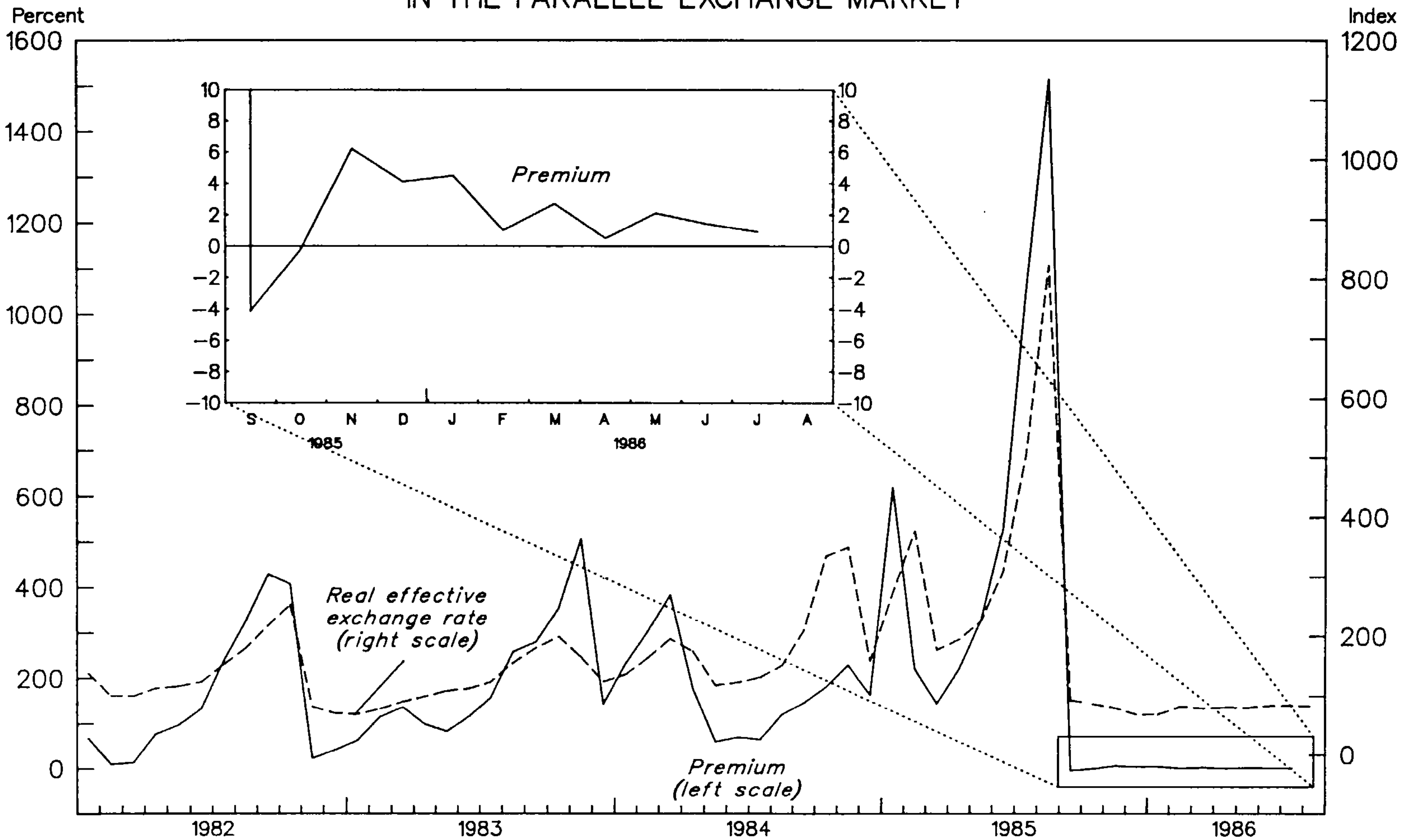
[1]Annual average calculated as the ratio of nominal GDP and the period average of liabilities to the private sector; 1986 partly projected.

[2]Money and quasi-money in billions of December 1980 pesos.

CHART 4

BOLIVIA[1]

REAL EFFECTIVE EXCHANGE RATE AND PREMIUM IN THE PARALLEL EXCHANGE MARKET



Source: Central Bank of Bolivia.

[1] Using monthly average exchange rates.

Table 6. Bolivia: Selected Monetary Indicators

	1982	1983	1984	1985	Program 1986 Orig.	Program 1986 Rev.	Prog. 1987	Prog. 1988	Prog. 1989
				(Percentage change) 1/					
Credit to nonfinancial public sector	204	256	1,483	3,891	89	-139	--	-3	-3
Credit to private sector	233	104	465	4,249	129	133	49	35	25
				(End of period stock in billions of Bolivian pesos)					
Money and quasi-money	88	256	3,874	285,638	516,700	525,600	643,800	718,200	802,500
Money	57	178	3,347	208,765	367,700	262,100	308,400	343,000	383,000
Quasi-money	31	78	527	76,873	149,000	263,500	335,400	375,200	419,500
				(End of period stock in billions of 1980 Bolivian pesos)					
Money and quasi-money	18.6	11.6	7.8	7.0	7.6	7.8	8.7	9.5	9.8
Money	12.1	8.1	6.7	5.1	5.4	3.9	4.2	4.5	4.7
Quasi-money	6.5	3.5	1.1	1.9	2.2	3.9	4.5	5.0	5.1
				(GDP/liabilities to private sector) 2/					
Velocity	6.9	8.1	17.8	26.5	15.8	15.7	11.9	11.4	11.2

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

1/ Annual effective flows of credit in relation to liabilities to private sector at the beginning of the period.
2/ Calculated as a period average.

Balance of payments data for the first six months of 1986 indicate that exports were in line with original projections while imports were somewhat higher. Disbursements of external loans were lower than expected, but this shortfall was more than offset by large positive errors and omissions (probably reflecting unrecorded exports and the repatriation of private capital), which led to the substantial increase in net international reserves. As a result of these developments, the authorities expected a net international reserves gain of the Central Bank of about US$64 million at the time of the discussions, compared with a deficit of about US$50 million that had been envisaged originally (Table 7 and Chart 5). However, in light of the further accumulation of international reserves through September 1986, even this revised objective may be exceeded if current policies are maintained.

Substantial progress has been made in normalizing relations with foreign creditors. An agreement was reached with the Paris Club in July 1986 whereby approximately US$400 million of arrears and debt service payments falling due in the period July 1986-June 1987 were restructured over ten years with four and five years' grace, respectively. 1/ The authorities have begun to negotiate bilateral agreements with their official creditors, which under the terms of the Agreed Minute must be concluded by March 31, 1987. Nonparticipating countries and private creditors without official guarantee also have been invited to negotiate restructuring agreements along the lines of the Paris Club agreement.

Negotiations with the coordinating committee of Bolivia's commercial creditors continue. Bolivia has not made any payments to the banks since March 1984 and the bulk of principal owed of some US$680 million has in the meantime fallen into arrears. Including past due interest (but excluding penalty interest) arrears to the banks were estimated at about US$800 million in mid-1986. The authorities are currently seeking agreement from the banks to buy back some of their debt at a discount before restructuring the remainder in early 1987. Such a scheme would permit Bolivia to offer for a limited period to purchase its debt, directly or indirectly, from those banks willing to sell at a specified price. The authorities have requested assistance from foreign Governments in the form of grants to finance such purchases. It is envisaged that the impact of any such purchases in excess of grants received could be accommodated within the program targets.

The authorities also have been successful in obtaining financial support from multilateral lenders. After a hiatus of six years, the World Bank approved two IDA credits of about SDR 48.4 million for emergency imports for reconstruction in May 1986 and about SDR 12.8

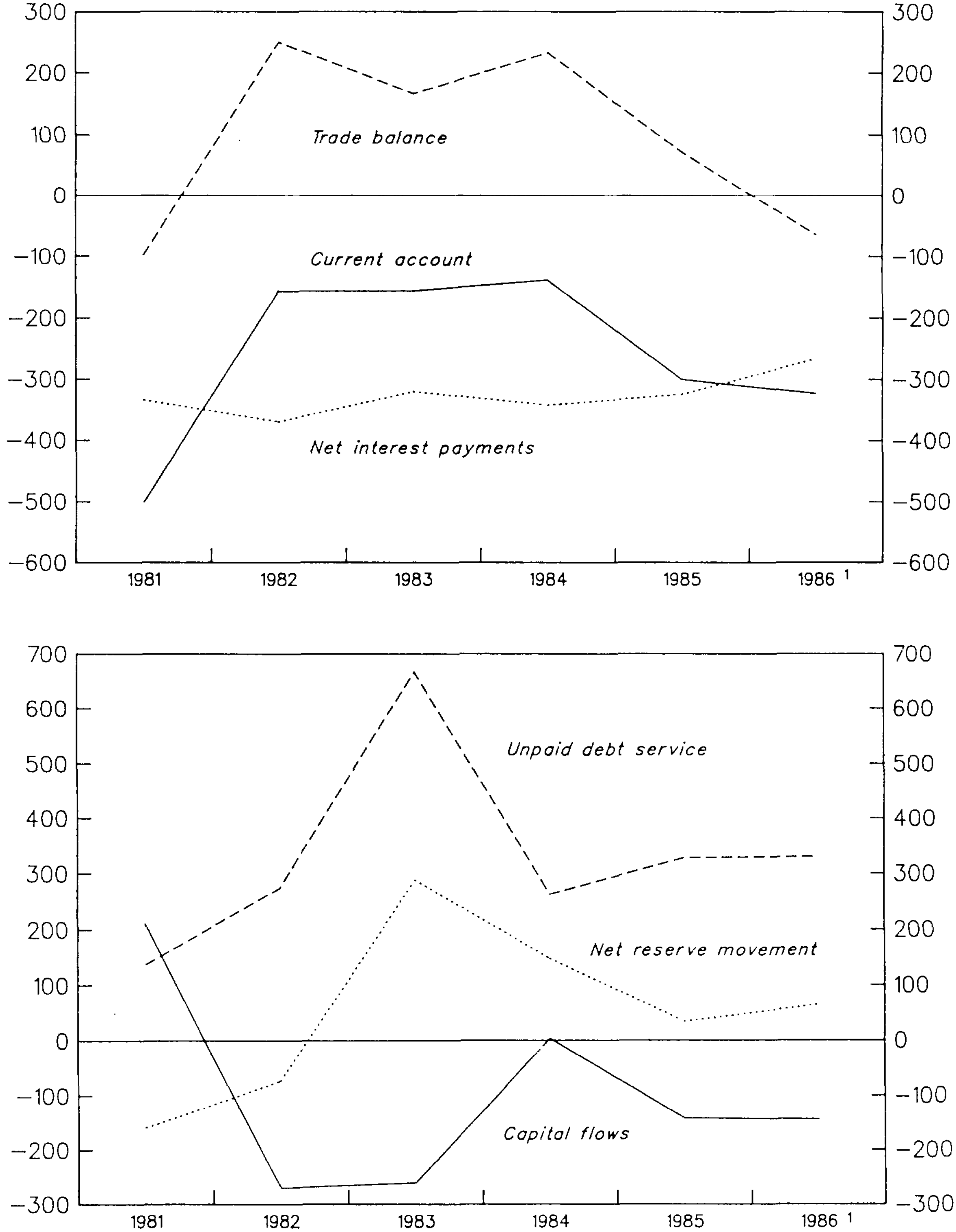
1/ The terms of the agreement are described in EBS/86/174, 8/4/86. Brazil, Bolivia's third largest official bilateral creditor, participated in the Paris Club meeting. Argentina, Bolivia's largest official bilateral creditor, agreed beforehand to extend Paris Club terms to Bolivia.

CHART 5

BOLIVIA

SELECTED BALANCE OF PAYMENTS FLOWS

(In millions of U.S. dollars)



Source: Central Bank of Bolivia.

[1] Projected.

Table 7. Bolivia: Summary of Balance of Payments

	1982	1983	1984	1985	Prog. 1986 Orig.	Prog. 1986 Rev.
	(In millions of U.S. dollars)					
Current account	-155.8	-155.2	-137.9	-300.1	-353.7	-323.3
Exports f.o.b.	827.7	755.1	724.4	623.4	544.0	505.7
Imports c.i.f.	-577.5	-589.1	-491.6	-551.9	-610.7	-570.1
Interest, net	-370.8	-320.1	-342.8	-324.6	-268.0	-266.9
Other factor services (net)	-53.8	-108.0	-98.4	-104.0	-105.4	-73.0
Nonfactor services (net)	-26.9	0.7	-18.0	-23.0	-18.6	-14.0
Transfers (net)	45.5	106.2	88.5	80.0	105.0	95.0
Capital account	-193.8	-223.4	21.6	-3.8	-27.3	55.0
Nonfinancial public sector 1/	-125.2	-162.4	-184.7	-176.3	-75.3	-141.0
Disbursements	206.7	92.0	104.9	84.5	190.0	144.4
Amortization	-331.9	-254.4	-289.6	-260.8	-265.3	-285.4
Banking system 2/	-37.2	-141.1	-2.1	91.0	7.0	-14.9
Private sector 3/	-113.9	178.4	20.1	47.0	41.0	214.1
Overdue receipts for gas exports to Argentina	-145.3	-98.3	188.3	34.5	--	-3.1
Allocation of SDRs and gold monetization	1.9	0.9	0.9	9.9 4/	2.0	2.0
Overall balance	-347.7	-377.7	-115.4	-294.0	-379.0	-266.3
Unpaid debt service (changes)	274.5	666.2	262.9	327.7	328.0	330.3
Arrears and deferred debt	134.3	207.0	262.9	327.7	-1,071.0	-1,048.6
Rescheduled debt	140.2	459.2 5/	--	--	1,399.0	1,378.9
Net official reserves (increase -)	73.2	-288.5 5/	-147.5	-33.7	51.4	-64.0
Memorandum items						
Current account deficit (as percent of GDP) 6/	3.8	3.9	3.6	8.0	7.9	8.6
Interest paid (as percent of GDP)	7.8	7.2	7.5	7.5	4.8	3.9
Gross official reserves						
(in millions of U.S. dollars)	182.0	176.7	286.3	273.9	250.0	488.1
(in months of imports, c.i.f.)	3.8	3.6	7.0	6.0	4.9	10.3
Terms of trade (percentage change)	-0.2	3.3	-0.8	2.2	-23.8	-24.9
Official exchange rate (period average, Bolivian pesos per U.S. dollar)	67	230	2,230	446,215	2,108,800	1,930,300
Stock of external payments arrears, end of period (in millions of U.S. dollars) 7/	252	458	721	1,049	--	--

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

1/ Includes short-term debt; excludes balance of payments support loans, involuntary financing of gas exports to Argentina, and impact of debt restructuring.

2/ Includes contributions to international organizations and due but unpaid debt of the banking system.

3/ Includes errors and omissions.

4/ Includes a US$10 million allocation of Andean pesos from the Andean Reserve Fund.

5/ Includes rescheduling of US$369.6 million of short-term debt of the Central Bank as medium-term debt.

6/ U.S. dollar GDP calculated on 1986 base, using real growth and U.S. inflation.

7/ Includes deferred debt service payments in 1982 and 1983, includes estimated interest on interest of US$7 million in 1984 and US$28 million in 1985.

million for a gas recycling project in June 1986. Disbursements under these credits are expected to begin shortly. Disbursements from the Inter-American Development Bank, which remained involved in Bolivia in recent years and has a loan pipeline of about US$425 million, have continued to be substantial and are likely to be increased further in the near future following the approval of a US$100 million agriculture sector loan in November 1986. Among other multilateral lenders, the Andean Reserve Fund disbursed a four-year loan of US$100 million to the Central Bank in July 1986, two thirds of which refinanced liabilities falling due at the time.

3. Performance under the stand-by arrangement

When performance criteria were established for the period April-September 1986, which encompassed the first two program quarters under the stand-by arrangement, it was envisaged that real GDP would remain unchanged in 1986 while the rise of consumer prices and the loss of net international reserves of the Central Bank would be kept to 85 percent and about US$50 million, respectively. However, as described above, GDP is contracting and a very tight demand management policy reduced the deficit of the nonfinancial public sector below target and triggered large private capital inflows. So far, Bolivia has met with ample margins all but one of its quantitative performance criteria (see Table 2).

On June 30, 1986 payments arrears on public and publicly guaranteed external debt to creditors other than official bilateral lenders, private lenders with official bilateral guarantee and commercial banks exceeded the limit established for that date by US$10.4 million. Payments effected in July 1986 and a refinancing operation formalized in September 1986 lowered the arrears outstanding below the limit for June 30, 1986. In September 1986, the Bolivian authorities requested and obtained a waiver for the nonobservance of this performance criterion on June 30, 1986. Arrears outstanding on September 30, 1986 exceeded the limit stipulated for that date by less than US$300,000. The authorities have set aside an amount of US$300,000 to pay these arrears in the event that these arrears cannot be restructured. In the meantime, the authorities are requesting a waiver for the nonobservance of the performance criterion.

In view of performance through September 1986, understandings were reached with the authorities during the stand-by review discussions on a substantial tightening of the targets and limits for the last quarter of 1986, which had been set on an indicative basis at the time of the approval of the stand-by arrangement. To give Bolivia time to reach understandings with its major creditor groups, the program had excluded payments arrears on public and publicly guaranteed external debt to official bilateral creditors and to foreign commercial banks from the arrears ceiling until December 30, 1986. On the basis of progress made to date, the authorities now expect that a debt restructuring agreement with the commercial banks will be reached in early 1987. For this reason, they are requesting a modification of the performance criterion on external payments arrears by excluding arrears to the banks for another quarter until March 30, 1987.

III. The Program For July 1986-December 1987

The authorities' program for July 1986-December 1987 aims at a resumption of economic growth while consolidating the progress made in stabilizing the economy. Although the attainment of sustained output growth is not envisaged until certain structural adjustment measures that will be taken to improve economic efficiency take effect over the medium term, the authorities expect that the contraction of output will be arrested and reversed by an increased flow of concessional external resources, lower domestic interest rates in real terms, and a measured reorientation of fiscal policy toward employment generation and investment.

Following a contraction of about 3 percent in 1986, real GDP is expected to grow by about 3 percent in 1987, largely reflecting rebounds of agricultural and mining output. The program will limit the loss of net international reserves of the Central Bank to US$12.5 million in the period July 1986-December 1987. The balance of payments and growth objectives should be compatible with further progress on inflation, permitting the reduction of consumer price increases to 13 percent at an annual rate in the second half of 1986 and to below 10 percent in 1987.

1. Fiscal policy

The key element of the program is the pursuit of a fiscal policy that makes room for higher investment outlays by the nonfinancial public sector without recourse to the domestic banking system, thereby providing the private sector access to the full amount of domestic and external financial resources accruing to the financial system. After a dramatic improvement in 1986, nonfinancial public sector savings are projected to decline by about 1 percentage point of GDP to about 1/2 percent of GDP in 1987 as a result of an expected reduction of the export price for natural gas. The further recovery of public investment from 5.5 percent of GDP in 1986 to about 7 1/2 percent of GDP means that the overall deficit of the nonfinancial public sector will increase from 3.8 percent of GDP in 1986 to about 6 percent of GDP. The combined overall deficit in 1986-87 will remain about unchanged from the two-year deficit envisaged in the original program. Moreover, the deficit in 1986 is expected to be fully financed with concessional external resources. Quarterly limits have been established consistent with the annual deficits for 1986 and 1987 (see Table 10).

a. Central administration revenue

In the Central Administration, tax collections on hydrocarbons are expected to yield 10.4 percent of GDP on an annual basis in the second half of 1986 and then to decline to 8.8 percent of GDP in 1987. The requirement for the petroleum company to transfer to the Treasury 65 percent of the value of its domestic sales and 59 percent of the value of its exports will be maintained, but collections are likely to decline in 1987 because of lower export prices. The drop of revenue from hydrocarbons will be offset in part by higher collections from import duties and internal revenue taxes, which are projected to increase from 3.4 percent of GDP at an annual rate in the second half of 1986 to 4.8 percent of GDP in 1987. The increase in collections is expected to result from the full-year effect of the customs tariff reform, from the implementation of the tax reform, and from better tax administration. The authorities consider these estimates conservative and hope to exceed them as a result of the determined enforcement of the reformed customs tariff and internal tax system. To support these efforts, they have created the position of an undersecretary of taxation and they are considering the creation of a Ministry of Taxation.

In August 1986, a uniform customs tariff of 20 percent ad valorem replaced the temporary tariff introduced in August 1985 and a number of additional taxes and levies. 1/ At the same time, virtually all tariff exemptions were withdrawn. The Government intends to let the exemption for wheat imports, which was retained for one year, lapse in August 1987 and to reduce further the number of exemptions for the hydrocarbons sector, which already has been reduced from 1,200 to 750 items. A more accurate customs valuation basis is now being provided by an international inspection company, which assesses the value of merchandise prior to shipment to Bolivia. The authorities are confident that these measures will help direct an increasing proportion of imports through legal channels.

With the implementation of the tax reform of May 1986, the structure of collections from internal taxes is expected to undergo major changes. A one-time tax on corporate net worth and selected personal property items is being collected to regularize tax liabilities for 1985. Through October 1986 it yielded revenue equivalent to 0.3 percent of GDP. Implementing guidelines for the remaining taxes are being prepared with technical assistance from the United Nations. The authorities plan to implement all new taxes--including the property tax on rural land holdings and the value added tax with its complementary income tax--before the end of 1987, starting with the annual taxes on selected property items and corporate net worth, which use the same tax bases as the regularization tax. Particular care will be taken not to withdraw any of the existing taxes before their replacements are being implemented.

1/ Contrary to the expectation in September 1986 when the policy memorandum was being prepared, the authorities have successfully resisted pressures to lower the tariff for a number of investment goods to 10 percent.

b. Central administration expenditure

The authorities intend to limit central administration expenditure in the period through the end of 1987 to the projected levels of revenue collection and net receipts of foreign loans (including refinancing operations) and grants. The budget for 1987, which the authorities intend to submit to Congress shortly, is being formulated on this basis. Because of the unusually great uncertainty in projecting tax collections in a period during which major tax reform measures are scheduled to be implemented, the authorities are determined to cut or defer expenditure, if necessary, to ensure that the finances of the Central Administration are handled without recourse to domestic bank credit. To relieve pressure on the central administration finances in early 1987, all unused budgetary allocations will lapse at the end of 1986. Nevertheless, outlays for the reduction of employment in the state mining company (COMIBOL) in November 1986 and the payment of the thirteenth monthly wage in December 1986 are likely to put considerable strain on the Treasury's finances in late 1986.

Current expenditure in the Central Administration other than wages (see below) and interest payments will be kept under tight control. As a result, it is expected that there will be room equivalent to about 0.5 percent of GDP in the second half of 1986 and about 1.1 percent of GDP in 1987 for severance payments in connection with the reduction of employment in the public sector. This policy on current expenditure is expected to ensure a level of savings in the Central Administration that is sufficient to generate the local counterpart funds necessary for investment and the amortization payments for those external loans that cannot be restructured.

c. Wage policy

A tight wage policy continues to be the most important measure to restrain expenditure in the public sector. Following the wage increase in June 1986, the authorities plan to grant only one further wage increase before the end of 1987. The increase, which may be given in early 1987, will not exceed 10 percent of the wage bill. However, the present policy of distribution to public sector employees of savings from employment reductions will be continued. After taking into account the payment of the thirteenth monthly wage in December, outlays for wages are programmed to run at 8.2 percent of GDP at an annual rate in the second half of 1986. On a yearly basis, outlays for wages are expected to be a little more than 7 percent of GDP in 1986 and 1987.

d. Public sector investment policy

Following the slow rate of disbursement of foreign loans and grants in the first half of 1986, the authorities expect that investment activity will accelerate toward the end of 1986 and in 1987. The World Bank staff has examined the authorities' investment plans for 1986 and 1987 in the course of preparing for the Consultative Group meeting referred to above and it considers that the investment program reflects an appropriate balance among sectors and that, in general, the projects included are sound and support the Government's development objectives. During 1987 the World Bank staff will review the public investment program in greater depth.

The authorities are taking actions to speed the implementation of projects and to redefine sector strategies and investment programs in line with their sectoral priorities, which emphasize agriculture, energy, mining (other than tin), and transportation. Existing loan commitments and projects in progress are being examined to reallocate funds and redesign projects, where appropriate, to achieve higher investment levels. Disbursements from loans and credits recently approved by the Inter-Development Bank and the World Bank are expected to bolster investment during 1987. Toward the end of 1987, these flows may be reinforced by resources obtained in the wake of the Consultative Group Meeting.

e. Policies toward state enterprises

The authorities will impose strict financial discipline on the state enterprises while carrying out major structural changes. The pricing policies of the enterprises will be kept under close scrutiny in order to ensure an adequate level of revenues. In particular, domestic sales prices of petroleum products will not be permitted to fall below the equivalent of US$0.23 per composite liter. 1/ At present, the state enterprises must deposit their liquid funds with the Central Bank, which permits no overdrafts and transfers any sizable deposit accumulations to frozen accounts. Funds in the frozen accounts are released only with the approval of the Ministry of Finance.

As part of a planned reorganization of the Central Bank, the authorities intend to transfer the accounts of the state enterprises to the commercial banks. In that event, the Central Bank will impose a 100 percent reserve requirement on the deposits of the enterprises and ensure the timely reporting of transactions in these accounts to the cashflow control unit in the Central Bank. The Government will not provide any guarantees for credit extended by the commercial banks to the state enterprises nor will the Central Bank provide refinancing for this purpose. As in the Central Administration, investment of the state enterprises was very low in the first half of 1986, but it is programmed

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1/ The composite liter is a set of weights representing the projected volumes of sales of the individual petroleum products in the domestic market in the period July 1986-December 1987. The authorities will adjust the domestic prices whenever the arithmetic average of the official exchange rates (weighted by the number of business days) established in the auction market (bolsín) during the preceding month indicates that the price of the composite liter has fallen below US$0.23.

to increase throughout the program period, from 1.0 percent of GDP at an annual rate in the first half of 1986 to 2.0 percent of GDP in the second half of 1986, and to 2.6 percent of GDP in 1987.

Efforts to adjust the enterprise sector will focus on the state petroleum company (YPFB) and COMIBOL. Since the transfer to the private sector of retail sales of gasoline and liquified petroleum gas (LPG), YPFB has been giving consideration to selling its trucking operations to the private sector, allowing gasoline retailers to own their stations, and lifting zoning restrictions on the distribution of LPG. The authorities also are examining the possibility of reducing further YPFB's level of employment.

The Government's policy for the restructuring and decentralization of COMIBOL was announced in August 1986. It envisages the permanent closing of the two most unproductive mines and the transfer of nine others to their employees to be operated as cooperatives. The 12 remaining mines will be retained and operated in a decentralized form. Some of these mines will curtail their operations, while exploration and development activities will be carried out so as to enhance their future productivity. The authorities are confident that output in the new cooperative mines will increase sufficiently to offset any temporary output losses in the mines retained by COMIBOL. The cooperatives are free to obtain financing from commercial and specialized banks, but the Central Bank will not provide any resources to them except for the intermediation of foreign lines of credit. The Treasury has assumed all of COMIBOL's debts, including the internal floating debt, for which certificates (notas fiscales) will be issued after the company has been audited to determine their amount. These certificates can be used to pay taxes. Because of uncertainties regarding the size of the floating debt that will eventually be recognized and the timing for its payment, the program does not make allowance for revenue shortfalls arising from the redemption of certificates.

The Government is considering selling the assets of the rice storage and commercialization company (ENA), which has lost most of its functions with the liberalization of prices at the producer and consumer level, to the producers and distributors in the private sector.

2. Financial sector policies

Attainment of the program's objectives requires the pursuit of a restrictive credit policy, and the authorities' credit program has been designed accordingly. The Central Bank will not extend credit to the nonfinancial public sector and it is not envisaged that the state enterprises will obtain credit from the commercial banks once their accounts have been transferred to the commercial banks. Credit to the private sector will expand by about 2 percent of GDP in the second half of 1986 and about 4 percent of GDP in 1987, assuming a modest further decline of velocity as confidence continues to strengthen and inflation abates further, as well as net use of US$10 million and US$60 million of foreign credit lines in the two periods. It should be noted that private sector credit could expand further if additional foreign credit lines become available. To manage its credit program, the Central Bank has established quarterly limits on the expansion of its net domestic assets and of its net credit to the nonfinancial public sector (see Table 10). The latter limits are consistent with zero credit expansion in the period July 1986-December 1987.

Interest rates will remain free but the authorities expect them to decline further in real terms in light of the recent and prospective evolution of inflation and the exchange rate. Although deposit rates are to remain competitive with those abroad to protect the balance of payments and mobilize resources, the authorities are encouraging a reduction in both rates and spreads. The operation of an interbank market has been permitted since May 1986 and market transparency for bank customers will be enhanced by the recently issued instruction for banks to post effective lending rates and the regular publication of individual banks' lending and deposit rates. The intermedation of foreign loans will be facilitated by the streamlining of the Central Bank's approval procedures. Also, the requirement of prior government approval for credit applications of US$100,000 and above will shortly be abolished. The Central Bank has asked foreign lenders to agree to lowering contractually fixed onlending rates so as to bring them more in line with interest rates currently prevailing in international markets.

A new currency will begin to circulate at the beginning of 1987 at a rate of 1 new unit=$b 1,000,000, and all contracts and financial claims will be redenominated into the new currency. Both currencies will circulate in parallel until the end of 1987, at which time the peso-denominated currency notes will be demonetized.

The Central Bank will continue to influence liquidity conditions in the financial system through discretionary rediscounts and minimum reserve requirements. Following the establishment of tighter controls on compliance with the minimum reserve regulations in September 1986, the Central Bank is planning to revise the structure of reserve requirements with the aim of eliminating differential treatment of deposits in local currency and in U.S. dollars while encouraging the formation of long-term deposits in both currencies. The change would be made without affecting bank liquidity. The Central Bank also will examine the feasibility of conducting open market operations. Finally, it will strengthen the criteria for banking supervision, in particular with respect to limits on loan concentration and nonperforming assets.

The Central Bank will be reorganized with a view to limiting its functions to those of monetary authority and fiscal agent of the Central Administration. The development loan department will be restructured to expedite the use of foreign credit lines; eventually, it will become an independent institution. As already mentioned, the deposits of the state enterprises will be transferred to the commercial banks, thereby severing those enterprises' link with the Central Bank. An independent superintendency of banks may be created to replace the Central Bank's bank inspection department. The accounting system of the Central Bank is being rebuilt. Also, the two largest state banks, the Banco del Estado and the Banco Agrícola, will be reorganized. Finally, the authorities are examining the possibility of initiating the operation of a national securities exchange.

Both the Fund and the World Bank are providing technical assistance to the Central Bank. The staffs of both institutions are in close contact so as to coordinate their technical assistance efforts and ensure that advice given is consistent with the program objectives.

3. External sector policies

With the liberalization of the exchange rate and the provision of foreign exchange through the auction market for both current and capital transactions, Bolivia's exchange system has been effectively unified. Accordingly, as already noted, the official and parallel exchange rates have been virtually identical in recent months. However, the requirement to surrender exchange proceeds to the Central Bank is limited to merchandise exports. Consequently, an unknown, but undoubtedly large, amount of foreign exchange transactions continues to take place outside the Central Bank in the parallel market, which receives the proceeds of most invisibles (including recent private capital reflows) and of illegal exports.

The authorities will continue to pursue a flexible exchange rate policy. Since its introduction in September 1985, the auction system, which has removed the determination of the exchange rate from domestic political debate, has permitted the flexible adaptation of the exchange rate to exogenous shocks and changes in domestic policy. The authorities will continue to permit unlimited foreign exchange purchases for both current and capital transactions. In particular, only budgetary restrictions will be imposed on foreign exchange purchases by public sector entities.

In view of the difficult medium-term outlook for the balance of payments, the authorities will permit only a small loss of reserves until the end of 1987, notwithstanding the large gain of net international reserves since the initiation of the stabilization effort. Quarterly limits on minimum gains or maximum losses of the net international reserves of the Central Bank have been established in accordance with this objective (see Table 10). In the absence of further exogenous shocks and with the projected stance of demand management policy, the exchange rate of the peso should remain rather stable during the program period, maintaining approximately the level of competitiveness established immediately after the large depreciation in September 1985. However, the authorities are prepared to raise their international reserve target if sustained capital inflows create a bias toward currency appreciation.

Although the current exchange arrangements make the emergence of a large and lasting difference between the official and parallel exchange rates unlikely, the Central Bank stands ready to adapt its intervention policy to prevent the premium of the exchange rate in the parallel market--as measured by the moving average of the premia of the buying rates for either U.S. dollar checks or U.S. dollar currency notes for five consecutive business days--from exceeding 5 percent (see Table 10). Such an adaptation would be aimed at bringing the official exchange rate to within 5 percent of the parallel market rate during the five business days following any such deviation.

The authorities will maintain the liberal external trade and payments system and eliminate the few trade restrictions that remain. They intend to allow sugar imports, the only item currently prohibited, to help promote adjustment of the inefficient domestic sugar industry. Similarly, import duty exemptions for wheat and the petroleum industry will be lifted or reduced as indicated in subsection III.1.a above. The exchange system is free of restrictions subject to Article VIII of the Fund's Articles of Agreement except for arrears on certain external debt service payments (see below). The spreads resulting from (i) the operation of the auction market for foreign exchange, in which each successful bidder pays the price offered, and (ii) the operation of the parallel exchange market, in which the proceeds from nonmerchandise exports may be surrendered, have remained well below 2 percent in the recent past. 1/ However, a multiple currency practice could arise if either spread were to exceed 2 percent.

The program through the end of 1987 envisages an increase in imports of about 4 1/2 percent in real terms. As exports are expected to decline, the external current account deficit is projected to widen from 8.6 percent of GDP in 1986 to 9.4 percent of GDP in 1987. Given the authorities' international reserve target, their program requires a substantial amount of concessional foreign financing, both in the form of new lending or grants and the restructuring of debt service in arrears and falling due within the program period. As mentioned in section II.2.d., part of this financing has already been obtained. The authorities intend to return to the Paris Club around mid-1987 with a request to renegotiate debt service falling due in the period July 1987-June 1988. Official bilateral creditors not participating in the Paris Club and private suppliers without official guarantee will again be asked to extend restructuring terms at least as favorable to Bolivia as those granted by the Paris Club. Efforts continue to reach an agreement with the consortium of foreign commercial banks on the restructuring of arrears and a small amount of unmatured principal. It is the Government's intention to eliminate all arrears to external creditors through restructuring or cash payments by early 1987 (see Table 10).

1/ The spread between the maximum bid price and the price offered by the lowest successful bidder amounted to 0.1 percent on average in September and October 1986.

While the disbursement of loans and grants has been slow, the rate of commitments has begun to improve, especially as far as multilateral development banks are concerned. The required financing for the investment program through the end of 1986 has been arranged. The authorities hope that the Consultative Group meeting in December 1986 will facilitate their efforts to secure the resources still required to finance the investment plan for 1987, especially in the latter part of the year. To prevent the undue burdening of the debt service profile in the medium-term, the Government will limit net recourse to external public debt (including guaranteed debt) with original maturities of more than one year and up to ten years in the period July 1986-December 1987 to US$115 million and has established quarterly limits on that increase (see Table 10). In connection with the revamping of the Central Bank's accounting system, the authorities are developing a reporting system to monitor the short-term external debt position of the public sector. It is expected that an effective reporting system can be put into place by mid-1987. Short-term public debt outside the Central Bank is believed to be very small, and the Government does not intend to seek an increase in such credits other than for external trade financing during the program period.

IV. Medium-Term Prospects and Structural Adjustment Policies

The economic program through the end of 1987 outlined in the preceding section is part of a three-year program based on a policy framework covering the period 1987-89 that the Bolivian authorities have developed with the cooperation of the staffs of the Fund and the World Bank. This section summarizes this framework, which is reproduced in Attachment V; presents the balance of payments outlook through the early 1990s; and examines Bolivia's ability to meet on schedule its payments obligations to the Fund during that period.

1. The three-year policy framework

The three-year program aims at consolidating the stabilization effort undertaken since late 1985 on the basis of economic policies geared to the achievement of a sustainable rate of growth and balance of payments viability through export diversification, higher domestic savings, and price stability. The private sector is expected to play a more prominent role than in the past through increased private savings and investment. Apart from a few clearly delineated productive activities, the role of the state will be limited to the setting and enforcement of rules for the economy and the provision of basic infrastructure and essential social services.

The principal economic and financial objectives for the period 1987-89 are (i) real GDP growth of about 3 1/2 percent a year, mainly as a result of a rebound of economic activity and growth in sectors such as agriculture and mining other than tin; (ii) the reduction of the rate of price increase from about 65 percent in 1986 to about 5 percent in 1989; and (iii) overall balance of payments equilibrium.

The Government is committed to the pursuit of policies that would limit the external current account deficit to the availability of concessional financing, including the restructuring of debt service on favorable terms. Indications are that current account deficits (after official transfers) of about US$375 million a year--implying their gradual decline in relation to GDP from almost 9 1/2 percent in 1987 to below 8 percent in 1989--can be financed in this way. External public debt, although rising from US$3.7 billion at the end of 1986 to US$4.7 billion at the end of 1989, would remain unchanged in relation to GDP, but debt restructuring and more favorable terms on new loans would reduce debt service (including all payments to the Fund) in relation to exports of goods and nonfactor services from about 108 percent in 1986 (before debt restructuring) to about 78 percent in 1989. 1/

Of crucial importance for the attainment of the Government's objectives is the pursuit of a fiscal policy that permits public investment to grow to about 7-8 percent of GDP while avoiding recourse to domestic bank financing. The fiscal scenario underlying the policy framework paper foresees a reduction of the deficit of the nonfinancial public sector from 6.1 percent of GDP in 1987 to 5 1/2 percent of GDP in 1988 and 1989. Concessional foreign financing is likely to exceed the projected deficits in 1988 and 1989, thus permitting small reductions in the nonfinancial public sector's indebtedness to the domestic financial system.

To assure balance of payments viability, the authorities are committed to reducing the fiscal deficits and capital spending if concessional flows should fall short of the amounts currently projected. In the context of formulating the programs for the second and third year of the proposed structural adjustment arrangement, the Government will discuss with the Fund policies to increase public sector savings and reduce the deficits below the levels envisaged currently, with a view to channeling additional resources to the rest of the economy. Also, the World Bank will assist the authorities in ensuring that the concessional resources obtained are used efficiently in the priority areas of agriculture, mining, energy, and transportation. Progress in this respect will be reviewed annually with the Fund and the Bank.

Most of the fundamental decisions and measures associated with the opening of the economy to market forces were taken in late 1985 and during 1986. They need to be implemented with determination during the forthcoming three-year period and supplemented with other measures that, for various of reasons, require more time to elaborate and put into effect. Although prices were freed in late August 1985 and major institutional reforms have been initiated since then, the productive structure of the Bolivian economy still reflects the distortions of many years of resource misallocation. Consequently, relative prices are

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1/ After debt restructuring, the debt service ratio for 1986 would be about 65 percent.

likely to adapt further during the three-year period, as important structural measures will be implemented and the economy continues to adjust to a new but stable framework of rules and regulations.

In guiding the Bolivian economy through this adjustment process, the authorities intend to continue and, where appropriate, to strengthen policies in the following areas: (i) the pursuit of an exchange rate policy that ensures adequate external competitiveness; (ii) the maintenance of a liberal external trade and payments system with a moderate, uniform level of tariff protection and an export promotion system that avoids distortions; (iii) improved public investment planning and project execution capacity; (iv) the provision of incentives for private investment; (v) specific sectoral policies for agriculture, energy, mining (other than tin), and transportation; (vi) improvements in the public finances, especially through the implementation of the recently approved tax reform and restraint on current expenditure; (vii) reorganization and decentralization of the state enterprises; and (viii) institutional reform of the financial system and other measures to increase domestic resource mobilization. The principal measures to be taken and the timetable of their implementation are contained in the table attached to the policy framework paper (Attachment V).

2. The medium-term balance of payments outlook

The outlook for Bolivia's balance of payments in the medium-term depends critically on the availability of concessional external financing. In particular, external viability depends on the terms of the restructuring still to be negotiated between Bolivia and its commercial bank creditors. Also important for medium-term viability are export prices and market conditions for tin and hydrocarbons, which--even after the recent sharp price drops--are projected to account for more than 70 percent of 1986 exports. The staff's baseline scenario assumes that the authorities maintain their commitment to appropriate pricing policies--including a competitive exchange rate--and continued fiscal adjustment, with no domestic bank financing for the nonfinancial public sector.

Even with that assumption and projections that envisage the availability of a substantial amount of concessional external financing, Bolivia's medium-term outlook for the balance of payments remains difficult (Table 8). Additional reschedulings of debt service obligations will be needed in the period 1987-91 if Bolivia is to close its financing gap while achieving reasonable levels of imports and economic growth. Such reschedulings would probably also require Fund support beyond the current stand-by arrangement and the proposed structural adjustment arrangement.

It is estimated that projected financing needs in 1987-89 could be met through the restructuring of debt service falling due to bilateral creditors on terms similar to those agreed with the Paris Club in July 1986 and the refinancing on generous terms of commercial bank debt now

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

	1987	1988	1989	1990	1991	1992
	(In millions of U.S. dollars)					
Current account 1/	-375	-371	-369	-357	-337	-314
Merchandise trade	-144	-141	-135	-124	-110	-93
Exports, f.o.b.	474	513	566	623	690	762
Imports, c.i.f.	-618	-655	-701	-747	-800	-855
Interest, net 1/	-268	-273	-283	-288	-290	-292
Other services and transfers, net	36	43	49	55	63	71
Capital account	230	124	184	163	168	-2
Direct investment	20	35	45	50	54	60
Medium- and long-term borrowing	195	74	124	99	99	-77
Multilateral lenders, net	161	156	163	169	171	168
Disbursements	223	217	219	226	234	243
Existing commitments 2/	198	126	94	31	21	5
New commitments	25	92	125	195	213	238
Amortization	-62	-61	-56	-58	-63	-75
Official bilateral creditors, net	27	-66	-48	-97	-55	-89
Disbursements	216 3/	94	102	112	122	133
Existing commitments 2/	186 3/	63	66	39	24	3
New commitments	30	31	37	73	98	130
Amortization	-189	-160	-150	-208	-176	-222
Commercial banks, net	0	-27	-1	0	-46	-185
Other, net	8	10	11	27	28	30
Short-term, net	15	15	15	15	15	15
Net official reserves (increase-)	19	0	-15	0	0	0
Gross reserves	15	22	24	69	43	-12
Liabilities to IMF 4/	12	12	-6	-65	-63	-8
Other liabilities 5/	-8	-33	-33	-5	20	20
Financing requirement	-127	-247	-200	-194	-169	-316
Memorandum items						
As percent of GDP 6/						
Current account deficit	-9.4	-8.6	-7.9	-7.1	-6.2	-5.3
Exports	11.8	11.9	12.1	12.4	12.7	13.0
Imports	-15.4	-15.2	-15.0	-14.8	-14.7	-14.5
Interest due	7.2	6.8	6.4	6.0	5.6	5.2
Interest paid	5.4	5.3	5.3	5.3	5.1	4.8
As percent of exports 7/						
Interest due	48.9	45.7	42.5	39.4	35.9	32.7
Total debt service obligations	102.0	84.7	72.3	74.4	70.0	84.7
Gross official reserves in months of imports, c.i.f.	9.2	8.3	7.3	5.8	4.7	4.6
Principal assumptions: (in percent)						
Import growth in real terms	4.3	2.0	3.0	2.6	3.1	2.8
Export growth in real terms	3.5	1.3	6.6	6.5	7.2	6.3
Real GDP growth	3.2	3.4	4.2	4.0	4.0	4.0
LIBOR 8/	7.0	6.5	6.5	6.5	6.5	6.5
World inflation	3.5	3.9	3.9	3.9	3.9	3.9
Terms of trade	-12.9	3.0	-0.5	-0.5	-0.6	-0.6

Source: Fund staff estimates.

1/ Refers to effective interest payments and includes interest on financing needed to close the financing gap.
2/ Estimated.
3/ Includes rescheduling of maturities falling due January-June 1987 on Paris Club terms agreed in July 1986.
4/ *Includes structural adjustment facility.*
5/ Largely representing transactions with the Andean Reserve Fund.
6/ U.S. dollar GDP calculated on 1986 base, using projected real growth in Bolivia and U.S. inflation.
7/ Exports of goods and nonfactor services.
8/ It is assumed that most new borrowing is at concessional interest rates, averaging about 4-5 percent a year.

in arrears (the bulk of Bolivia's commercial bank debt) and maturities falling due in the future. As already noted, Bolivia is now involved in active negotiations with its commercial bank creditors, which--given Bolivia's particular circumstances--may require an innovative solution to Bolivia's commercial bank debt problem. For the purposes of the program, it is assumed, as in the original program, that Bolivia will resume interest payments to commercial banks, but that concessions will be involved in the agreement reached, as no new medium-term loans from the banks are envisaged. Also, as described above, one possible outcome of the current negotiations with commercial banks may be that Bolivia reduces its debt burden by buying back some of its debt at a discount, either directly or indirectly. The impact on the medium-term balance of payments of such a scheme would depend on the terms both of the buy back and of the rescheduling of the remaining outstanding debt.

On the assumptions just described, Bolivia's medium- and long-term external public debt will remain at about 100 percent of GDP in the period 1986-90 and then decline to about 95 percent of GDP in 1992 (Table 9). The debt service ratio (including Fund obligations) is, however, projected to improve more rapidly, from more than 100 percent of exports of goods and nonfactor services in 1986-87 to about 80-85 percent in 1991-92. However, as the grace periods on the 1986-87 debt restructurings expire in 1990-92, Bolivia may need additional exceptional financing, e.g., in the form of a rollover of previously restructured principal.

Variations in market interest rates would have only limited impact on Bolivia's debt service obligations, since about 70 percent of the country's debt is at fixed interest rates and Bolivia will contract new debt only on concessional terms. However, if the terms of new and restructured debt are less favorable than assumed in the projection, the balance of payments outlook will be seriously affected. If all newly contracted and restructured debt were to carry an interest rate 1 percentage point higher than assumed, Bolivia's debt service payments would be US$40-60 million higher in 1990-92 than is estimated in the projection, equivalent to 5-7 percent of projected exports of goods and nonfactor services. Similarly, a variation by 10 percent in the projected price of natural gas would affect export revenues by about US$30 million in 1992, equivalent to about 4 percent of projected merchandise exports.

A further uncertainty arises from the fact that the contract for natural gas exports to Argentina expires in 1992. The staff's projection assumes that the volume of gas exports remains constant in 1992, implying either that Argentina continues to import gas from Bolivia after the expiration of the contract, or that a gas pipeline to Brazil--currently under negotiation--will have been completed and that exports to Brazil will offset any reduction in exports to Argentina. If neither of these assumptions holds, Bolivia's exports could suffer a sharp decline in 1992. Further adjustment might then be needed to avoid debt servicing difficulties.

Table 9 . Bolivia: Medium-Term External Debt Projection 1/

	1986	1987	1988	1989	1990	1991	1992
	(In millions of U.S. dollars)						
Total debt service due 2/	657	630	575	546	663	659	801
Interest	282	287	291	298	304	306	308
Principal	375	343	284	248	359	354	493
Medium- and long-term public sector debt	568	533	476	445	514	541	742
Interest	222	221	228	236	244	250	253
Principal	346	312	248	209	270	291	489
IMF 3/ 4/	34	33	11	14	72	65	8
Charges	4	10	8	8	7	3	--
Repurchases	30	23	3	6	65	63	8
	(In percent)						
Debt service ratios 5/							
Total	108	107	90	78	86	77	85
Interest	46	49	45	43	39	36	33
Principal	62	58	45	35	47	41	52
Medium- and long-term public sector	93	91	75	63	67	63	79
Interest	36	38	36	33	32	29	27
Principal	57	53	39	30	35	34	52
IMF, total 3/ 4/	5.5	5.6	1.7	2.0	9.2	7.6	0.9
Medium and long-term debt outstanding at end of period 6/							
In millions of U.S. dollars	3,746	4,076	4,397	4,721	5,013	5,281	5,520
In percent of GDP	100	102	102	101	100	97	94
Short-term debt outstanding 7/							
In millions of U.S. dollars	5	20	35	50	65	80	95
In percent of GDP	--	1	1	1	1	1	2

Source: Fund staff estimates.

1/ Assumes rescheduling of bilateral debt in arrears at mid-1986 and falling due July 1986-June 1987 on the Paris Club terms agreed in July 1986, and of commercial bank debt in arrears at mid-1986 and principal falling due July 1986-December 1987. After this rescheduling, the debt service ratio would decline from 108 percent to 71 percent in 1986 and from 107 percent to 79 percent in 1987.

2/ Includes private sector interest estimated at US$45 million in 1986 and US$40 million annually 1987-1992 and IMF charges and repurchases.

3/ Excluding Trust Fund.

4/ Including proposed structural adjustment arrangement.

5/ In relation to projected exports of goods and nonfactor services.

6/ Public and publicly guaranteed debt.

7/ Excluding reserve liabilities.

The price projections underlying the medium-term scenario are consistent with the most recent World Economic Outlook, and it is assumed that export volumes will rise by about 10 percent a year in the period 1989-91, as officially recorded exports recover to their levels of the early 1980s. The medium-term scenario counts on a particularly rapid growth of nontraditional exports--mainly agricultural products--from an estimated US$72 million in 1986 to almost US$300 million in 1992. Such exports, which had peaked at US$150 million in 1980, would increase from 14 percent of total exports in 1986 to 35-40 percent by 1992. (This increase also reflects the lack of growth in natural gas exports.) The authorities' commitment to the maintenance of a market-determined exchange rate and the policies in support of export diversification that are described in the authorities' policy framework paper are believed to justify the projected rise in nontraditional exports.

Imports are assumed to increase by about 2 1/2-3 percent a year in real terms during the period 1988-92. As indicated in the attached policy framework paper, historical relationships and cross-country experience would suggest that a somewhat higher import growth rate than present financing prospects permit would be consistent with the targeted annual rates of real economic growth of 3 1/2-4 percent. Thus, the program assumes greater efficiency in the use of imports than in the past and some import substitution. In view of the prospects for concessional external financing of projects, a greater proportion of imports of investment goods would be expected during the program period. Efficient utilization of the foreign exchange available for other imports would be assured by the price mechanism in the freely operating auction market. If the repatriation of private capital continues or if exports grow more rapidly than projected, imports could be somewhat higher than presently expected.

In the capital account, gross disbursements from multilateral lenders are expected to rise sharply in 1987, to more than US$200 million, and to remain at about this level until 1992. This new lending is assumed to carry an average interest rate of about 4 1/2 percent, 1/ with an average overall maturity of 20 years, including a five-year grace period. The increase is based on projections from the World Bank and the Inter-American Development Bank (IDB) of substantially higher disbursements in 1986-87, reflecting the stepped-up involvement of the two institutions in Bolivia in the wake of the stabilization and adjustment effort initiated in late 1985. Thus, projected disbursements from both institutions amount to US$110 million in 1986 and US$180 million in 1987. 2/ Thereafter, the staff scenario assumes the level of these disbursements to be broadly maintained, with rising disbursements from

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1/ The World Bank will make new commitments with IDA funds. The Inter-American Development Bank will make special efforts to provide concessional resources from its Fund for Special Operations.

2/ Of these amounts, US$183 million (or almost two-thirds of the total) will be disbursed by the IDB.

the IDB offsetting a projected decline of disbursements from the World Bank.

The Bolivian authorities are now embarking on a major effort to generate external resources from bilateral and multilateral sources, to support the restructuring of the economy. As already noted, a Consultative Group meeting under the sponsorship of the World Bank has been convened for early December 1986, and similar meetings are planned to be held regularly thereafter. Given the country's difficult medium-term outlook, the authorities will attempt to obtain some bilateral financing in the form of grants; one major bilateral creditor already has indicated that its future commitments will be in the form of grants rather than loans. Net transfer receipts are thus projected to increase from $95 million in 1986 to $140-150 million in 1992, while bilateral lending is assumed to rise from US$70 million in 1986 to US$130 million in 1992.

Foreign commercial banks are not projected to extend new medium- and long-term loans to Bolivia during the period, although the exposure of banks not agreeing to the proposed buyback may increase significantly in early 1987 because of the need to refinance a substantial amount of interest in arrears. Private capital inflows, which were substantial in 1985 and 1986 following the liberalization of the external trade and payments system and implementation of the stabilization program, are not assumed to provide further financing in 1987 and beyond. This assumption could prove conservative, however, given the projected continuation of present tight monetary and fiscal policies. In reflection of measures to open the economy, and the authorities' intention to encourage new foreign investment, direct private investment flows are assumed to recover gradually to reach by 1992 the level achieved at the beginning of the 1980s.

On the basis of the above assumptions, Bolivia's external current account deficit is projected to decline from about 9 1/2 percent of GDP in 1987 to about 5-5 1/2 percent of GDP in 1992. Exports are projected to increase in relation to GDP, while imports would remain broadly unchanged. If no further restructuring of debt service falling due to bilateral creditors is assumed beyond June 1987, Bolivia would face a financing gap of about US$130 million in 1987. However, assuming that commercial bank maturities are refinanced, this gap would be closed by the restructuring of debt service falling due to bilateral creditors on terms similar to those agreed by the Paris Club for the rescheduling of 1986/87 maturities. Projected financing requirements would decline from about US$250 million in 1988 to about US$170 million in 1991. However, as principal payments fall due on the 1986-87 restructuring with bilateral creditors and on refinancing assumed for commercial banks, there would be a sharp increase in the gross financing requirement in 1992, to above US$300 million.

3. Ability to pay financial obligations to the Fund

Bolivia has experienced severe debt servicing difficulties in the past five years, and has built up substantial arrears on external debt service payments, mostly to private commercial banks. However, it has continued to service its obligations to the Fund and to multilateral development banks.

Bolivia's liabilities to the Fund will rise sharply before the end of 1986 if the proposed purchase under the Compensatory Financing Facility and the first disbursement under the Structural Adjustment Facility take place together with the next scheduled purchase under the stand-by arrangement. Thus, outstanding obligations to the Fund would amount to about 4 percent of GDP at the end of 1986, or the equivalent of 4 percent of total external public debt. Assuming that disbursements are made in the second and third years of the proposed structural adjustment arrangement, total liabilities to the Fund will be about US$185 million at the end of 1988, or about the same level in relation to GDP as projected for end-1986.

Debt service obligations to the Fund are projected at 6 percent of exports of goods and nonfactor services in 1987. A bunching of repurchase obligations under the proposed compensatory purchase and the stand-by arrangement would raise total debt service obligations to the Fund to US$65-70 million a year in 1990 and 1991, equivalent to about 8-9 percent of exports of goods and nonfactor services. Thereafter, assuming no further financial assistance from the Fund, debt service obligations to the Fund would fall to below 1 percent of exports of goods and nonfactor services, while outstanding liabilities at the end of 1992 would be equivalent to about 1 percent of total public sector debt and less than 1 percent of GDP.

Bolivia's program for 1987 allows for a loss in net international reserves of US$18.5 million. After a gain of similar magnitude in 1988-89, it is assumed that the net international reserves level will remain unchanged. It is envisaged that the proposed purchase under the Compensatory Financing Facility and the remaining purchases under the existing stand-by arrangement contribute to build up gross international reserves, which were equivalent to about 4 1/2 months of imports in mid-1986. Assuming no further purchases under Fund arrangements in the upper credit tranches, gross reserves are expected to rise to more than 6 months of imports at the end of 1987, and then to decline to 4 1/2 months of imports in 1992 as reserve liabilities to Fund and the Andean Reserve Fund fall due.

As already noted, about 60 percent of Bolivia's receipts from gas exports are paid into a special account in the Central Bank of Argentina which may be used only for imports from, or debt service payments to, Argentina. In mid-1986, such reserve holdings amounted to US$60 million (about 15 percent of total gross reserves); it is projected that they will increase rapidly as debt service payments to Argentina are rescheduled and Bolivia's imports from Argentina remain limited. The Bolivian authorities believe, however, that it may be possible to dispose of the reserves held in this account through their sale--probably at a discount--to third parties. It also should be noted that Bolivia's reserves include some undervalued holdings of gold, which amount to US$38 million at US$42.22 per ounce.

Given the fairly comfortable gross reserve position, Bolivia's past record in discharging its financial obligations to the Fund, and the relatively small proportion of its debt that will be due to the Fund, it is not envisaged that there will be difficulty in repayment to the Fund over the medium term, despite the difficult balance of payments outlook.

V. Performance Criteria and Benchmarks

To monitor the implementation of the program in the period July 1986-December 1987, a number of performance criteria and benchmarks have been established (Table 10). 1/ The following are performance criteria through the end of the stand-by arrangement period and financial benchmarks for the first year of the proposed structural adjustment arrangement: (i) quarterly limits on the borrowing requirement of the nonfinancial public sector; (ii) continuous ceilings on the net domestic assets of the Central Bank and continuous subceilings on the net debtor position of the nonfinancial public sector vis a vis the Central Bank; (iii) quarterly targets for the net international reserves of the Central Bank; (iv) quarterly ceilings on external arrears; (v) quarterly ceilings on external public and publicly guaranteed debt disbursed and outstanding with an original maturity of more than one year and up to 10 years; and (vi) the operation of the foreign exchange auction system during the program period in such a way that the five-day average of the premium of the exchange rate in the parallel market over the official exchange rate will not exceed 5 percent.

In addition, both arrangements contain the customary provisions on the exchange and trade system. The submission to Congress of a budget for 1987 that is consistent with the fiscal target is a performance criterion for purchases under the stand-by arrangement after February 15, 1987. For purposes of the proposed structural adjustment arrangement, the following constitute structural benchmarks for 1987: (i) implementation of the tax reform; (ii) a public sector investment program for 1987 that is endorsed by the World Bank; and (iii) the reorganization of the state mining company (COMIBOL).

1/ The quantitative performance criteria are set forth in Tables 1-5 of Attachment II and the financial benchmarks, which are identical with the quantitative performance criteria for the period of the stand-by arrangement extending into 1987, are set forth in the Table appended to Attachment VI.

Table 10. Bolivia: Quantitative Performance Criteria and Financial Benchmarks

	Calendar Quarter Ending					
	Sept.30 1986 1/	Dec.31 1986 1/	March 31 1987 1/2/	June 30 1987 2/	Sept.30 1987 2/	Dec.31 1987 2/
	(Cumulative flows from March 31, 1986 in trillions of Bolivian pesos)					
Borrowing requirement of the nonfinancial public sector	314.8	457.8	529.3	661.5	774.6	966.7
Net domestic assets of the Central Bank	198.9	35.3	61.7	63.3	96.7	113.2
Net position of the nonfinancial public sector in the Central Bank	71.4	-43.8	-41.4	-41.9	-48.6	-44.8
	(Cumulative flows from March 31, 1986 in millions of U.S. dollars)					
Minimum gain or maximum loss of net international reserves of the Central Bank	-70.9	13.6	6.1	8.6	1.1	-4.9
Increase of public and publicly guaranteed external debt with maturities of more than 1 year and up to 10 years	55.0	20.0	35.0	50.0	75.0	100.0
	(In millions of U.S. dollars)					
Arrears on public and publicly guaranteed external debt	6.1	0.7	--	--	--	--
	(In percent)					
Maximum premium of the exchange rate in the parallel market over the exchange rate in the official market 3/	5.0	5.0	5.0	5.0	5.0	5.0

Sources: Government of Bolivia, Memorandum of Understanding on Economic Policy Through the End of 1987, attached Tables 1-5; and Government of Bolivia, Memorandum on Economic and Financial Policies in the Period January 1, 1987-December 31, 1989, attached table.

1/ Performance criterion.
2/ Benchmark.
3/ Average of five consecutive business days.

VI. Staff Appraisal

The Government of Bolivia has embarked upon the most sweeping reorientation of economic policy in more than 30 years. Prices, interest rates, the exchange rate, and wages in the private sector have been freed and the external trade and payments system has been liberalized, and at the same time the authorities have been implementing restrictive financial policies. The authorities are to be commended for having maintained their course of policies in the face of adverse exogenous developments, such as the severe terms of trade deterioration as the result of the collapse of the two most important prices for the country's exports and the real income loss occasioned by action to suppress the production and processing of coca leaf.

Substantial progress has been achieved in stabilizing the economy. Inflation has been kept at a relatively low rate in recent months and net international reserves have been growing. However, the economy remains in a deep recession and unemployment has risen, largely because of the exogenous developments mentioned above and difficulties in mobilizing international aid flows. It is therefore very important that the thrust of policies be consistent with the recovery of the economy without endangering the financial stability that has been regained. The staff therefore welcomes the adoption by the authorities of a three-year policy framework aimed at the achievement of a sustainable rate of growth and balance of payments viability through export diversification, higher domestic savings, and the maintenance of price stability.

The principal aims of the three-year program are real GDP growth of about 3 1/2 percent a year, consumer price increases in the single-digit range, and overall balance of payments equilibrium with current account deficits that can be financed at concessional terms and decline gradually over time in relation to GDP. More specifically, for 1987 the Government is seeking growth of real GDP of about 3 percent, inflation below 10 percent, and an international reserve loss of no more than US$18.5 million. The staff would emphasize that, given the tight constraint that the difficult balance of payments outlook imposes on the growth of imports, the authorities' growth objective can only be obtained if the available concessional resource flows are used efficiently.

A key element of the authorities' adjustment strategy continues to be the limitation of the deficit of the nonfinancial public sector to a level that can be financed with concessional loans and grants from abroad. The authorities have given assurances that they will take action to reduce the deficit if concessional financing flows of the magnitude envisaged should fail to materialize. Beyond this, however, it would be advisable for the authorities to seek to achieve, through determined implementation of the tax reform and firm control over current expenditure, an improvement in public sector savings beyond those now in prospect in the next several years. This would make it possible to enlarge the small domestic financing surpluses currently expected after 1987, and thus to provide more resources to the rest of the economy for purposes of capital formation.

To ensure that the substantial amounts of concessional foreign resources that the authorities are now seeking will contribute to the attainment of sound growth and balance of payments viability, it is important that the authorities cooperate closely with their foreign lenders, and in particular with the World Bank, to ensure that efficient use is made of these resources. This requires that Bolivia's planning and implementation capacity be strengthened and that the design and implementation of projects be monitored closely and reviewed periodically. The Fund staff will seek the advice of the World Bank in this regard in connection with the annual reviews of the proposed structural adjustment program.

Implementation of the tax reform and a tight wage policy are two crucial elements of fiscal adjustment. The new taxes--in particular the value added tax and the tax on rural land holdings--will broaden the tax base substantially and lessen the dependence of tax collections on hydrocarbons and mining. The authorities will need to give priority in the coming year to the full implementation of the new taxes, and to withdraw the existing taxes only after the new ones have been put in place. Apart from the pursuit of tax reform and measures to strengthen tax administration in the customs and internal revenue areas, the authorities will need to continue to exercise restraint over current expenditures. Under present conditions there is no room for generalized real wage increases in the public sector except for the distribution of wage savings from employment reductions, and therefore it is very important that the authorities adhere strictly to their proposed wage policy for 1987.

The authorities' program calls for improvements in the efficiency of state enterprise management. In the near term, the authorities are right in focusing their efforts on the reorganization and decentralization of the state mining company and the state petroleum company. Both companies would benefit from further employment reductions. The staff would urge the authorities to keep the enterprises' pricing policies under close review so as to ensure that their revenues cover, as a minimum, the operating costs and the local counterpart requirements of their investment projects. In view of its importance for the finances of the Central Administration and the regional bodies, the pricing policy of the petroleum company continues to be of particular importance. If the authorities decide to permit the state enterprises to transfer their accounts from the Central Bank to commercial banks, particular care will need to be exercised to avoid a loosening of control over the finances of these enterprises.

The authorities' decision to leave the determination of interest rates to market forces has led to substantial capital reflows and the rapid growth of domestic financial assets, as well as to some reduction in real interest rates. Interest rates may be expected to decline further if the authorities succeed in achieving their objectives of bringing about a lasting improvement of inflation. The staff supports the credit policies being pursued and welcomes the decision of the authorities to tighten their credit program in the light of the better than expected inflation performance. In reforming the domestic financial system, it would be advisable that the authorities give priority to measures that strengthen the financial position of the commercial banks and improve bank surpervision.

The pursuit of a flexible exchange rate policy with free access to the auction market has been vital for the strengthening of confidence. The staff welcomes the intention of the authorities to maintain the present exchange arrangements. Because of the crucial importance of a competitive exchange rate for the growth and diversification of exports in the medium term, the staff would urge the authorities to keep exchange rate policy under close review to avoid a situation in which private capital reflows result in a significant erosion of competitiveness.

The authorities have made considerable progress in normalizing relations with their foreign creditors, and their achievements in this area should facilitate the arrangement of the financing flows required under their program. It is important that the authorities move expeditiously to finalize the bilateral agreements under the terms of the Paris Club agreement, and every effort should be made to reach agreement with the foreign commercial banks at an early date. With the resumption of regular Consultative Group meetings, it is hoped that the required concessional flows can be mobilized.

The authorities are committed to the maintenance of a liberal external trade and payments system. The staff welcomes their intention to eliminate the few remaining import restrictions and tariff exemptions and to resist pressures for special tariff treatment outside the new uniform customs tariff. Exchange practices subject to Article VIII are limited to arrears on external debt service payments to foreign commercial banks and a few private lenders without official guarantee. In view of the authorities' intention to eliminate these arrears before March 31, 1987 through debt restructuring or cash payment, the staff proposes their approval on a temporary basis. In addition, a multiple currency practice might arise as a result of the operation of the auction market for foreign exchange or the emergence of a premium of the exchange rate in the parallel market. Spreads or premia in excess of 2 percent have not been recorded in recent months and the program is designed in such a way as to render unlikely the emergence of spreads or premia that are either large or protracted; therefore, the staff also proposes their approval on a temporary basis.

The staff supports the authorities' request for a waiver and modification of the performance criterion on external payments arrears. It is recommended that the waiver be approved in view of the small size of the deviation, the setting aside of funds in a special account for the eventual reduction of the arrears through cash payments, and the observance of the other performance criteria. The staff also recommends the modification of the performance criterion on external payments arrears by excluding arrears to foreign commercial banks through March 30, 1987 so as to give Bolivia more time to reach an agreement with its bank creditors.

In sum, the authorities have so far implemented their stabilization and adjustment program with determination and considerable success. They are now proposing a program that aims at consolidating the achievements to date while laying the basis for sustained growth. It must be recognized that the program continues to be subject to many risks and that the balance of payments outlook in the early 1990s remains very difficult. The staff supports the authorities' program as one that seeks to limit the risks and offers a promising way out of a very difficult situation. It is clear, however, that the Fund will need to remain in close contact with Bolivia in the years ahead through discussions on policy, technical assistance, and financial support. With the continued implementation by Bolivia of appropriate economic policies, it is expected that the international financial community will assist the country through debt relief and new financial assistance on suitable terms.

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

VII. Proposed Decisions

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

I. 1986 Consultation

1. The Fund takes this decision relating to Bolivia's exchange measures subject to Article VIII, Section 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.

II. Review Under the Stand-By Arrangement

1. Bolivia has consulted with the Fund in accordance with paragraph 4(d) of the stand-by arrangement for Bolivia (EBS/86/120, Sup. 1) and paragraph 4 of the letter of the Minister of Planning and Coordination, the Minister of Finance, and the President of the Central Bank of Bolivia dated May 29, 1986, annexed thereto, in order to review policies and establish performance criteria for the remaining period of the stand-by arrangement.

2. The letter dated October 30, 1986 from the Minister of Planning and Coordination, the Minister of Finance, and the President of the Central Bank of Bolivia (Attachment I to EBS/86/263) and the annexed Memorandum of Understanding on Economic Policy Through the End of 1987 (Attachment II to EBS/86/263) shall be attached to the stand-by arrangement for Bolivia, and the letter dated May 29, 1986 shall be read as supplemented by the letter of October 30, 1986 and its annexed Memorandum of Understanding.

3. Accordingly, Bolivia will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Bolivia's currency in the credit tranches beyond 25 percent of quota:

a. During any period in which

(i) The ceiling on the changes in net domestic assets of the Central Bank of Bolivia, as set forth in paragraph 11 and Table 2 of Attachment II to EBS/86/263; or

(ii) The ceiling on changes in the net position of the nonfinancial public sector with the Central Bank of Bolivia, as set forth in paragraph 11 and Table 2 of Attachment II to EBS/86/263, is not being observed; or

b. During any period in which the data at the end of the preceding period indicate that

(i) The borrowing requirement of the nonfinancial public sector, as set forth in paragraph 10 and Table 1 of Attachment II to EBS/86/263; or

(ii) The limit on minimum gain or maximum loss of net international reserves of the Central Bank of Bolivia, as set forth in paragrah 16(b) and Table 3 of Attachment II to EBS/86/263; or

(iii) The limit on payment arrears on public and publicly guaranteed external debt, as set forth in paragraph 18(a) and Table 4 of Attachment II to EBS/86/263; or

(iv) The limit on increase in public and publicly guaranteed external debt, as set forth in paragraph 18(b) and Table 5 of Attachment II to EBS/86/263, has not been observed; or

c. During any period after February 15, 1987 in which the intention relating to the 1987 budget expressed in paragraph 10 of Attachment II to EBS/86/263, is not carried out.

4. The Fund decides that the review contemplated in paragraph 4(d) of the stand-by arrangement is completed and that Bolivia may proceed to make purchases under the arrangement.

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

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

2. The Fund approves the arrangement set forth in EBS/86/263.

Table 11. Bolivia: Macroeconomic Flows

(In percent of GDP)

	1982	1983	1984	Prel. 1985	Program 1986 Orig.	Program 1986 Rev.	Program 1987	Program 1988	Program 1989
I. Balance of Payments									
Current account balance	-3.8	-3.9	-3.6	-8.0	-7.9	-8.6	-9.4	-8.6	-7.9
Trade balance	6.0	4.2	6.0	1.9	-1.5	-1.7	-3.6	-3.3	-2.9
Factor payments (net)	-10.2	-10.8	-11.4	-11.4	-8.3	-9.0	-8.4	-8.0	-7.6
Other services and transfers	0.4	2.7	1.8	1.5	1.9	2.2	2.6	2.6	2.6
Capital account	2.0	11.2	7.4	8.9	6.8	10.3	9.0	8.6	8.2
Nonfinancial public sector	0.1	-0.8	5.8	4.8	5.4	5.6	6.1	5.8	5.8
Other capital 1/	1.9	12.0 2/	1.6	4.1	1.4	4.7	2.8	2.9	2.5
Change in official net international reserves (increase -)	1.8	-7.3 2/	-3.8 3/	-0.9	0.4	-1.7	0.5	—	-0.3
II. Nonfinancial Public Sector									
General Government									
Current account savings	-11.7	-19.2	-21.3	-10.4	0.9	2.0	1.2	1.0	1.0
Total revenue	11.5	11.3	4.8	11.3	17.3	19.2	18.8	19.3	20.0
Total expenditure	25.7	28.9	28.1	23.7	19.4	21.1	21.7	22.0	22.5
Overall surplus or deficit (-)	-14.2	-17.6	-23.4	-12.4	-2.1	-1.9	-2.9	-2.7	-2.5
Nonfinancial state enterprises									
Current account savings	2.8	1.2	-2.5	1.4	-1.4	-0.4	-0.7	0.5	1.0
Capital expenditure (net)	4.6	2.8	2.2	1.5	2.9	1.5	2.6	3.3	4.0
Overall surplus or deficit (-)	-1.8	-1.6	-4.7	-0.1	-4.2	-1.9	-3.2	-2.8	-3.0
Consolidated nonfinancial public sector									
Current account savings	-8.9	-18.0	-23.8	-9.0	-0.4	1.7	0.5	1.5	2.0
Capital revenue and net lending	0.4	4.4	0.3	0.3	1.4	--	0.7	0.5	0.5
Capital expenditure	7.5	5.7	4.6	3.8	7.3	5.5	7.3	7.5	8.0
Overall deficit	-16.0	-19.2	-28.1	-12.4	-6.4	-3.8	-6.1	-5.5	-5.5
Net foreign financing	0.1	-0.8	5.8	4.8	5.4	5.6	6.1	5.8	5.8
Net domestic financing	15.9	20.0	22.3	7.6	1.0	-1.8	--	-0.3	-0.3
III. Savings and Investment									
Fixed capital formation	11.6	7.0	5.3	5.0	9.5	10.2	12.4	14.3	15.6
Nonfinancial public sector	7.5	5.7	4.6	3.8	7.3	5.5	7.3	7.5	8.0
Private sector	4.2	1.4	0.7	1.2	2.2	4.7	5.1	6.8	7.6
Investment = savings	9.8	3.6	6.4	4.2	10.5	9.5	12.4	14.3	15.6
External savings	3.8	3.9	3.6	8.0	7.9	8.6	9.4	8.6	7.9
National savings	6.0	-0.3	2.8	-3.8	2.6	0.9	3.0	5.7	7.7
Nonfinancial public sector	-9.0	-17.9	-23.8	-8.9	-0.4	1.7	0.5	1.5	2.0
Private sector	15.0	17.6	26.6	5.1	3.0	-0.8	2.5	4.2	5.7

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

1/ Includes net borrowing by the financial public sector, nonofficial reserve movements, and net errors and omissions.
2/ Includes the medium-term refinancing of US$405 million (or 10 percent of GDP) of central bank reserve liabilities.
3/ Includes a US$115 million (or 3 percent of GDP), increase in inconvertible balance resulting from payments for gas exports by Argentina.

Table 12. Bolivia: Selected Economic and Financial Indicators

	1982	1983	1984	1985	1986	Program 1987	Program 1988	Program 1989
	(Percentage change)							
I. Income and Prices								
GDP at constant (1980) prices	-4.8	-7.3	-3.2	-4.1	-2.9	3.2	3.4	4.2
Agricultural value added (1980 prices)	10.4	-27.6	15.8	2.5	-1.5	3.0	4.0	4.0
Mining value added (1980 prices)	-3.9	-1.0	-13.9	-12.3	-11.7	6.0	2.8	6.4
Manufacturing value added (1980 prices)	-12.8	-3.4	-15.2	-11.6	4.2	2.0	3.0	5.0
Real GDP per capita	-7.4	-9.8	-5.8	-6.7	-5.5	0.4	0.6	1.4
GDP deflator	169.2	275.7	1,343.8	11,407.9	253.9	11.2	7.8	5.5
Consumer prices (end-of-year)	296.5	328.5	2,177.2	8,163.4	65.8	9.2	5.4	5.0
II. External sector (US$ basis)								
Exports, f.o.b.	-9.3	-8.8	-4.1	-14.0	-18.9	-6.3	8.3	10.3
Imports, c.i.f.	-42.9	2.0	-16.6	12.3	3.3	8.3	5.9	7.2
Export volume	-4.6	-8.3	-2.8	-9.9	1.8	3.5	1.3	6.6
Import volume	-40.0	5.9	-16.1	15.0	-2.6	4.2	1.9	3.1
Terms of trade (deterioration -)	-0.2	-3.3	-0.8	-2.2	-24.9	-12.9	3.0	-0.5
Effective exchange rates (depreciation -)								
Nominal (average-of-year)	-33.6	-61.0	-86.8	-99.7	... 10/	...	...	...
Real (average-of-year)	9.0	18.7	75.3	-73.2	... 10/	...	...	...
III. Nonfinancial public sector								
Total revenue 1/	108.9	207.7	448.3	28,786.3	406.9	10.7	34.4	16.4
Total expenditure 2/	202.9	265.7	1,392.1	8,190.8	208.2	23.3	43.1	14.9
Number of employees (public sector) 3/	196,266	224,435	235,922	237,130	220,130	...	...	...
IV. Money and Credit 4/								
Net domestic assets 5/6/	340.2	203.1	997.9	8,448.0	86.4	53.1	32.9	22.1
Nonfinancial public sector (net) 6/	204.1	255.5	1,483.1	3,890.6	-138.6	-3.7	-4.9	-3.4
Private sector (gross) 6/	232.6	104.2	464.7	4,248.7	132.3	52.1	31.9	20.7
Liabilities to the private sector	247.5	201.2	1,357.8	9,658.2	109.9	23.1	11.6	11.8
Velocity (GDP/private sector liabilities)	6.9	8.1	17.8	28.9	15.7	11.9	11.4	11.2
Interest rate (end-of-year) 7/	32.0	45.0	140.0	10.4	4.1 10/	...	...	...
	(In percent of GDP)							
V. Nonfinancial Public Sector								
General government total revenues	11.5	11.3	4.8	11.3	19.2	18.8	19.3	20.0
General government total expenditures	25.7	28.9	28.1	23.7	21.1	21.7	22.0	22.5
General government over-all deficit (-)	-14.2	-17.6	-23.4	-12.4	-1.9	-2.9	-2.7	-2.5
State enterprises over-all deficit (-)	-1.8	-1.6	-4.7	-0.1	-1.9	-3.2	-2.8	-3.0
Nonfinancial public sector deficit (-)	-16.0	-19.2	-28.1	-12.4	-3.8	-6.1	-5.5	-5.5
Domestic financing	15.9	20.0	22.3	7.6	-1.8	—	-0.3	-0.3
Foreign financing	0.1	-0.8	5.8	4.8	5.6	6.1	5.8	5.8
VI. Savings and Investment								
Gross national savings	6.0	-0.3	2.8	-3.8	0.9	3.0	5.7	7.7
Gross domestic investment	9.8	3.6	6.4	4.2	9.5	12.4	14.3	15.6
Current account deficit	-3.8	-3.9	-3.6	-8.0	-8.6	-9.4	-8.6	-7.9
Financed by:								
Capital account, n.i.e. (net)	-4.6	-5.6	0.6	0.2	1.5	1.0	2.9	3.9
Exceptional financing 8/	6.6	16.8	6.8	8.7	8.8	7.9	5.7	4.3
Change in net reserves (increase -)	1.8	-7.3	-3.8	-0.9	-1.7	0.5	—	-0.3
Memorandum items								
Balance of payment current account (in millions of U.S. dollars)	-155.8	-155.2	-137.9	-300.1	-323.3	-376.7	-371.0	-369.0
Public sector external debt (in millions of U.S. dollars)	2,803	3,176	3,208	3,261	3,746	4,076	4,397	4,721
Gross official reserves 9/ (in months of imports)	3.8	3.6	6.9	6.0	10.3	9.2	8.3	7.3

Sources: Bolivian authorities; and Fund staff estimates.

1/ Includes operating surplus of state enterprises.
2/ Includes operating deficit of state enterprises.
3/ Includes employees of the financial public sector.
4/ Foreign currency denominated balances valued at average official exchange rate.
5/ Includes other assets and liabilities.
6/ Change in relation to the stock of banking system liabilities to the private sector at the beginning of the period.
7/ Nominal rate on time deposits; since late 1985, monthly rate.
8/ Includes arrears, reschedulings, deferred debt, and balance of payments support loans.
9/ Includes nonusable reserves in escrow account.
10/ August 1986.

Table 13. Bolivia: Monetary Survey

(Stocks in trillions of Bolivian pesos at end-of-period exchange rate)

End of Period	1985	Prel. Sept. 1986	Program 1986	Program 1987	Program 1988	Program 1989
Central Bank						
Net international reserves	238.6	443.8	415.9	399.9	404.4	438.3
Medium- and long-term foreign assets	-387.5	-433.6	-449.5	-607.4	-771.6	-893.3
Net domestic assets	332.5	213.8	264.1	478.7	668.8	791.8
Nonfinancial public sector	-63.8	-489.8	-484.1	-546.0	-583.9	-613.5
Banking system	103.3	163.7	186.5	405.7	619.7	768.3
Other	293.3	539.9	561.7	619.0	633.0	637.0
Liabilities to private sector	183.6	224.0	230.5	271.2	301.6	336.8
Financial system						
Net international reserves	140.6	379.3	323.2	301.9	305.3	338.8
Medium- and long-term foreign assets	-626.9	-713.7	-739.5	-913.2	-1,080.7	-1,203.3
Net domestic assets	784.7	962.5	1,040.3	1,383.4	1,637.3	1,827.7
Nonfinancial public sector	-78.8	-511.1	-494.1	-556.0	-593.9	-623.6
Private sector	505.7	904.7	902.8	1,240.5	1,515.8	1,731.0
Other	357.8	568.9	631.6	698.9	715.4	720.3
Liabilities to private sector	298.4	628.1	623.9	772.0	861.8	963.2
Memorandum item						
Exchange rate ($b per US$1)	1,692,000	1,917,000	2,027,345	2,142,333	2,166,476	2,173,206

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

Bolivia - Basic Data

Area and population	
Area	1,098,000 square kilometers
Population (proj. 1987)	6.8 million
Annual rate of population increase (1976-87)	2.78 percent
GDP per capita (proj. 1987)	SDR 504

	1983	1984	Prel. 1985	Prog. 1986	Prog. 1987
Origin of real GDP			(percent)		
Agriculture	17.0	20.3	21.7	22.0	22.0
Mining	17.5	15.5	14.2	12.9	13.3
Manufacturing	13.6	11.9	11.0	11.8	11.6
Construction	3.7	3.2	3.5	3.7	3.8
Transport and communication	5.9	5.9	5.8	6.0	5.9
Government	13.2	13.2	14.0	12.0	12.3
Other services	29.1	29.1	29.8	31.6	31.1
Ratios to GDP					
Exports of goods and nonfactor services	14.4	12.4	15.1	16.2	14.7
Imports of goods and nonfactor services	11.6	9.1	14.0	18.3	18.6
Central administration revenues	7.9	3.1	9.3	14.0	14.1
Central administration expenditures	25.4	23.4	15.7	17.3	17.2
External public debt (end of year)	80.0	83.0	87.0	99.5	101.9
National saving	-0.3	2.8	-3.8	0.9	3.0
Gross domestic investment	3.6	6.4	4.2	9.5	12.4
Money and quasi-money (stock) 1/	18.8	19.9	13.4	8.6	9.2
Annual changes in selected indicators					
Real GDP per capita	-9.8	-5.8	-6.7	-5.5	0.4
Real GDP	-7.3	-3.2	-4.1	-2.9	3.2
GDP at current prices	248.8	1,339.6	10,719.4	243.7	14.7
Domestic expenditures (at current prices)	252.5	1,332.9	10,971.8	254.4	16.8
Investment	27.4	2,486.5	6,964.9	674.6	50.9
Consumption	278.0	1,288.8	11,547.0	235.8	13.3
GDP deflator	275.7	1,343.8	11,407.9	253.9	11.2
Cost of living (annual averages)	275.7	1,281.2	11,741.0	275.0	13.9
Central administration total revenues	347.9	463.6	32,235.7	420.6	15.6
Central government expenditures	315.4	1,227.6	7,153.5	277.7	14.4
Money and quasi-money	186.5	1,423.5	7,252.3	109.9	23.1
Money	205.2	1,797.1	6,117.1	25.5	17.7
Quasi-money	151.6	575.8	14,485.2	244.7	26.[illegible]
Net domestic assets of the financial system 2/	203.1	997.9	8,448.0	86.4	53.1
Credit to nonfinancial public sector (net)	255.5	1,483.1	3,890.6	-138.6	-3.7
Credit to private sector	104.2	464.7	4,248.7	132.3	52.1

	1983	1984	Prel. 1985	Prog. 1986	Prog. 1987
Central government finances		(trillions of pesos)			
Total revenues	0.1	0.6	195.9	1,020.1	1,178.8
Total expenditures	0.3	4.6	331.9	1,253.8	1,434.1
Current account surplus or deficit (-)	-0.3	-3.7	-95.7	51.6	84.6
Overall deficit (-)	-0.2	-4.0	-136.0	-233.7	-255.3
External financing (net)	--	--	4.1	410.4	400.6
Internal financing (net)	0.2	4.0	131.9	-176.7	-145.3
Balance of payments		(millions of U.S. dollars)			
Merchandise exports (f.o.b.)	755	725	623	506	474
Merchandise imports	-589	-492	-552	-570	-618
Factor income (net)	-428	-441	-429	-341	-335
Other services and transfers (net)	107	71	57	81	103
Current account balance	-155	-138	-300	-324	-375
Nonfinancial public sector 3/	4	17	-12	75	179
Unpaid amortization 4/	-167	-202	-165	-262	-245
Banking system (net)	-141	-2	91	39	69
Private capital (net) 5/	178	20	57	206	38
Arrears on gas exports	-98	188	35	--	--
Allocation of SDRs and gold monetization	1	1	--	--	--
Overall balance	-378	-115	-294	-266	-334
Exceptional financing 6/	666	295	635	330	316
Change in official net international reserves (increase -)	-289	-148	-34	-64	19
International reserve position		(millions of SDRs)			
Central Bank (gross)	168.8	291.1	249.4	428.2	415.1
Central Bank (net)	-38.2	109.7	128.5	179.9	163.7
Rest of banking system (net)	-40.5	-50.8	-40.6	...	...

1/ Average end-of-month stocks.
2/ In relation to the stock of money and quasi-money at the beginning of the period.
3/ Includes regular disbursements, assumption of restructured debt, amortization paid, and short-term capital.
4/ Public sector.
5/ Includes net errors and omissions.
6/ Includes balance of payments support loans and total unpaid debt service (arrears, deferments, and restructuring).

Bolivia--Fund Relations
(As of October 31, 1986)

I. Membership Status

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

A. Financial Relations

II. General Department

(a)	Quota:	SDR 90.70 million.
(b)	Total Fund holdings of Bolivian pesos:	SDR 140.17 million, equivalent to 154.54 percent of quota
(c)	Fund credit to Bolivia	SDR 49.45 million, equivalent to 54.51 percent of quota:

	Millions of SDRs	Percent of Quota
Credit tranche	29.08	32.07
Ordinary resources	(24.05)	(26.52)
Supplementary financing	(5.03)	(5.55)
Compensatory financing	11.19	12.33
Buffer stock	9.18	10.11

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

(a) One-Year stand-by arrangement for SDR 50 million approved on June 19, 1986.

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

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

(d) Trust Fund loans: Bolivia received two loans in 1978 and 1980 totaling SDR 36.16 million.

IV. SDR Department:

(a)	Net cumulative allocation:	SDR 26.7 million.
(b)	Holdings:	SDR 1.04 million.

V. Administered Accounts:

(a)	Trust Fund	
	Disbursed:	SDR 36.16 million
	Outstanding:	SDR 20.93 million
(b)	SFF Subsidy Account	
	Payments by the Fund	SDR 3.85 million
(c)	Structural Adjustment Facility:	
	Disbursed	—
	Outstanding	--

VI. Overdue Obligations to the Fund: —

B. Nonfinancial Relations

VII. Exchange Rate Arrangement: The Bolivian currency is the peso. Since early September 1985, the exchange rate of the peso in terms of the U.S. dollar is being determined by means of foreign exchange auctions, which are held at least twice a week by the Central Bank. Successful bidders are charged the prices submitted in their bids (Dutch auction system) and the official exchange rate--which remains in effect until the next auction for all surrenders of foreign exchange and public sector external debt service payments--is the weighted average of the successful bids. On October 31, 1986, the official exchange rate was $b 1,924,000 per U.S. dollar, compared with a buying rate of $b 1,925,000 per U.S. dollar in the parallel market.

VIII. Last Consultation: The 1985 Article IV consultation was concluded on September 23, 1985 (SUR/85/108). Bolivia has been on the standard twelve-month consultation cycle.

IX. Technical Assistance: Bolivia has received a substantial amount of technical assistance in the recent past. Staff members from the Bureau of Statistics provided technical assistance in monetary statistics on two missions in 1984 and one mission in 1985. Another staff member of the Bureau of Statistics traveled to La Paz in March 1986 and July 1986 to give technical assistance in the area of balance of payments statistics. A Central Banking Department expert was on a ten-month assignment in the area of external debt statistics in Bolivia until November 1985 and returned to La Paz on a follow-up visit in July 1986. Two Central Banking Department experts recently took up their duties, for one year initially, in the Central Bank of Bolivia as Research Advisor and Accounting Advisor, respectively. A request for technical assistance from the Central Banking Department is still pending in the area of organization and methods. The Fiscal Affairs Department sent a staff member to La Paz for six weeks in April-May 1985 to aid in budget preparation and control and a three-man mission to assist the authorities in preparing, executing, and controlling the 1986 budget visited La Paz in November 1985. A staff member from the Fiscal Affairs Department and an outside expert returned to La Paz in January 1986 to continue that work. Another expert returned to La Paz for three months in the period March-June 1986 and will return for another six months in December 1986 to continue that work and assist with the preparation of the 1987 budget. A staff member from the Fiscal Affairs Department visited La Paz in July 1986 and November 1986 to assess progress with this technical assistance project. A staff member of the Western Hemisphere Department advised the Central Bank on the operational aspects of an auction-based exchange rate system in the period August 31-September 6, 1985.

X. Resident Representative: Mr. David Hoelscher has been posted as resident representative in La Paz since January 1985. His assignment has been extended for a second year until January 1987.

XI. Current Data: Generally not adequate because of conceptual and methodological problems in all areas. These problems have been aggravated in recent years because of the high turnover and the deteriorating quality of supervisory and technical staff.

Bolivia--Status of World Bank Group Operations

1. Statement of World Bank loans and IDA credits (as of September 30, 1986)

Loan or Credit Number	Fiscal Year	Borrower	Purpose	Amount Disbursed Bank	Amount Disbursed IDA	Undisbursed	Total
				(In millions of U.S. dollars)			
Ten loans and twelve credits fully disbursed				218.4	89.9	--	308.3
933	1979	Bolivia	Omasuyos-Los Andes Rural Development		1.7	1.3	3.0
940	1979	Bolivia	National Mineral Exploration Fund		1.9	5.6	7.5
948	1979	Bolivia	Santa Cruz Water Supply and Sewerage		8.2	0.8	9.0
1404	1977	Bolivia	Education and Vocational Training	10.6		1.4	12.0
1489	1977	Bolivia	Urban Development	16.7		0.3	17.0
1510	1978	Bolivia	Ulla Ulla Development	3.5		5.5	9.0
1587	1978	Bolivia	Highway Maintenance	23.4		1.6	25.0
1703	1986	Bolivia	Reconstruction Import Credit		--	55.0	55.0
1719	1986	Bolivia	Vuelta Grande		--	15.0	15.0
Total				272.6	101.7	86.5	460.8
Of which has been repaid				74.1	4.9	--	79.0
Total now outstanding				198.5	96.8	—	295.3
Amount sold				0.05			0.05
Of which has been repaid				(0.05)			(0.05)
Total now held by Bank and IDA				198.5	96.8	—	295.3
Total undisbursed						86.5	86.5

2. Statement of IFC investment (as of September 30, 1986)

	Loan	Equity	Total
	(In millions of U.S. dollars)		
Total gross commitments	8.3	1.0	9.3
Less cancellations, terminations, repayments, and sales	7.6	0.4	8.0
Total commitments now held by IFC	0.7	0.6	1.3
Total undisbursed	—	—	—

3. Recent and prospective IBRD institutional development support

The IBRD is financing specific institutional development components in some of its on-going development projects, and has previously assisted in the improvement of investment planning and programing as well as external debt reporting in Bolivia. Assistance in the area of institutional reorganization and development is currently being given to the state petroleum company (YPFB) and the state mining company (COMIBOL). Appraisal of a public sector financial management project--focused on public financial sector restructuring--will be undertaken by the mission mentioned in 7.f below.

4. IBRD views on the investment program

Because of severe fiscal constraints, no more than 50 percent of the budgeted investment expenditures are likely to be disbursed in 1986. These actual expenditures, however, appear sound and are directed to high priority investments in key sectors. The Government is taking action to speed implementation of projects and to redefine sector strategies and investment programs in line with the new economic policies. During 1987 World Bank staff will review the public expenditure program in greater depth. A significant portion of this effort will be devoted to reviewing sector strategies and associated investment proposals, analyzing recurrent cost issues as they affect investment, and assessing Bolivia's investment programming and budgeting processes.

5. Structural Adjustment Facility

The Fund and World Bank staffs have prepared a policy framework paper that forms the basis for a three-year program that would be supported by disbursements under the Fund's Structural Adjustment Facility. The policy framework paper was discussed by the Committee of the Whole of the World Bank's Executive Board on November 25, 1986.

6. Resident representative

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

7. Recent and prospective economic and sector missions

(a) Mission to discuss draft 1986 updating economic report - October 1986.

(b) Mission to finalize the preparation for a Consultative Group meeting - October 1986.

(c) Mission to pre-appraise several components of a potential public sector financial management project - October 1986.

(d) Mission to review financial sector - November 1986.

(e) Mission to review agricultural sector - January 1987.

(f) Mission to appraise public sector financial management project (see (c) above - January 1987.

(g) Mission to continue detailed review of public sector expenditure program (see point 4 above) - January 1987.

Bolivia--Statistical Issues

1. Outstanding Statistical Issues

a. Consumer price index

The present consumer price index is based on a 1966 survey of lower- and middle-income households in La Paz. A broader based index, with an up-to-date base period and covering the cities of La Paz, Cochabamba, and Santa Cruz, is under preparation. Pending completion of the requisite survey, the National Statistics Office (INE) has updated the main components of the 1966 index and assigned the food component a lower weight in relation to the other components of the index. Although the modified index shows lower inflation rates than the old one in recent months (see table), the current report continues to use the old index.

Consumer Price Index

(Percentage Changes)

1986	General	Foodstuffs	Housing	Clothing	Others
		(Base 1986)			
May	0.44	-0.34	-0.14	3.67	0.93
June	2.69	1.62	2.94	5.31	3.72
July	1.48	-0.90	3.43	4.97	4.50
		(Base 1966)			
May	0.97	1.05	-1.44	2.28	-5.80
June	4.26	4.78	2.17	5.45	1.93
July	1.78	1.12	3.33	4.88	2.26

b. Government finance

Data published in the 1985 Government Finance Statistics Yearbook (GFSY) are available through 1983. The last year includes for the first time social security and some decentralized units (universities). Data for 1984 have been provided for inclusion in the 1986 GFSY but there remains a need to compile data on external debt flows, and the remaining decentralized units of the Central Government.

c. Monetary accounts

The Central Bank of Bolivia has implemented most of the recommendations made during three technical assistance visits during 1984-1985. Problems remain with the sectorization of the accounts of the branches of the Central Bank. A CBD advisor in accounting is assisting the Central Bank with the implementation of the pending adjustments and with the adaptation of the rest of the financial system's accounts to the new scheme.

d. Balance of payments

Balance of payments statistics are being reported in accordance with recommendations made by two technical assistance visits in 1986.

e. International banking

There are discrepancies between the two sets of data on external liabilities of deposit money banks provided to the Bureau of Statistics, namely monetary data in local currency and data in U.S. dollars reported specifically on international banking statistics. These discrepancies are being investigated jointly by the authorities and the staff.

f. External debt

Because of staffing problems, the quality and timeliness of external debt data have deteriorated in the recent past. No information is currently available on short-term external debt outside the Central Bank.

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 October 1986 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 and infrequent basis.

Status of IFS Data

		Latest Data in October 1986 IFS
Real Sector	- National Accounts	1984 1/
	- Prices: CPI	April 1986
	- Production (crude petroleum)	December 1985
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	December 1985
	- Financing	December 1985
	- Debt	n.a.
Monetary Accounts	- Central Bank	December 1985
	- Deposit Money Banks	December 1985
	- Other Financial Institutions	December 1985
Interest Rates	- Discount Rate	December 1984
	- Deposit Rate	December 1984
	- Lending Rate	December 1984
External Sector	- Merchandise Trade: Values	December 1985
	Prices	December 1985
	- Balance of Payments	1985
	- International Reserves	July 1986
	- Exchange Rates	August 1986

1/ Net factor payments abroad are only available through 1982.

Bolivia--Summary of the Program for July 1986-December 1987

I. Major Assumptions

1. Real GDP: After a decline of 2.9 percent in 1986, real GDP is expected to increase by 3.2 percent in 1987. The decline in 1986 would result from contractions in mining and hydrocarbons (-12 percent), government services (-16 1/2 percent), and agriculture (-1 1/2 percent). The growth in 1987 essentially would represent a rebound in those sectors (mining and hydrocarbons: 6 percent; government services: 5 1/2 percent; agriculture: 3 percent); strong growth in construction (6 percent), and moderate rates of expansion elsewhere.

2. Export volume: Export volume is assumed to increase by 1.8 percent in 1986 and by 3.5 percent in 1987. Tin exports are expected to continue to fall from 16,100 tons in 1985 to 13,000 tons in 1986 and to 10,000 tons in 1987. Volumes of other metals are expected to fall in 1986 and to recover in 1987--except for silver and zinc, which are expected to show a growth of export volume in both years. Natural gas exports under the contract with Argentina are likely to remain unchanged in both years. Largely due to volume growth, the value of nontraditional exports is expected to double to US$72 million in 1986 and to increase further by about 25 percent in 1987.

3. Export and import prices: The price of tin is forecast at US$2.54 per pound in 1986 and at US$2.61 per pound in 1987. Natural gas exports will be effected in 1986 at the negotiated price of US$3.70 per one million BTU. For 1987, it is assumed that the price will be 15 percent lower. The prices of nontraditional exports (in U.S. dollar terms) are assumed to increase by 4.4 percent in 1986 and by 3.5 percent in 1987. Import prices (in U.S. dollar terms) are assumed to increase by 6.1 percent in 1986 and by 3.9 percent in 1987.

4. Financial sector: Real money and quasi-money are projected to grow by 11 percent in 1986 and 15 percent in 1987, thus implying a gradual drop in velocity.

II. Targets

1. Inflation: Consumer prices are expected to increase by 66 percent in 1986 and by 9 percent in 1987 on an end-of-period basis; the corresponding average rates are 275 percent and 14 percent. The GDP deflator would increase by 254 percent in 1986 and by 11 percent in 1987.

2. Overall balance of payments: The Central Bank will aim at increasing its net international reserves by US$11 million in the second half of 1986. This would represent a minimum improvement of its net international reserve position of US$64 million in 1986. In 1987, the loss of net international reserves of the Central Bank is to be limited to US$18.5 million.

3. External current account: Because of the expected deterioration of the trade balance, the external current account deficit is projected to widen from US$323 million in 1986 to US$375 million in 1987. In relation to GDP, the current account deficit would increase from 8.6 percent to 9.4 percent.

III. Principal Policy Elements

1. Exchange rate policy: The Central Bank will conduct frequent exchange auctions to maintain a flexible exchange rate system with unrestricted access to the official exchange market. The Central Bank will conduct the auctions in such a way that the premium of the exchange rate in the parallel market does not to exceed 5 percent on average during five consecutive business days.

2. Fiscal policy: a. The borrowing requirement of the nonfinancial public sector will be limited to 3.8 percent of GDP in 1986 and to 6.1 percent of GDP in 1987. A reduction of the nonfinancial public sector's domestic indebtedness by 1.8 percent of GDP is envisaged in 1986, and no reliance on domestic financing is projected for 1987.

b. Tax collections of the Central Administration are expected to decline from 15 percent of GDP on an annual basis in the second half of 1986 (yielding 14 percent of GDP in all of 1986) to 13.5 percent of GDP in 1987. The decline is more than accounted for by lower transfers from the petroleum company because of an expected reduction of the price of natural gas exports. Collections of other taxes are expected to increase as a result of the implementation of the tax reform and better tax administration.

c. Expenditure in the Central Administration and the state enterprises will be strictly controlled. An important element is a tight wage policy, which foresees only one increase in 1987 of about 10 percent in the total public sector wage bill and further reductions in public sector employment. Investment spending is expected to amount to 7.0 percent of GDP on an annual basis in the second half of 1986 (5.5 percent in all of 1986) and 7.3 percent of GDP in 1987.

d. 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 through layoffs and reorganization as well as decentralization measures. The prices of petroleum products will be maintained at the equivalent of US$0.23 per liter on average.

3. Monetary policy: a. Credit to the private sector is programmed to expand by 14 percent in real terms in the second half of 1986 and by 26 percent in real terms in 1987. Net use of external credit lines is assumed to be US$10 million in 1986 and US$60 million in 1987. Higher net use of credit lines in the two periods can be accommodated under the monetary program provided it does not raise net disbursements of external debt in the 1-10 year maturity range beyond the program limits.

b. Interest rates will remain free during the program period. They are projected to decline in real terms as confidence strengthens in the light of the past and prospective evolution of prices.

c. A new currency will be introduced at the start of 1987 and a number of institutional reforms will be carried out in the financial system.

4. External debt policy: a. The program calls for stepped-up disbursements from multilateral development banks and official bilateral lenders. It also assumes continued debt relief from bilateral creditors through the negotiation of implementing agreements along the lines of the terms specified in the July 1986 Paris Club agreement and through another restructuring agreement with the Paris Club covering maturities falling due in the second half of 1987. The program also assumes that an agreement will be reached in early 1987 with the foreign commercial banks.

b. Net disbursements of external public debt in the 1-10 year maturity range are subject to quarterly limits under the program.

c. A reporting system for short-term external public debt is to be set up by mid-1987.

d. No new official guarantees on private external debt will be provided during the program period.

5. External trade and payments policy: a. The trade system will remain open and a uniform tariff of 20 percent ad valorem will apply to all imports.

b. The authorities will not introduce restrictive exchange practices and trade restrictions for balance of payments purposes.

Table 14. Bolivia: Principal Objectives and Targets of the Program for July 1986-December 1987

	1985	1986 Original Program	1986 Revised Program	Prog. 1987
	(Annual percentage change)			
Output and prices				
Real GDP	-4.1	--	-2.9	3.2
Consumer prices (end-of-period)	8,163.4	84.3	65.8	9.2
	(In millions of U.S. dollars)			
External sector				
Current account deficit	-300	-354	-323	-377
In percent of GDP	(-8.0)	(-7.9)	(-8.6)	(-9.4)
Change in net international reserves	34	-51	64	-18
Gross loan disbursements to public sector	109	246	189	319
	(In percent of GDP)			
Nonfinancial public sector				
Nonpetroleum revenue of General Government	3.4	6.0	7.0	7.5
Overall deficit	-12.4	-6.4	-3.8	-6.1
Domestic financing	7.6	1.0	-1.8	—
	(Annual percentage change)			
Financial system				
Liabilities to private sector	7,246.7	80.9	109.1	23.7
Real credit to private sector	84.1	10.9	8.2	25.8
	(In percent of GDP)			
Savings and investment				
Gross domestic investment	4.2	10.5	9.5	12.4
National savings	-3.8	2.6	0.9	3.0

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

La Paz, October 30, 1986

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D. C. 20431
U. S. A.

Dear Mr. de Larosière:

1. Attached hereto is a Memorandum of Understanding on Economic Policy Through the End of 1987 outlining the economic policies that the Government of Bolivia intends to pursue during the remaining period of the current stand-by arrangement from the International Monetary Fund and the corresponding quantitative targets. It updates and supplements the Memorandum of Understanding on Economic Policy that is attached to our letter dated May 29, 1986.

2. We are pleased to report that substantial progress has been made in the last twelve months in reducing the imbalances in the Bolivian economy, through the pursuit of tight fiscal and credit policies. Inflation has been all but stopped, and net international reserves have been growing in the context of exchange rate stability. However, the sharp drop in the prices of Bolivia's principal exports has meant that these results have been accompanied by a deepening recession and rising unemployment. Accordingly, the policies outlined in the attached Memorandum, which was worked out in the context of discussions with the Fund staff to review progress in implementing the economic program that is supported by a stand-by arrangement from the International Monetary Fund, aim at reactivating the economy while consolidating further the progress achieved toward financial stabilization.

3. The Government of Bolivia believes that the policies set out in the attached Memorandum of Understanding on Economic Policy Through the End of 1987 are adequate to achieve the objectives of its program but will take any further measures that may become appropriate for this purpose. The Government will discuss with the Fund and reach suitable understandings on the adoption of any measures that may become appropriate.

Yours sincerely,

Gonzalo Sanchez de Lozada
Minister of Planning
and Coordination

Juan Cariaga
Minister of Finance

Javier Nogales
President

Central Bank of Bolivia

Memorandum of Understanding on Economic Policy Through the End of 1987

1. Since initiating its stabilization effort one year ago, Bolivia has made substantial progress toward eliminating the severe imbalances that beset the economy in the years prior to the inauguration of the government of President Paz Estenssoro. Inflation was reduced from 23,450 percent in the twelve months ended September 1985 to 92 percent in the subsequent twelve-month period. Since March 1986, consumer prices have been rising at an annual rate of 25 percent. Tight fiscal and credit policies and the recovery of the demand for domestic financial assets led to an increase in the net international reserves of the Central Bank of Bolivia from US$ 114 million at the end of August 1985 to US$ 210 million at the end of August 1986. The exchange rate in the official market has remained virtually unchanged at $b 1.9 million per US$1 since mid-March 1986 while the premium in the parallel market, which had reached 1,500 percent prior to the stabilization, virtually disappeared. The Government attributes its success to date mainly to a tight demand management policy that was complemented by the liberalization of prices and the opening of the economy.

2. These important achievements notwithstanding, the Government is concerned about growing recessionary tendencies and rising unemployment. The expectation had been that economic activity would revive in the second half of 1986 so as to permit real GDP to remain constant in 1986 after five years of decline. However, it appears now that real GDP will contract by about 2 1/2-3 percent in 1986. Besides substantial employment cuts in the public sector and high domestic interest rates associated with the tightening of demand management, the revival of economic activity has been impeded by the slow pace of disbursement of external resources for development and by large real income losses sustained as a result of substantial price declines for tin and natural gas exports and operations undertaken to suppress the production and distribution of cocaine.

3. In the light of these developments, the Government has adopted a comprehensive plan for the period July 1986-December 1987 (the "program period") that aims at stimulating economic growth while consolidating the progress made in stabilizing the economy. The program, which spells out the specific policy actions to be taken in the early part of a three-year policy framework developed jointly with the staffs of the International Monetary Fund and the World Bank, envisages major structural adjustments that will tend to depress economic growth in the short-run while improving economic efficiency and growth prospects in the medium-term. Nonetheless, the Government expects that the contractionary effects of the structural adjustment measures will be overcome during the program period by an increased flow of concessional external resources, lower domestic interest rates in real terms, and a measured reorientation of fiscal policy toward employment generation and investment. These factors should allow real GDP to grow by about

3 percent in 1987. Following the international reserve gain since August 1985, the Government intends to limit the loss of net international reserves to US$28.5 million during the period September 1, 1986-December 31, 1987. The balance of payments and growth objectives should be compatible with a reduction of the rate of inflation to 13 percent on an annual basis in the second half of 1986 and to below 10 percent in 1987. The key element of the program will be the pursuit of a tight fiscal policy, with the deficit of the consolidated nonfinancial public sector temporarily rising to 8 percent of GDP on an annual basis in the second half of 1986, largely because of higher investment spending, a one-time outlay to reduce public sector employment, and seasonal factors, before falling to 6 percent of GDP in 1987. The nonfinancial public sector will continue to refrain from using domestic bank financing on a net basis during the program period, thus providing the private sector access to the full amount of domestic and external financial resources accruing to the financial system.

4. (a) Revenue collections of the Central Administration increased from 9 percent of GDP in 1985 to 13 percent of GDP on an annual basis in the first half of 1986. Despite this increase, collections remained substantially below expected levels, mainly as a result of a shortfall in transfers from the state petroleum company (YPFB). After increasing further to 15 percent of GDP on an annual basis in the second half of 1986, revenue collections are likely to decline to 13 1/2 percent of GDP in 1987, reflecting lower transfers from YPFB as a result of the poor prospects for international petroleum prices. To strengthen revenue collections from other sources, an Undersecretary of Revenue Collections was appointed in August 1986 and put in charge of the customs and internal revenue administrations, which will be thoroughly reorganized during the program period. The Government is examining the possibility of creating a separate Ministry of Taxation.

(b) In August 1986 the import tariff was set at a uniform rate of 20 percent ad valorem, with a 10 percent tariff for some 200 items of machinery and equipment. At the same time, virtually all tariff exemptions were withdrawn. The Government intends to let the exemption for wheat imports, which was retained for one year, lapse in August 1987 and to reduce further the scope of exemptions for the hydrocarbons industry, which was already reduced from 1,200 to 750 customs items. It is expected that the new tariff, which replaces the temporary tariff introduced in August 1985 and a number of additional taxes and levies, will redirect imports to legal channels. This effect is likely to be reinforced by the provision of a clear customs valuation basis by an international inspection company that began to inspect exports to Bolivia in August 1986. Import duty collections are programmed to yield 1.4 percent of GDP on an annual basis in the second half of 1986 and 1.7 percent of GDP in 1987.

(c) The structure of collections from internal revenue taxes is expected to undergo major changes during the program period as the tax reform is implemented. The one-time regularization tax for liabilities covering the 1985 tax year on corporate net worth and selected personal property items is being collected and expectations are that it will yield 0.6 percent of GDP in 1986. A group of experts provided by the United Nations will assist the Bolivian tax authorities from mid-September 1986 to issue the implementing guidelines and enforce the remaining taxes. The Government is determined to enforce the annual taxes on corporate net worth and selected property items, which use the same tax bases as the regularization tax but apply lower rates to them, and the monthly taxes on transactions and selected consumer goods by late 1986 or early 1987. More time is required for the introduction of the property tax on rural land holdings and the value added tax with its complementary income tax. The tax authorities will proceed cautiously in this area and ensure that existing taxes, such as the sales tax and the present income tax, will not be withdrawn until their replacements are actually enforced. Internal revenue taxes are programmed to yield 2.0 percent of GDP on an annual basis in the second half of 1986 and 3.1 percent of GDP in 1987.

(d) The tax regime governing the hydrocarbons sector will remain unchanged during the program period. The requirement for YPFB to transfer to the Treasury 65 percent and 59 percent of the values of domestic sales and exports, respectively, will be maintained. Since February 1986 these transfers have been used as an advance for existing taxes on the production, domestic sales and exports of hydrocarbons; the considerable margin left after these deductions is retained as a permanent transfer of excess profits. The tax collections on hydrocarbons are programmed to yield 10.4 percent of GDP on an annual basis in the second half of 1986 and 8.7 percent of GDP in 1987.

5. The Government will submit shortly to the Congress its proposal for the 1987 budget of the consolidated nonfinancial public sector. The budget for the Central Administration will be limited to the projected levels of domestic revenue collections and net receipts of foreign loans (including refinancing operations) and grants. Because of the unusually great uncertainty in projecting tax revenue collections in a period during which major tax reform measures are scheduled to be implemented, the Government is determined to cut or defer expenditures so as to manage the finances of the Central Administration without recourse to domestic bank credit. To relieve pressures on the Central Administration finances in early 1987, all unused budgetary authorizations will lapse at the end of 1986. Outlays for the reduction of employment in the state mining company (COMIBOL) in November 1986 and the payment of the thirteenth monthly wage in December 1986 are likely to put some strain on the Treasury's cashflow in late 1986. The Government counts on the recently established control units for budget execution and cash flow to play an important role in managing this situation.

6. (a) A tight wage policy remains the most important measure to keep expenditure in the General Government and the state enterprises under control. A wage increase was granted in June 1986 that increased the average wage bill of the General Government and the state enterprises by 15 percent. The wage bills of individual public sector entities and enterprises were increased in inverse proportion to the average wage paid by each institution, with entities and enterprises paying average monthly wages of more than $b300 million (about US$157) not receiving any increase. During the program period, the Government intends to give only one further wage increase in early 1987 that will not exceed 10 percent of the wage bill. Effective wage increases will, however, remain possible through the distribution to employees of savings (limited to 50 percent of such savings in the case of the enterprises) resulting from employment reductions. Outlays for wages are programmed to amount to 8.2 percent of GDP on an annual basis in the second half of 1986 and to 6.7 percent of GDP in 1987.

(b) Current expenditure in the Central Administration other than wages and interest payments will be kept under tight control so as to make possible the spending of $b39.5 trillion, or 0.5 percent of GDP, in the second half of 1986 and of $b88.9 trillion, or 1.1 percent of GDP, in 1987 for severance payments in connection with the reduction of employment in the public sector and the reduction of domestic arrears. This policy on current expenditure is expected to ensure a level of savings in the Central Administration that is sufficient to generate the local counterpart funds necessary for investment and the amortization payments on those external loans that cannot be restructured. Following the disappointingly slow rate of disbursement of foreign loans and grants in the first half of 1986, the Government expects that investment activity will accelerate toward the end of 1986 and in 1987 after the World Bank-sponsored Consultative Group meeting in late 1986. The public sector investment plans for 1986 and 1987 have been examined by the World Bank staff in the course of preparatory work for the Consultative Group and the projects included have been found to be of high priority. It is expected that investment spending in the General Government will amount to 5.0 percent of GDP on an annual basis in the second half of 1986 and to 4.7 percent of GDP in 1987.

7. (a) The Government will continue to exercise strict control over the finances of the state enterprises. As in the Central Administration, the overall objective for the state enterprise sector is the achievement of an aggregate current account surplus that is large enough to finance the local counterpart requirements for their investment projects and external amortization payments without recourse to the domestic banking system. The pricing policy of the state enterprises will remain under continuous review so as to ensure an adequate level of revenues. This applies in particular to YPFB, which will maintain its domestic sales price at the equivalent of US$0.23 per composite liter. The composite liter is a set of weights representing the projected volumes of sales of the individual petroleum products in the domestic market in the period July 1986-December 1987. The domestic prices will

be adjusted whenever the arithmetic average of the official exchange rates (weighted by the number of business days) established in the auction market (Bolsin) during the preceding month indicates that the price of the composite liter has fallen below US$0.23.

(b) Currently the state enterprises must deposit their liquid funds with the Central Bank, which permits no overdrafts and transfers any sizable deposit accumulations to frozen accounts. Funds in the frozen accounts are released only for justified purposes. As part of the planned reorganization of the Central Bank referred to in paragraph 15 below, the accounts of the state enterprises will be transferred to the commercial banks. The Central Bank will enforce a 100 percent reserve requirement on their deposits and ensure the timely reporting of transactions in these accounts to the cashflow control unit in the Central Bank. The Government will not provide any guarantees for credit extended by the commercial banks to the state enterprises nor will the Central Bank provide refinancing for this purpose. As in the Central Administration, investment activity in the state enterprises was very low in the first half of 1986, but is programmed to increase throughout the program period to 2.0 percent of GDP on an annual basis in the second half of 1986 and to 2.6 percent of GDP in 1987.

8. During the program period, the Government will continue with the restructuring of the state enterprises. Following the transfer of the assets of the enterprises fully owned by the Bolivian Development Corporation (CBF) and of the road transport corporation (ENTA) to regional and local bodies and the transfer of the assets of the smelting company (ENAF) and the lead-silver smelter (SCMK) to COMIBOL, the Government's efforts are now concentrating on COMIBOL and YPFB. In YPFB, the retail sale of gasoline and liquified petroleum gas (LPG) has been handed over to the private sector but the authorities are seeking to improve the distribution of YPFB's products further by spinning off trucking operations, allowing gasoline retailers to own their stations, and lifting the zoning restrictions on the distribution of LPG. In August 1986, the Government announced its policy for the restructuring and decentralization of COMIBOL. Of the company's 23 mines, the two most unproductive ones will be closed permanently, nine will be offered to their workers as cooperatives, and twelve will be operated by COMIBOL in a decentralized fashion. Some of these mines will curtail their operations while exploration and development activities will be carried out so as to enhance their future productivity. However, the Government expects total mining production to decline only modestly as the mines operated as cooperatives are expanding their output. The cooperatives are free to obtain financing from the commercial and specialized banks, but the Central Bank will not provide any resources to them except for the onlending of foreign lines of credit. The Treasury has assumed all of COMIBOL's debts, including the internal floating debt for which certificates (notas fiscales) will be issued after the company has been audited to determine their amount. These certificates can be returned to the Treasury in lieu of tax payments. With the liberalization of prices at the producer and consumer level in August 1985, the rice

storage and commercialization company (ENA) lost most of its functions. The Government is considering selling its assets to the producers and distributors in the private sector.

9. The restructuring of the state enterprises and the efforts to disrupt the production and distribution of cocaine have contributed to a substantial increase in unemployment. To alleviate this problem, the Government has decided to implement immediately an employment program to construct and repair roads and build simple housing in both urban and rural areas. It is expected that the program, which will be continued under the 1987 budget, will provide employment to 20,000-30,000 workers. In a parallel effort, the Government is stepping up its efforts to distribute land to unemployed workers desirous to take up agricultural or mining production.

10. The measures outlined in the preceding six paragraphs are considered adequate to limit the overall deficit of the consolidated nonfinancial public sector to no more than 8.1 percent of GDP on an annual basis in the second half of 1986 and to 6 percent of GDP in 1987. Consistent with this objective, the Government has set ceilings on the borrowing requirement of the consolidated nonfinancial public sector, as set forth in Table 1. This borrowing requirement will be satisfied fully with external resources without Government recourse to domestic bank credit. The Government will submit to the Congress a budget that is consistent with the quantitative limits for 1987 in Tables 1 to 5 as soon as possible but no later than February 15, 1987. Should developments during the program period jeopardize the attainment of the above fiscal objectives, the Government is committed to take appropriate additional action including, for example, an increase in the prices of petroleum products on an emergency basis.

11. The credit policy for the program period has been designed to be consistent with the program objectives outlined in paragraph 3 above. The growth of liabilities to the private sector is estimated at 26 percent for the second half of 1986 and 24 percent in 1987, implying some further decline in velocity as confidence in economic management continues to improve and inflation abates further. In accordance with these monetary policy objectives, the Government has established ceilings on the expansion of net domestic assets of the Central Bank, as set forth in Table 2. In line with the intention to eliminate net access of the nonfinancial public sector to the Central Bank during the program period, continuous subceilings have been established on the flow of Central Bank credit to that sector, as set forth in Table 2. As a result of this limitation, and because the state enterprises (the deposit accounts of which will be transferred to the commercial banks during the program period) are not expected to have net access to bank credit during the program period, the private sector will be able to benefit in full from the growth of deposits in the domestic financial system. It is estimated that private sector credit will expand by 14 percent in real terms, or 2 percent of GDP, during the second half of 1986 and by 25.5 percent in real terms, or 4 percent of GDP, in 1987.

These estimates include the net use of external credit lines of US$10 million in the second half of 1986 and of US$60 million in 1987. Private sector credit could expand further as a result of external disbursements beyond the amounts just indicated, provided that the limits on net disbursements of external public debt referred to in paragraph 18 (b) below are observed.

12. Although domestic interest rates declined substantially in the first half of 1986, they remain high in light of the recent inflation and exchange rate experience and in relation to the expected further abatement of inflationary pressures. The Government is aware that, for balance of payments reasons, deposit rates must remain somewhat above international rates in the foreseeable future but the Central Bank has recently permitted the operation of an interbank market in an effort to induce a reduction of the spread between lending and deposit rates. To guide lending rates down further, the Central Bank will revise its procedures so as to ensure the smooth and timely onlending of external lines of credit at interest rates that reflect refinancing costs in international financial markets. In line with agreements with the foreign lenders, the foreign resources available will benefit particularly the productive sectors of the economy and exports. To expedite the extension of such credits, the Government will shortly repeal the prior approval requirement for credit applications of US$100,000 and above. In an effort to increase the efficiency of financial intermediation, the Central Bank will begin to publish shortly the individual banks' lending and deposit rates.

13. A new currency, the condor, is expected to begin to circulate on January 1, 1987 at a rate of C$1 = $b1,000,000 and all contracts and financial claims will be redenominated into condores at that rate. Both currencies will circulate in parallel until the end of 1987, at which time the peso-denominated currency notes will be demonetized.

14. In the absence of a developed capital market with suitable financial instruments, the Central Bank is limited to affecting liquidity conditions in the financial system through rediscount and minimum reserve requirement policies. Rediscounts are granted at the Central Bank's discretion at the commercial banks' average lending rate for very short-term refinancing operations and at higher rates for longer-term recourse to the Central Bank. New regulations on the implementation of minimum reserve requirements took effect on September 1, 1986, raising the portion of minimum reserve deposits to be held with the Central Bank from 80 percent to 100 percent and imposing stiffer penalties for reserve deficiencies. The Central Bank will continue to refine its policy instruments during the program period. It also will strengthen its criteria for banking supervision, in particular with respect to limits on loan concentration and nonperforming assets.

15. The Government will proceed with a number of institutional reforms in the financial sector during the program period. The recent introduction of an interbank market and the possible operation of a

national stock exchange will provide the institutional setting for eventual Central Bank open market operations. Plans are ready to reorganize the Central Bank and reduce the size and scope of its operations to those of monetary authority and fiscal agent of the Central Administration. Thus, its development loan department will be made more efficient so as to expedite the use of foreign lines of credit; eventually, it will become an independent development bank for the intermediation of foreign lines of credit. The deposits of the state enterprises will be transferred to the commercial banks, thereby severing those enterprises' direct financial links with the Central Bank. Finally, with technical assistance from the World Bank and the International Monetary Fund, a major effort is underway to rebuild the accounting system of the Central Bank.

16. (a) The Government is satisfied with the operation of the foreign exchange auction system, which has enhanced flexibility in determining the exchange rate. In the past year, this system has demonstrated itself capable of allowing for the flexible adjustment of the exchange rate to exogenous shocks and to changes in domestic economic policy. The Government will maintain the auction system during the program period. It considers that the unrestricted access to the market is important for the maintenance of confidence in the economy and will therefore continue to permit unlimited foreign exchange purchases for both current and capital transactions. In particular, no restrictions other than budgetary ones will be imposed on foreign exchange purchases by public sector entities.

(b) In recent months, there has been a substantial accumulation of net international reserves, together with a high degree of exchange rate stability. In light of the difficult medium-term outlook for the balance of payments, the Central Bank will limit the loss of net international reserves during the program period, in line with the quarterly limits established in Table 3. The Government expects that, given its tight fiscal stance, this policy toward foreign reserves will be accompanied by continued stability in the foreign exchange market, provided that there are no further major exogenous shocks. Although the real effective exchange rate of the peso has appreciated in the first half of 1986, it remains at about the level established immediately after the large depreciation in September 1985. Because it believes that it is important to ensure Bolivia's international competitiveness, the Government will adjust its reserves targets if sustained capital inflows during the program period indicate a bias toward currency appreciation.

(c) In the very short-term, the exchange rate policy of the Government will be guided by the behavior of the exchange rate in the parallel market. In recent months, the premium of the parallel exchange rate generally has been insignificant, turning on occasion into a small discount. To correct any incipient imbalances, the Central Bank will reduce the rate of foreign exchange sales through the auction market if the premium of the exchange rate in the parallel market--as measured by the moving average of the premia of the buying rates for either U.S. dollar checks or U.S. dollar currency notes for five consecutive business days--exceeds 5 percent. The reduction of foreign exchange sales must be sufficient to bring the official exchange rate to within 5 percent of the parallel market rate during the next five business days.

17. Bolivia's external trade system is virtually free of restrictions. Only the importation of sugar has been restricted but the Government intends to allow such imports in order to promote adjustment of the inefficient domestic sugar industry. The Government is determined not to yield to pressures for import restrictions and for revisions in, and exemptions from, the new customs tariff. On the contrary, it intends to reduce the few remaining exemptions further. The exchange system is free of restrictions subject to Article VIII of the Fund's Articles of Agreement except for arrears on certain external debt service payments (see paragraph 18 (a) below). The spreads resulting from (i) the operation of the auction market for foreign exchange, in which each successful bidder pays the price offered, and (ii) the operation of the parallel exchange market, in which the proceeds from nonmerchandise exports may be surrendered, have remained well below 2 percent in the recent past. However, a multiple currency practice could arise if either spread were to exceed 2 percent.

18. (a) The program outlined in the preceding paragraphs requires a substantial amount of foreign financing, both in the form of new lending or grants and the restructuring on generous terms of debt service in arrears and falling due within the program period. Part of this financing has already been obtained. The Paris Club agreed in July 1986 to restructure arrears and debt service falling due through mid-1987. The Government will return to the Paris Club around mid-1987 with a request to restructure debt service falling due in the period July 1987-June 1988. Official bilateral creditors not participating in the Paris Club and private suppliers without official guarantee have been asked to accept restructuring terms at least as favorable to Bolivia as those granted by the Paris Club. Efforts continue to reach an agreement with the consortium of foreign commercial banks on the restructuring of arrears and a small amount of unmatured principal. It is the Government's intention to eliminate all arrears to external creditors through restructuring or cash payments by early 1987 in accordance with the limits set forth in Table 4. No new arrears will be incurred thereafter.

(b) While the disbursement of new loans and grants has been slow, the rate of commitments has begun to improve, especially as far as multilateral development banks are concerned. The required financing for the investment program through the end of 1986 has been arranged. The Government is currently preparing sectoral investment plans for the period 1987-1991 for submission to a Consultative Group meeting that is scheduled to be held in late 1986 under the auspices of the World Bank. It is expected that pledges will be received at that meeting to secure the resources still required to finance the investment plan for 1987, especially in the latter part of the year. To prevent the undue burdening of the debt service profile in the medium-term, the Government has established quarterly limits on the increase during the program period of external public debt (including guaranteed debt) disbursed and outstanding with original maturities of more than one year and up to ten years. These limits are set forth in Table 5. Because of difficulties in the accounting system of the Central Bank, the Government has not been able yet to develop an effective reporting system to monitor the short-term external debt position of the public sector. The Government intends to put an effective reporting system into place by mid-1987, facilitated by the reform of the Central Bank's accounting system referred to in paragraph 15 above. Short-term public debt outside the Central Bank is believed to be very small, and the Government does not intend to seek an increase in such financing other than for external trade during the program period.

19. The Government's program for the period through the end of 1987 provides for a small increase in imports in real terms. However, because of the continued drop of exports, the improved flow of real resources to the economy will come at the expense of a further widening of the external current account deficit, from 8.6 percent of GDP in 1986 to 9.3 percent of GDP in 1987. Both imports and the current account deficit would be lower if the flow of external financing were to turn out to be smaller than expected. Nonetheless, the collapse of the international prices for tin and petroleum and the bleak outlook for metals prices in general make it imperative for the Government to pursue an active export promotion policy. The Government believes that maintenance of the current level of the exchange rate in real terms, the liberalization of domestic prices (including wage rates in the private sector), and the moderate level of import protection have created an atmosphere conducive to the growth and diversification of exports. Nevertheless, the Government will seek to promote exports further through the provision of export credit, competitive transportation costs, and the rebate of domestic indirect taxes and import duties paid. Investor confidence is likely to be strengthened by a new investment law currently under preparation and by the negotiation of foreign investment protection agreements with the United Kingdom, Germany, Japan, and possibly other countries that follow the pattern of the agreement reached in late 1985 with OPIC of the United States. Beyond the program period, the Government expects to ameliorate the difficult balance of payments outlook through the improvement of transportation infrastructure and the negotiation of alternative government-to-government contracts on the export of natural gas.

Table 1. Bolivia: Ceilings on the Borrowing Requirement of the Nonfinancial Public Sector 1/

(Cumulative amounts in trillions of Bolivian pesos from March 31, 1986)

Date	Limits
September 30, 1986	314.8
December 31, 1986	457.8
March 31, 1987	529.3
June 30, 1987 2/	661.5
September 30, 1987 2/	774.6
December 31, 1987 2/	966.7

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 nonfinancial state enterprises.

2/ Indicative limit.

Table 2. Bolivia: Ceiling on the Changes in Net Domestic Assets of the Central Bank of Bolivia and Subceiling on the Changes in the Net Position of the Nonfinancial Public Sector with the Central Bank of Bolivia

(Cumulative amounts in trillions of Bolivian pesos)

Time Period	Limits
1. Cumulative changes in net domestic assets of the Central Bank 1/	
March 31, 1986 - September 30, 1986 2/	198.9
March 31, 1986 - December 31, 1986 2/	35.3
March 31, 1986 - March 31, 1987 2/	61.7
March 31, 1986 - June 30, 1987 2/ 3/	63.3
March 31, 1986 - September 30, 1987 2/ 4/	96.7
March 31, 1986 - December 31, 1987 2/ 4/	113.2
2. Cumulative changes in the net position of the nonfinancial public sector with the Central Bank of Bolivia 5/	
March 31, 1986 - September 30, 1986 2/	71.4
March 31, 1986 - December 31, 1986 2/	-43.8
March 31, 1986 - March 31, 1987 2/	-41.4
March 31, 1986 - June 30, 1987 2/ 3/	-41.9
March 31, 1986 - September 30, 1987 2/ 4/	-48.6
March 31, 1986 - December 31, 1987 2/ 4/	-44.8

1/ Defined as the difference between the changes in currency issue and the changes in net international reserves.

2/ Accounting rates for cumulative changes:

March 31, 1986 - September 30, 1986	$b 2,181,333/US$1
March 31, 1986 - December 31, 1986	$b 1,975,270/US$1
March 31, 1986 - March 31, 1987	$b 2,059,596/US$1
March 31, 1986 - June 30, 1987	$b 2,074,422/US$1
March 31, 1986 - September 30, 1987	$b 2,089,355/US$1
March 31, 1986 - December 31, 1987	$b 2,107,893/US$1

3/ Indicative limit after June 18, 1987.

4/ Indicative limit.

5/ Excluding changes in the following frozen deposits: Fondo Nacional de Desarrollo and Fondo de Amortización de la Deuda Externa (FADE).

Table 3. 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 March 31, 1986)

Date	Limits
September 30, 1986	-70.9
December 31, 1986	13.6
March 31, 1987	6.1
June 30, 1987 2/	8.6
September 30, 1987 2/	1.1
December 31, 1987 2/	-4.9

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 purchases made under the Trust Fund.

2/ Indicative limit.

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

(In millions of U.S. dollars)

Date	Limits
September 30, 1986	6.1
December 31, 1986	0.7
March 31, 1987	0.0

1/ Arrears outstanding on external public and publicly guaranteed debt, excluding until December 30, 1986 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) private commercial banks.

Table 5. Bolivia: Limits on Increase in Public and Publicly Guaranteed External Debt 1/

(Cummulative amounts in millions of U.S. dollars)

Maturities of more than 1 year and up to 10 years 2/	Limits
March 31, 1986 - September 30, 1986	55
March 31, 1986 - December 31, 1986	20
March 31, 1986 - March 31, 1987	35
March 31, 1986 - June 30, 1987 3/	50
March 31, 1986 - September 30, 1987 3/	75
March 31, 1986 - December 31, 1987 3/	100

1/ Excludes (a) changes in those liabilities of the Central Bank of Bolivia with an original maturity of more than one year defined in Table 3 as part of net international reserves, (b) the refinancing of reserve liabilities as medium- and long-term debt, and (c) the restructuring of debt service obligations of the public sector.
2/ Including debt with unknown original maturity.
3/ Indicative limit.

Bolivia--Structural Adjustment Facility--
Three-year and First Annual Arrangements

Attached hereto are (i) a letter, with an annexed Policy Framework Paper and a Memorandum on Economic Policy and Financial Policies in the Period January 1, 1987-December 31, 1989, dated November 21, 1986 from the Minister of Planning and Coordination, the Minister of Finance, and the President of the Central Bank of Bolivia, requesting from the Fund a three-year structural adjustment arrangement and the first annual arrangement thereunder, and (ii) a Memorandum of Understanding on Economic Policy Through the End of 1987, 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 International Monetary Fund grants the requested arrangements in accordance with the following provisions and subject to the Regulations for the administration of the Structural Adjustment Facility:

1. For a period of three years from -----------, 1986 Bolivia will have the right to obtain three successive loans from the Fund under the Structural Adjustment Facility in a total amount equivalent to SDR 42.629 million.

2. The first loan, in an amount equivalent to SDR 18.14 million, is available for disbursement at the request of Bolivia.

3. The second and third loans will be available upon approval by the Fund of the corresponding annual arrangements and will be disbursed at the request of Bolivia. The amount of the second loan will be equivalent to SDR 12.245 million, and the amount of the third loan will be equivalent to SDR 12.244 million.

4. 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 10, 11, 15(b), 15(c), 18(a) and 18(b) of the Memorandum of Understanding on Economic Policy Through the End of 1987 and in Tables 1-5 attached thereto,

(b) progress in implementing the policies indicated in paragraphs 4(c), 6(b), and 8, respectively, of the Memorandum of Understanding on Economic Policy Through the End of 1987, with regard to the tax reform, the public sector investment program, and the reorganization of the state mining company (COMIBOL),

(c) imposition or intensification of restrictions on payments and transfers for current international transactions,

(d) introduction or modification of multiple currency practices,

(e) conclusion of bilateral payments agreements which are inconsistent with Article VIII,

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

5. 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 the first annual arrangement.

6. In accordance with paragraph 4 of the attached letter, Bolivia will discuss with the Fund and reach suitable understandings on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director requests such discussions because he considers that discussions on the program are desirable. These discussions may include correspondence and visits of officials of the Fund to Bolivia or of representatives of Bolivia to the Fund.

Bolivia - Letter of Transmittal, Request for a Three-Year Arrangement Under the Structural Adjustment Facility and the First Annual Arrangement Thereunder

La Paz, Bolivia
November 21, 1986

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosiere:

1. The attached Medium-Term Economic and Financial Policy Framework, 1987-89 (the Policy Framework Paper) has been prepared in collaboration with the staffs of the Fund and the World Bank. It describes the major economic problems and challenges facing Bolivia; the objectives of a three-year medium-term program; the priorities and the broad thrust of macroeconomic and structural adjustment policies; and the likely external financing requirements, together with the available sources of such financing.

The Government of Bolivia will remain in close contact with the staffs of the Fund and the World Bank on developments and progress in implementing these policies, and the Policy Framework Paper will be updated annually as the program is implemented.

2. The attached Memorandum on Economic and Financial Policies in the Period January 1, 1987-December 31, 1989 pursuant to the policy framework described above sets out the objectives and policies that the Government of Bolivia intends to pursue for the period January 1, 1987 to December 31, 1989, and the objectives and policies for the first year of the three-year program, for which balance of payments assistance is needed. In support of these objectives and policies, Bolivia hereby requests from the Fund a three-year structural adjustment arrangement in the amount that will be available to Bolivia under the Fund's Structural Adjustment Facility, and the first annual arrangement thereunder.

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

4. The Government believes that the policies set forth in the attached Memorandum on Economic and Financial Policies in the Period January 1, 1987-December 31, 1989 are adequate to achieve the objectives of its program but will take any further measures that may become appropriate for this purpose. Bolivia will discuss with the Fund and reach suitable understandings on the adoption of any measures that may be appropriate, at the initiative of the Government of Bolivia or whenever the Managing Director requests such discussions.

Yours sincerely,

Gonzalo Sánchez de Lozada
Minister of Planning
and Coordination

Juan Cariaga
Minister of Finance

Javier Nogales
President
Central Bank of Bolivia

Attachments: Medium-Term Economic and Financial Policy Framework, 1987-89.
Memorandum on Economic and Financial Policies in the Period January 1 1987-December 31, 1989.

Bolivia

Medium-Term Economic and Financial Policy Framework, 1987-89

I. Introduction

1. The Government of President Paz Estenssoro, which took office in August 1985, faced a country in acute economic crisis. Real GDP was contracting for the fifth consecutive year, shortages were widespread, and the annual rate of inflation exceeded 20,000 percent. The external payments situation was characterized by extreme currency overvaluation, the virtual depletion of usable international reserves, and the rapid accumulation of external payments arrears. The new Government initiated a far-ranging stabilization and adjustment program in late August 1985, termed the New Economic Policy and embodied in Supreme Decree No. 21060. The primary objectives of the comprehensive and coherent program were to reduce inflation rapidly, to restore external balance, and to lay the foundations for a sustained economic recovery. Centered on a sharp reduction of the deficit of the nonfinancial public sector, the program was designed to accomplish stabilization and adjustment with minimal controls, reducing the state's role and encouraging a free market economy. While the stabilization program has met with substantial success, the serious reverse in export prices has forced the economy into a still deeper recession.

2. The Government inherited an economy that presents particular development challenges. Bolivia is one of the poorest countries in Latin America and per capita income has declined sharply in recent years (by about a third in the period 1980-86). Bolivia's landlocked position and mountainous terrain render transport costs high and access difficult. Both internal communications and links to neighboring countries are poorly developed. The population density is rather low with about 6 1/2 million inhabitants living within an area of 1.1 million square kilometers but population growth is high (some 2.8 percent a year). About one-half of the economically active population is employed in agriculture, but primarily on the highlands of the altiplano where subsistence farming predominates and potential for growth is limited. The vast, sparsely populated lowlands have good potential for agricultural production, but difficult access, lack of infrastructure, and a poor policy environment have dampened development and growth in the past. The mountains are rich in minerals but the major product--tin--has poor prospects and there has been insufficient exploratory work to exploit other minerals in the short term. Bolivia has important hydrocarbon resources, especially natural gas, but export prospects are uncertain because neighboring countries also have deposits which are being developed. The manufacturing sector is small and dominated by a few agro-industrial enterprises. The sharp increase in coca leaf production and processing during the 1980s has altered the structure of the economy, favoring the development of illicit activities and giving rise to domestic social problems. Recently, however, the

Government has taken vigorous action to eradicate the illicit production of coca.

3. Buoyant commodity prices and relative political stability provided easy access to foreign financing in the 1970s. Gross investment increased to more than 20 percent of GDP in the middle of the decade. The growth of investment reflected primarily large-scale public investment projects, many highly questionable. Investment declined in the late 1970s but private and public savings declined more rapidly, thus leading to increased recourse to external financing (including an increasing share of commercial bank lending). The result was a rapidly mounting external debt. By the early 1980s, severe internal and external imbalances had become apparent. Real GDP began to contract and investment and national savings declined. External financing sources dried up, and net international reserves became depleted. A major cause of the mounting problems was a sharp drop in tax collections, from 9 percent of GDP in 1981 to 3 percent of GDP in 1984 in the Central Administration. Public sector finances deteriorated rapidly; the overall deficit of the nonfinancial public sector widened from 8 percent of GDP in 1981 to 28 percent of GDP in 1984. The increasing reliance on domestic credit expansion to finance this deficit fueled inflation, which ran at almost 24,000 percent in the 12 months ended in September 1985. Bolivia's external public medium- and long-term debt increased to about US$3.2 billion at the end of 1984, equivalent to close to four-and-one-half times merchandise exports. Servicing the external debt had become a serious problem by 1982 and external payments arrears amounted to about US$1 billion when the new Government took office. Maintenance of a fixed exchange rate led to a sharp overvaluation of the peso and a very wide (20 times at one point) gap between official and parallel market rates. This led to massive misallocation of resources and stifled export growth.

4. Behind the very poor economic performance of the early 1980s lay deep-seated structural problems. Of primary importance were the increased role of the state and its declining effectiveness. After the 1952 revolution, the share of Government in the economy assumed large proportions. Numerous state enterprises, active in many fields including mining, manufacturing, and transport, operated in a confused policy environment without controls or support. Most have declined steadily in efficiency over the past decade. Frequent changes of Governments exacerbated uncertainties about the overall policy framework, organization, and procedures. Public sector management was exceptionally weak. These problems accounted in large measure for declining Government revenues, uncontrolled current expenditures, and poor investment project selection and implementation performance. Developments in the financial system were characterized by a decreasing level of resource mobilization, a distorted credit allocation to finance the public sector, growing solvency problems of the commercial banks, and the increasing decapitalization of the state banks. The environment for private investment has long been poor, and the private sector has focussed on trading and other short-term activities. Capital flight has

been substantial and capacity has been underutilized by widening margins.

5. A fundamental issue for Bolivia's future is the need to bring about a profound change in the structure of exports. The vulnerability of Bolivia's exports has been apparent for some time, but there have been sharp reverses over the past year which call for special efforts to diversify exports over the medium term. In 1985, natural gas and tin accounted for more than 80 percent of total export earnings. Earnings from cocaine-related activities are not known with certainty but until recently may have reached or even exceeded total legal export earnings. The world tin market collapsed in late 1985 and Bolivia, a high cost producer, needs to cut back production sharply. Natural gas is exported to Argentina but the Government-to-Government contract expires in 1992 and its renewal is uncertain because Argentina has vast natural gas reserves of its own. Contract prices, which are negotiated periodically, were substantially reduced in 1986 and payment for about two-thirds of shipments to Argentina is now made in kind. Gas exports to Brazil may prove feasible but an agreement must be negotiated and large investments must be made in a pipeline and other infrastructure. The Government has decided that firm action to stop coca leaf production and processing is vital both to preserve Bolivia's own political and social fabric and its international standing. Initial actions to curtail processing have already resulted in sharp price declines for coca leaves and lower unofficial export earnings. A major shift to new exports is thus essential.

6. The Government's stabilization program is far-ranging and has been carried out with vigor over the past year. The key actions have included the maintenance of a competitive exchange rate (effected through daily public auctions) after a large initial depreciation, which has brought the gap between official and parallel market rates close to zero; very tight fiscal and monetary management, which has sharply reduced the nonfinancial public sector deficit; passage by Congress in May 1986 of a tax reform bill, which overhauls the tax system; the virtually complete freeing of prices and substantial increases in prices of goods and services provided by the public sector; and sweeping trade and payments liberalization including, in August 1986, introduction of a virtually uniform import tariff of 20 percent. Employers in the public and private sectors were permitted to dismiss workers, and in the public sector a hiring freeze was imposed and public sector wages were frozen for six months; thereafter an increase of only 10 percent was granted. All this was accomplished without controls on wages or prices outside the public sector, and in an environment of intense pressure on the Government to relax its tight policies. Bolivia has advanced in addressing the problems of its external debt. In June 1986 the Paris Club agreed on a rescheduling of some US$400 million in bilateral debt on generous terms. Several meetings have taken place with the commercial banks and progress is being made in defining options for addressing what is clearly a very difficult problem in view of the large debt and high arrears. Although the Government recognizes its external

obligations, Bolivia's current economic situation does not permit the full servicing of this debt. The Government has also taken some important steps to address broader structural problems, notably by starting a restructuring of the state mining company (COMIBOL) which has already entailed layoffs of some 10,000 miners. In sum, the record of the Government's first year in office has been extraordinary.

7. Bolivia is working closely with the IMF and the World Bank in its stabilization, adjustment, and development program. The Fund approved a one-year stand-by arrangement in an amount of SDR 50 million on June 19, 1986, to support a program focused on stabilizing the economy through tight fiscal management and maintenance of a flexible exchange rate. Bolivia has met its performance targets to date except for the limit on external payments arrears, which was exceeded by a small amount. A waiver for the nonobservance of this performance criterion was given and the purchases available so far under the arrangement have been made. The World Bank Group approved an IDA credit for SDR 49 million in May 1986 to finance emergency imports for reconstruction and an SDR 13 million credit in June 1986 for a gas recycling project. Work is underway to prepare a meeting of the Bolivia Consultative Group in December 1986, designed to mobilize resources in support of the medium-term program and enhance aid coordination.

II. Medium-Term Economic Framework

8. The structural adjustment program that Bolivia will be implementing in the period 1987-89 will consolidate the stabilization effort undertaken since late 1985 and shift the thrust of economic policies toward the achievement of a sustainable rate of growth in a setting of restored economic and financial solvency. The program also addresses the need to monitor the social impact of the adjustment and restructuring process and to strengthen social services. To this end, the program will seek to achieve export diversification within the context of higher domestic savings, regained price stability, and balance of payments viability. The authorities are creating conditions for the private sector to play a more prominent role in the economy through increased private savings and investment. Apart from a few clearly delineated productive activities, the role of the state will be limited to the management of the economy and the provision of essential social services. The efficiency of the public sector will be improved by implementing better management in the General Government and the enterprises, with investment focused on economic growth and current spending rationalized in an effort to make room for social expenditure to create employment and provide adequate health and education services. Policies will be aimed at reducing Bolivia's dependence on traditional exports and encouraging the growth of new exports, particularly in agriculture and mining other than tin.

9. The Government has discussed the macro-economic scenario attached to the medium-term program with the staffs of the Fund and the Bank. The projections for 1987-89 are considered reasonable. The principal

economic and financial objectives for the three-year period are (i) real GDP growth of about 3 1/2 percent a year (compared with annual population growth of 2.8 percent), mainly as a result of a rebound of economic activity and growth in sectors such as agriculture and mining other than tin; (ii) the reduction of consumer price increases from 65 percent in 1986 to about 5 percent in 1989; and (iii) overall balance of payments equilibrium, with a small loss of net official international reserves in 1987 about offset by a gain of similar magnitude in 1989. The Government will limit the current account deficit of the balance of payments to the availability of concessional financing, including the restructuring of maturing debt on concessional terms. The Government believes that annual current account deficits (after official transfers) of about US$375 million can be financed in this way. This would imply the gradual reduction of these deficits in relation to GDP from about 9 1/2 percent in 1987 to less than 8 percent in 1989. External public debt, although rising from US$3.7 billion at the end of 1986 to US$4.7 billion at the end of 1989, would remain at about 100 percent of GDP, but debt restructuring and more favorable terms on new loans would mean that debt service (including all payments to the Fund) would decline in relation to exports of goods and nonfactor services from about 108 percent in 1986 (before debt restructuring) to about 78 percent in 1989. (After debt restructuring, the debt service ratio for 1986 would amount to about 65 percent). If the repatriation of private capital continues during the program period, productive domestic investment and imports may be higher than is implied by the above mentioned current account projections. On current indications, net concessional flows from abroad are likely to be sufficient to finance deficits of the nonfinancial public sector of 6.1 percent of GDP in 1987 and of 5 1/2 percent of GDP in 1988 and 1989. Such deficits, however, will be reduced should concessional financing prove to be lower. For 1988 and 1989, the Government will discuss with the Fund in the context of formulation of annual programs policies to increase public sector savings and lower the deficits further with a view of channeling additional resources to the rest of the economy. Efficiency in the use of concessional resources will be critical for the growth-oriented adjustment effort. Therefore, the Government and the World Bank will collaborate to ensure that the concessional flows obtained are used efficiently in the priority areas outlined in paragraphs 19-22 below. Progress in this area will be reviewed annually with the staffs of the Fund and the Bank in connection with the updates of the policy framework, with the Fund in connection with the annual programs, and with the Bank in connection with its lending program.

10. Although the current macro-economic projections indicate a viable external financing scenario through the end of the present decade, assuming adequate concessional financing is available, they also suggest that the situation in the 1990s will continue to be difficult. Starting in 1990, when the grace period on debt restructured under the terms of the 1986 Paris Club agreement expires and when large repurchases to the Fund fall due, and in 1992, when the natural gas export contract with Argentina expires, Bolivia's external financial situation may worsen.

The current economic program will, however, provide a strong basis for overcoming these projected difficulties, and the Government intends, through its programming of public investment, to take these long-term problems into account. However, it must be recognized that the problems the Bolivian economy faces are of such magnitude that they will not be fully resolved within the period of the current three-year program.

11. Most of the fundamental decisions and measures associated with the opening of the economy to market forces were taken in late 1985 and during 1986. They need to be implemented with determination during the program period and supplemented with other measures that, for technical or political reasons, require more time to elaborate and put into effect. Although prices were freed in late August 1985 and major institutional reforms have been initiated since then, the productive structure of the Bolivian economy still reflects the distortions of many years of resource misallocation. Consequently, relative prices are likely to adapt further during the three-year period, as important structural measures will be implemented and the economy continues to adjust to a new but stable framework of rules and regulations. In guiding the Bolivian economy through this liberalization process, the authorities intend to continue and strengthen further the following policies: (i) the pursuit of a flexible exchange rate policy, (ii) the maintenance of a liberal external trade and payments system with a moderate, uniform level of tariff protection and a nondistortionary export promotion system, (iii) improved public investment planning and project execution capacity, (iv) the provision of incentives for private investment, (v) specific sectoral policies, (vi) improvements in the public finances, especially through the implementation of the recently approved tax reform, (vii) reorganization and decentralization of the state enterprises, and (viii) institutional reform of the financial system and the increase in domestic resource mobilization. A more detailed description of the policies to be pursued, their likely social impact, and the external financing requirements during the program period is provided in the following sections.

a. External sector policies

12. Under the program, the authorities will continue to pursue a flexible exchange rate policy. The official exchange rate will be determined by means of foreign exchange auctions conducted frequently by the Central Bank, and the authorities are committed to provide free access to the auction market to the private sector and to the public sector up to the amounts budgeted. Net purchases of foreign exchange by the Central Bank after the initiation of the stabilization effort in late August 1985 have raised its international reserves to a comfortable level. The balance of payments target mentioned above implies that there will be no more net foreign exchange sales by the Central Bank after 1987.

13. The authorities will keep the external trade and payments system free of restrictions during the program period. Mindful that a differentiated customs tariff is difficult to administer in Bolivia's circumstances, that a high tariff would lead to wide-spread contraband, and that the country's land-locked position already provides a natural protection against imports from overseas, the authorities will maintain the customs tariff at the recently introduced uniform rate of 20 percent ad valorem. The few remaining duty exemptions will be reduced further while exporters will benefit from a rebate of customs duties and other indirect taxes at a moderate, uniform rate. Export activities will be further encouraged by the provision of unsubsidized pre- and post-shipment financing intermediated through the commercial banks. Also, export procedures will be streamlined and no quotas or prohibitions will be imposed for the benefit of the domestic market. Compliance with the foreign trade regulations, including the payment of import duties, will be facilitated by the retention of the services of a foreign inspection company. Finally, exports should benefit from more competitive freight rates and from the improvements in transportation infrastructure mentioned in paragraph 22 below. While these policies and a competitive exchange rate should go a long way toward assuring the sustained growth and diversification of exports, the Government will examine whether additional infrastructure development support measures, expecially to facilitate exports, and other promotion measures that do not involve subsidies will be required. As mentioned in greater detail in paragraphs 19-22 below, the most promising areas for export growth are agricultural products (especially soybeans and quinua, a high-protein grain), metals other than tin (especially gold, silver, zinc, and lithium), and natural gas sales to Brazil.

14. During the program period, the Government intends to move toward restoring Bolivia's international creditworthiness by regularizing relations with external creditors. The Government will limit new medium- and long-term foreign borrowing to concessional sources (see paragraph 16 below). It also is aware of the need to seek debt relief during the program period. The Paris Club has already agreed to restructure debt service falling due until mid-1987 and expressed its readiness to consider granting further debt relief for the one-year period thereafter. The Government intends to renegotiate in mid-1987 the maturities falling due in the period July 1, 1987-June 30, 1988 and to return to the Paris Club in mid-1988 and mid-1989 for further one-year debt restructurings. Also, Bolivia will need to restructure its arrears and some as yet unmatured debt to foreign commercial banks. Bolivia does not intend to seek cash loans from foreign banks during the program period. With the progressive conclusion and implementation of bilateral agreements under the terms of the 1986 Paris Club agreement and the improvement of relations with the commercial banks, Bolivia has made important progress toward the restoration of orderly relations with its foreign creditors. The external debt monitoring and control system will be further improved with technical assistance from the Fund and extended by mid-1987 to cover short-term public debt.

b. Policies to improve public sector management and the efficiency of resource allocation

15. The authorities, with assistance from the World Bank, will continue to improve the efficiency of public sector management during the program period. The number of civil servants and of employees in the state enterprises will be reduced further while higher pay scales will be introduced to recruit and retain highly qualified specialists and top-level managers. A number of public sector entities and enterprises will be reorganized, including the Ministry of Finance, the Ministry of Planning and Coordination, the Central Bank (see paragraph 25 below), the state mining and petroleum companies (see paragraphs 20 and 21 below), the state railway company (ENFE), the state electricity company (ENDE), and the municipalities. Efforts will be undertaken to ensure that social services, such as education and health, are well targeted and efficiently delivered. The authorities do not plan to extend public sector activity into new areas; instead, they will reduce employment and close unproductive enterprises, especially in the mining sector. Also, some of the retailing and distribution functions of the state petroleum company will be transferred to the private sector. All efforts will be made to improve efficiency to internationally comparable levels. Until that time, prices will be set to cover operating costs and the local counterpart requirements of investment projects. The ultimate objective is to charge long-run marginal costs with economically efficient enterprises. The authorities will pay particular attention to maintaining the prices of petroleum products, utilities and transportation at levels that are compatible with these objectives. All efforts will be undertaken to raise the quality of enterprise management. Sound procedures will be established for budgeting and financial control. Taking into account the recently established centralized units for the monitoring and control of budget execution and cash flow, an emergency program will be launched to update accounts and establish basic financial control systems in the major public sector entities. The Government plans to rely on external technical assistance in its institution building effort and to ensure that such assistance is well coordinated.

16. The public investment program for 1987-89, which is still being formulated with technical assistance from the World Bank, will foresee the execution of projects equivalent to 7-8 percent of GDP a year. The projects will focus on rehabilitation and expansion in the agriculture, mining, energy, and transport sectors (see paragraphs 19-22 below). They will generally be export oriented and have short gestation periods and high rates of return. Criteria for project selection are being established and include completing viable projects which are well advanced, financing programs which promote exports and rebuild infrastructure, and financing key social services. Existing loan commitments and ongoing projects are being examined to ensure that priority activities are implemented; where necessary, previously committed funds will be reallocated and projects will be redesigned to achieve the priority objectives. To raise implementation capacity, the

Government is removing constraints on the basis of advice from the World Bank. Medium- and long-term borrowing on commercial terms is not envisaged. External financing on concessional terms is expected to be arranged with the aid of a Consultative Group meeting that will convene in December 1986 and regularly thereafter under the sponsorship of the World Bank. The local financing requirements are envisaged to remain around one-fifth of aggregate investment value. The three-year investment program will be implemented in annual tranches, which will be formulated on the basis of updated estimates of concessional resource inflows and of the budgetary local currency contribution that is compatible with the agreed fiscal objectives (see paragraph 24 below). The three-year program will be updated annually in a rolling programming exercise. Pending the completion of a three-year investment budget, the Government has established a "core" investment program. The World Bank will continue to support the Bolivian planning authorities (the Ministry of Planning and Coordination and UDAPE, a U.S. AID-sponsored research group) and assist the executing agencies in order to facilitate project execution.

17. The authorities are determined to give private investment broader room than in the past. The freeing of prices in the economy, the return to collective bargaining in the private sector coupled with the repeal of employment stability regulations, and the removal of exclusive exploration and exploitation rights for the public sector in the areas of hydrocarbons and mining are important in this respect, as are the lifting of exchange restrictions on profit remittances abroad and the guarantees to foreign investment under recently concluded bilateral and multilateral agreements. A new investment code is under preparation and administrative and procedural requirements to obtain approvals will be simplified. The stance of fiscal policy will ensure the availability of domestic credit to the private sector. The authorities do not intend to provide subsidies to the private sector, but they intend to rely more heavily on the private sector and they are prepared to consider possible joint ventures with the private sector, especially in certain sectors with high growth potential such as mining, hydrocarbons, and agriculture. Private investment will benefit from public investment in infrastructure, the financial sector reform (see paragraph 25 below), and the maintenance of a stable regulatory framework.

c. Sectoral policies

18. The structural adjustment of the Bolivian economy requires the formulation and implementation of coherent sectoral policies. The priority sectors for recovery and growth have been identified as agriculture, mining, energy, and transportation. Policy statements covering these and other sectors are being discussed with the World Bank staff. The Planning Ministry will continue to refine and update these sectoral policies during the 1987-89 period, seeking the advice and cooperation of other Ministries, the World Bank, and other multilateral development banks. Within the budgetary constraints, the Government

also will finalize preparation of social action programs in 1987 to address basic social needs during the program period.

19. The primary objectives in agriculture are the expansion of domestic production for export and efficient import substitution. This will require an expansion of production in the lowlands both for exports and local consumption, especially in the region of Santa Cruz. In addition, support will be given to promising export commodities, such as soybeans and quinua. Imports of wheat should be declining once the import duty exemption for wheat lapses in 1987. Two further objectives of agricultural policy are (i) to support unemployed miners and farm workers interested in shifting to agriculture through land grants and service programs and (ii) to encourage alternative crops in the key coca growing areas. The complementary needs for appropriate transport infrastructure (including storage and loading facilities) and greater credit availability are taken into consideration in the policies described in paragraphs 22 and 25-27 below. Agricultural policy also will include the identification and preparation of development programs, monitoring of development and action to remove production bottlenecks, and the rebuilding of agricultural research and extension services. During the program period, the Government intends to prepare a strategy for handling environmental issues, with priority to reforestation and prevention of indiscriminate forest destruction in the tropical lowlands.

20. The objectives in mining are to support a restructuring from public sector mining to private mining (including cooperative forms of production) and from tin mining to other minerals with more promising market prospects. This requires a sharp reduction of the size of COMIBOL, the redefinition of its objectives and operating policies, and its reorganization. The Government has already announced its policy in this regard and begun to implement it by retiring and laying off workers and closing down the most unprofitable mines. The Government continues to study the possibility of offering many of COMIBOL's mines to their workers as cooperatives while retaining the most promising mines and smelting facilities and developing them to enhance their profitability. Private mines will receive support and encouragement through the full implementation of the mining tax, as reformed in late August 1985, and the mining code and the investment law that are currently being revised. Private mines also will benefit from the permission to operate in areas previously reserved for exclusive exploration and exploitation by COMIBOL and the armed forces' development corporation (COFADENA).

21. The primary objectives in the energy sector are (i) the development of domestic and foreign markets for natural gas to lessen the dependence on Argentina as the dominant buyer, and (ii) the increase in the production of crude petroleum, in which Bolivia currently is barely self-sufficient. The domestic use of natural gas will be increased following completion of a gas pipeline to the altiplano, which is under construction with financial support from the Inter-American Development

Bank. Discussions are underway with Brazil on proposed gas sales and the construction of a pipeline. The World Bank will finance during the program period much of the work (including analysis of options, project preparation, and negotiations) required to advance this project. The Government hopes to start implementation of this project during the program period with financial assistance from the World Bank and other external lenders. Petroleum output will increase after the completion of the gas recycling project at Vuelta Grande, which is underway with financial support from the World Bank, and after the conclusion of satisfactory arrangements with foreign petroleum companies that have shown interest in prospection and development. The announced reorganization of the state petroleum company (YPFB) will be completed during the program period with technical and financial assistance from the World Bank. Some of the company's distribution and retailing operations will be transferred to the private sector and its domestic pricing policy will support the attainment of a small exportable surplus (see paragraph 15 above). The Government is negotiating with two foreign petroleum companies operating in Bolivia in an effort to arrive at mutually satisfactory arrangements for the settlement of past and future purchases of their output by the state petroleum company. Private investment in the petroleum sector will be encouraged. Finally, measures will be taken to reinforce the state electricity company (ENDE) and prepare future investment in electricity generation, transmission and distribution. In this respect, the linking of the local system in Santa Cruz with the national transmission and distribution network has high priority.

22. The objectives of transport policy are to rehabilitate, modernize, and expand the road and railway system to support export growth and facilitate internal communications. In developing and maintaining the transport links needed for exports, priority will be given to improve the Santa Cruz-Corumba railroad, river transportation to the River Plate, and rail and road links to Chile and Peru. Major road reconstruction and maintenance works are needed in the altiplano and the adjoining valleys, which also would alleviate the unemployment problems in the mining areas. A new and expanded road maintenance program will be prepared and initiated. A comprehensive transport sector plan will be prepared and the investment and maintenance program for the period 1988-92 will be established. Policy measures to support the sector will include further deregulation of the trucking industry and private rights to use certain rail lines.

d. Fiscal policy

23. The full implementation of the tax reform is crucial for the progressive reduction of the deficit of the nonfinancial public sector and for the achievement of a domestic financing surplus after the first program year, especially in view of reduced tax revenue from exports of hydrocarbons and metals. Tax implementation guidelines are being prepared with technical assistance from the Inter-American Development Bank and the United Nations. It is expected that most of them will be

issued before the end of 1986. While public sector revenue will continue to be heavily dependent on the hydrocarbon sector, the Central Administration and the regional and local bodies, which will share the revenue of the new taxes, will benefit increasingly from the implementation of the tax reform package. The corporate net worth tax and the complementary income tax will be implemented by early 1987. All other taxes--the value added tax, the general transactions tax, the ad valorem excise taxes, and the taxes on property values--will be implemented in the course of 1987. The Government expects that general government revenue will increase steadily each year during the program period to about 20 percent of GDP in 1989. At the same time, the savings of the state enterprises are expected to reach about 1 percent of GDP in 1989.

24. Following the sharp cut in general government expenditure since late 1985, the authorities will make every effort to limit expenditure during 1987-89. While investment spending will be planned and executed in line with the principles governing the public sector investment program, wage policy will continue to be tight and an effort will be made to reduce further the level of public sector employment. Although there is no room for across-the-board real wage increases, the authorities intend to offer competitive salaries to a small number of specialists and high-level managers to improve the quality of decision making and administration. Subsidies have been eliminated and no new subsidies will be introduced. However, the Government intends to provide room in its budgets for the types of social expenditure referred to in paragraphs 28-30 below. The Government expects that total spending of the General Government (including investment) will rise less rapidly than its revenue during the program period, so as to reach a level of about 22 1/2 percent of GDP in 1989. At the same time, investment spending by the state enterprises is expected to increase each year to about 4 percent of GDP in 1989. All expenditure will be authorized on the basis of congressionally approved annual budgets. A special effort will be made to reduce public sector arrears during the program period. As experience is gained with the design and execution of the budget, the authorities will strengthen their budgetary procedures. In particular, procedures to control budget execution and cash flow are expected to be improved, in part as a result of the operation of the two control units recently established with technical assistance from the Fund.

e. Financial sector policies

25. Institutional and policy reforms in the financial sector will reduce the role of the Central Bank in the resource allocation process and enhance the role of private financial intermediaries. The Government intends to submit to Congress a new banking law in order to create a coherent set of regulations for the financial sector. Institutional reforms to be introduced during the program period include (i) the creation of an effective superintendency of banks, (ii) the cessation of central bank approval of individual development loans,

(iii) the reform of the two largest state banks, the Banco del Estado and the Banco Agricola, and (iv) the possible creation of a national securities exchange. As part of a broader effort to develop an integrated public sector accounting system, the Central Bank also will rebuild its internal accounting system with technical assistance from the World Bank and the Fund. Finally, the authorities will introduce a new currency at the start of 1987 to simplify accounting and transactions and strengthen confidence in their new economic policy.

26. To improve domestic resource mobilization and prevent capital flight, interest rate determination will continue to be left to market forces. The development of an interbank money market with Central Bank support will make competition among banks more efficient and eliminate interest rate differentials. As part of the new banking law, banks would be permitted to issue bearer certificates of deposit to encourage domestic financial savings. Competition among the banks and the continued expansion of domestic financial assets are likely to reduce further the spread between deposit and lending rates. Given the large number of banks operating in Bolivia, the authorities are taking a positive attitude toward bank mergers, which may lead to a further reduction in spreads via cost reduction and efficiency gains. Specific measures will be introduced to rehabilitate the banking system. These measures would induce, over the medium term, the consolidation of the system in order to permit lower intermediation costs, minimize distress borrowing by insolvent borrowers, improve the solvency of the financial system, and ultimately to allow an increased volume of credit operations to meet the financing needs of the productive sectors.

27. To achieve their price level and balance of payments objectives, the authorities will follow a cautious credit policy. Sufficient room for the expansion of credit to the private sector in real terms will be assured by the elimination of net credit expansion to the nonfinancial public sector in the first program year and the net accumulation of deposits by that sector in the following two years.

f. Social impact

28. The economic crisis has had a substantial negative impact on the social welfare of the Bolivian population. In particular, the deterioration of prices of Bolivian exports in the international market has had a negative impact on employment, most immediately for the miners. Services for low income groups, including both the rural and urban population, for example health care and education, have long been inadequate. The Government will have limited resources to alleviate these social problems over the program period. Nevertheless, it intends to take appropriate compensatory measures where possible to ease the dislocation of the most affected low income groups. In the medium term, the program is designed to improve living standards for all Bolivians. The macroeconomic framework, which provides for the resumption of broad-based economic growth through an improved incentive system, should increase employment and incomes for all groups. Examples for this

beneficial effect are the increased public and private investment and the freeing of agricultural prices that has benefited the large number of small farmers. The tax reform should establish the basis for a more equitable sharing of social costs and provide more resources for social services. Further, within the overall budgetary constraint, the Government plans emergency programs to address directly the problems of unemployment and will embark on a program to rebuild social services.

29. The actual and planned closing of tin and other mines is putting large numbers of miners out of work. There are virtually no alternative sources of employment in the mining centers and unemployment in the urban areas is already very high. Further, the legacy of economic problems and the deepening recession have led to migration to the cities. Floods in the altiplano disrupted production and supply patterns in early 1986. These problems must be addressed if the Government is to succeed in its program and, therefore, a series of emergency measures are planned in cooperation with the World Bank to: (i) address unemployment problems through a targeted works program and job creation efforts; and (ii) organize targeted relief efforts, particularly in urban areas. Efficiency and sustainable implementation procedures will be principal criteria in the design of these programs.

30. The Government intends to improve the delivery of basic social services, notably education and health. Beyond the targeted programs outlined above, the Government plans to monitor the poverty impact of the economic crisis to facilitate timely intervention in appropriate instances. During the program period social action programs for each social ministry and agency will be drawn up aiming at improved efficiency, better focus on the poorest segments of the population, and assuring adequate budget allocations. The Government will enlist external support in this effort, including the World Bank, the Inter-American Development Bank, U.S.-AID, and nongovernmental organizations.

III. External Assistance Requirements

31. The balance of payments outlook during the program period is being adversely affected by sharp deteriorations of the terms of trade in 1986 and 1987 and the need to raise imports, especially for investment, after many years of economic decline. Following another reduction to about US$590 million in 1987, the value of exports of goods and nonfactor services is projected to recover to about US$700 million in 1989. At the same time, the enhanced flow of external financing will permit imports of goods and nonfactor services to continue their expansion. Historical relationships and cross country experience would suggest that a growth of GDP of 3 1/2 percent, as is envisaged for 1987-89, is likely to involve a level of imports higher than presently identified external financing prospects would provide for. Thus the attainment of the growth target will require increased efficiency in the use of imports. Other critical determinants of Bolivia's balance of payments outlook will be the scope and terms of debt restructuring expected, particularly with regard to commercial banks and Paris Club debt. Assuming a

restructuring of debt obligations--and in particular an interest rate of 4.5 percent of debt to foreign commercial banks--the current account deficit, after transfers, would average US$375 million over the 1987-89 period; if interest due on the external bank debt were accrued at market rates, then the current account deficit would be higher.

32. While the Government expects that the policy framework described above will lead to a more rapid growth of exports, the present export projections, which call for a resumption of growth in value terms in 1988 after six consecutive years of decline, are based on the following conservative assumptions: a continued decline in tin exports, from 13,000 tons in 1986 to 8,500 tons in 1989; a slow recovery of world metals prices; another reduction in natural gas prices; and constancy of gas export volumes. In addition, based on previous performance of the agriculture sector, strong growth of nontraditional exports (including soybeans, tropical fruits, coffee, cocoa, and quinua) is expected, raising such exports to about one-fifth of overall exports in 1989.

33. During the program period the gross external financing requirement, consisting of the external current account deficit plus amortization falling due on the external public debt, declines from about US$685 million in 1987 to about US$580 million in 1989. After a modest increase in net inflows of foreign investment and short-term capital from US$35 million in 1987 to US$60 million in 1989 and a shift from a reserve loss of US$19 million in 1987 to a reserve gain of US$15 million in 1989, and assuming new loan disbursements on concessional terms of US$320-US$330 million a year, approximate residual financing requirements remain of US$315 million in 1987, US$250 million in 1988, and US$200 million in 1989. These financing requirements could be met by annual debt restructuring from official bilateral creditors and the refinancing of maturing principal of foreign bank loans. The Paris Club already has agreed to restructure debt service falling due through mid-1987 and has indicated its willingness to consider restructuring debt service due after June 1987.

34. The projected disbursements of medium- and long-term external loans in 1987-89 assume an increase in disbursements from multilateral development banks from about US$120 million in 1986 to over US$200 million a year in 1987-89. Loans from official bilateral lenders and suppliers would increase gradually during the three-year period. Initially, the disbursements are expected to contain a substantial share of program lending from the multilateral development banks, including substantial quick-disbursing policy-based assistance from the World Bank. Project loan disbursements will assume an increasing share, as discussions with lenders of the existing loan pipeline lead to the enhancement of implementation capacity and the redirection of loans to priority needs. The Government will present to the Consultative Group meeting in December 1986 its medium-term strategy and financing needs with a view to mobilizing support on appropriate terms and improving the coordination of external assistance. Consultative Group meetings will be held regularly during the program period.

35. In 1987, the estimated gross financing requirement of US$687 million will be covered as follows. Multilateral lenders are estimated to provide US$223 million, including US$70 million from the World Bank, US$110 million from the Inter-American Development Bank (IDB), and US$43 million from the Andean Development Corporation (CAF), the Fund for the River Plate (FONPLATA) and other multilateral lenders. The World Bank's disbursements include US$48 million from the reconstruction import credit approved in May 1986 and US$9 million from the Vuelta Grande project approved in June 1986. The remainder is expected to come from a technical assistance project, the existing loan pipeline and, possibly, from initial disbursements from a second reconstruction import credit. It is recognized that approval of this credit is subject to normal World Bank evaluation procedures. The projected disbursements from the IDB are based on a large, active loan pipeline and include US$15 million expected to be disbursed under a US$100 million sector loan to agriculture that is in an advanced stage of negotiation. Official bilateral lenders are projected to disburse about US$90 million in 1987. Suppliers' credits are assumed to amount to US$10 million. Direct foreign investment and short-term trade credits are expected to yield net inflows of US$20 million and US$15 million, respectively. The drawdown of net international reserves will provide another US$19 million of financing. Official bilateral creditors are expected to provide debt relief of about US$250 million, about one half of which is covered by the terms of the Paris Club agreement of July 1986. In addition, about US$60 million of maturing principal to foreign commercial banks is assumed to be refinanced.

36. The Fund is expected to provide balance of payments support immediately before and during the program period under the existing stand-by arrangement (with an undisbursed balance of SDR 25.95 million available after November 14, 1986), three annual disbursements under the Structural Adjustment Facility totaling SDR 42.63 million (or 47 percent of quota), and the compensatory financing facility (maximum entitlement of SDR 64.1 million in late 1986). The Government of Bolivia intends to initiate discussions with the Fund in early 1987 on a follow-up arrangement.

Attachments

Bolivia: Summary and Timetable of Implementation of Principal Policy Measures Structural Adjustment Facility, 1987-1989

Policy areas	Objectives and Actions	Strategies and Measures	Timetable
1. External Sector			
a. Exchange rate policy	(a) Maintain flexible exchange rate	-Conducts foreign exchange auctions	During the entire program period.
		-Maintain unrestricted access to auction market	During the entire program period.
		-Limit net foreign exchange sales to net official international reserve targets	Annual targets.
b. External trade and payments policy	(a) Liberal trade and payments system	-Avoid introduction of exchange and trade restrictions	During the entire program period.
	(b) Uniforms import tariff without duty exemptions	-Maintain uniform import tariff of 20 percent	During the entire program period.
	(c) Promote export growth and diversification	-Reduce and possibly eliminate import duty exemptions	August 1987 for wheat.
		-Rebate customs duties and indirect taxes to exporters at a uniform rate	During the entire program period.
		-Provide unsubsidized pre- and post-shipment credit	Early 1987.
		-Refrain from export quotas and prohibitions	During the entire program period.
		-Establish competitive freight rates for exports	1987.
c. External borrowing	(a) Restore international creditworthiness	-Borrow at concessional terms only	During the entire program period.
	(b) Improve terms of external financing	-Revive Consultative Group meetings	Late 1986; regularly thereafter.
	(c) Improve debt monitoring	-Negotiate and implement bilateral agreements in accordance with the 1986 Paris Club Agreement	Until March 1987.
		-Obtain further debt relief from official bilateral creditors	Annual Paris Club meetings in mid-1987, mid-1988, and mid-1989.
		-Restructure commercial bank debt	Early 1987.
		-Establish monitoring and control system for short-term external public debt	Mid-1987.
2. Public sector management and efficiency of resource allocation			
a. Public sector management	(a) Reduce size and improve quality of civil service and state enterprise staff	-Cut public sector employment	During the entire program period.
		-Introduce incentive pay scales for specialists and top-level managers	1987.
	(b) Raise executing capacity	-Reorganize public sector entities and enterprises, in particular the Ministries of Finance and of Planning and Coordination, the Central Bank, YPFB, COMIBOL, ENDE, ENFE, and the municipalities	During the program period with particular emphasis on 1987.
		-Target better and deliver efficient social services	During the entire program period.
		-Generate after-tax state enterprise savings for local counterpart financing of investment through pricing policy and cost cutting	Annually, during the program period.
		Update accounts and establish basic financial control system	1987.

Bolivia: Summary and Timetable of Implementation of Principal Policy Measures, 1987-1989 (Continued)

Policy areas	Objectives and Actions	Strategies and Measures	Timetable
b. Public investment	(a) Improve and expand basic infrastructure	-Establish a "core" investment program	Late 1986/early 1987.
	(b) Encourage private investment	-Define national medium-term strategy	1987.
		-Establish three-year investment program and review it annually	1987, with reviews in early 1988 and early 1989.
	(c) Improve planning, project screening, and monitoring capacity	-Examine loan commitments and ongoing projects to ensure the attainment of priority objectives	Early 1987.
	(d) Improve aid coordination	-Remove constraints to implementation capacity	1987.
		-Arrange concessional financing	Regularly held Consultative Group meetings.
c. Private investment	(a) Support increase in private investment, especially for export	-Stimulate investment through flexible prices, collective bargaining, freedom to hire and fire, unrestricted access to mineral rights, unlimited profit remittances, investment guarantees, joint ventures in certain areas, infrastructure investment, financial sector reform, and a stable regulatory framework	During the entire program period.
		-Revise investment code and simplify approval procedures	1987.
		-Prepare sector policy statements	1987, to be refined and updated during the program period.
3. Sectoral policies			
a. Agriculture	(a) Increase output and productivity		
	(b) Promote exports and efficient import substitution	-Lower freight rates	1987-89.
		-Provide export financing	1987-89.
		-Improve transport infrastructure	1987-89.
		-Improve research and extension services	1987-89.
		-Ensure input availability	During the entire program period.
	(c) Provide alternatives to coca leaf production	-Provide agricultural credit	1987-89.
	(d) Raise farm income, especially on the altiplano	-Support unemployed miners and farm workers through land grants and service program	During the entire program period; land grants especially in 1987.
b. Mining	(a) Increase mining production, particularly of nontin minerals	-Restructure COMIBOL	1987.
		-Revise mining code	1987.
		-Implement the mining tax system	During the entire program period.
		-Lower freight rates	1987-89.
		-Support geological work and exploration activities	1987-89
		-Initiate new investments, including joint ventures	During the entire program period.
c. Energy	(a) Increase production of crude petroleum, domestic consumption of natural gas, and exports of hydrocarbons	-Complete ongoing YPFB projects	1987-88.

Bolivia: Summary and Timetable of Implementation of Principal Policy Measures, 1987-1989 (Continued)

Policy areas	Objectives and Actions	Strategies and Measures	Timetable
	(b) Lower the dependence on gas exports to Argentina		
	(c) Improve the efficiency of electricity generation and distribution	-Analyze options for a gas export agreement with Brazil on the basis of an existing agreement with the World Bank	1987.
		-Negotiate gas export agreement with Brazil	1987-88.
		-Set domestic prices so as to conserve energy	During the entire program period.
		-Obtain agreements with foreign companies to promote joint ventures	1987-89.
		-Transfer part of YPFB retailing and distribution operations to the private sector	1987-89.
		-Improve the distribution of electricity by linking Santa Cruz to the national network and revise pricing policy	1987-89.
d. Transport	(a) Create efficient export corridors	-Rehabilitate, modernize, and expand road and railway system with priority for export corridors (Santa Cruz-Corumba railroad, river transportation to Argentina, rail and road links to Chile and Peru).	1987-89.
	(b) Promote national integration	-Continue the construction of the national road system	1987-89.
		-Repair and maintain roads	1987-89.
	(c) Lower transport costs, especially for exports	-Deregulate trucking industry and some railway lines	1987-88.
4. <u>Fiscal policy</u>	(a) Raise tax revenue while lowering the dependence on the hydrocarbon sector	-Implement the tax reform by issuing guidelines and enforcing the new taxes	Late 1986 and early 1987 for guidelines. Enforcement of all taxes in the course of 1987.
	(b) Rationalize expenditure so as to make room for investment, social spending, and domestic arrears reduction	-Limit expenditure through improved budgeting and expenditure control procedures	1987-89.
	(c) Reduce nonfinancial public sector deficit to 5 1/2 - 6 percent of GDP	-Avoid subsidies	During the entire program period.
		-Maintain tight wage policy	During the entire program period.
		-Introduce special pay scale for qualified personnel	1987.
		-Increase investment spending	1987-89.
		-Provide for well targeted social spending, especially education and health	1987-89.
		-Reduce public sector arrears	1987-89.
		-Limit overall deficit to available foreign financing	1987-89.
		-Achieve a small domestic financing surplus	1988, 1989.

Bolivia: Summary and Timetable of Implementation of Principal Policy Measures, 1987-1989 (Concluded)

Policy areas		Objectives and Actions	Strategies and Measures	Timetable
5. Financial sector policy a. Institutional reform	(a)	Reform banking law	-Submit bill to Congress	Mid-1987.
	(b)	Reduce the role of the Central Bank in the resource allocation process	-Create superintendency of banks	1987.
			-Eliminate approvals of individual development loans by the Central Bank	Early 1987.
	(c)	Rehabilitate state and private banks	-Reform the Banco Agrícola	1987.
			-Reform or liquidate the Banco del Estado	1987.
			-Study the creation of a national securities exchange	During the program period.
	(d)	Simplify accounting and transactions in the economy	-Currency reform	Early 1987.
			-Improve the functioning of the interbank money market	During the program period.
			-Improve the Central Bank's accounting system	1987-89.
b. Interest rate policy	(a)	Increase domestic resource mobilization while encouraging lower real lending interest rates	-Maintain market determination of interest rates	During the entire program period.
	(b)	Improve efficiency of intermediation via lower spreads	-Permit banks to issue bearer certificates of deposits	Mid-1987, concurrent with banking law
c. Credit policy	(a)	Reduce concentration of credit to public sector	-Limit credit to public sector	1987-89.
6. Social sector policy	(a)	Alleviate poverty effects of the economic crisis	-Implement action plans for the social ministries (including employment programs) to improve efficiency, target programs, and assure budget allocations	1987-89.
			-Monitor the poverty impact of the economic crisis	During the entire program period.
	(b)	Strengthen investment in human capital	-Strengthen the education system	1987-89
	(c)	Reduce infant mortality	-Implement emergency health programs with the assistance of nongovernmental organizations	1987-88.
			-Implement targeted work programs to alleviate unemployment	1987-89

Bolivia - Structural Adjustment Facility

Memorandum of Economic and Financial Policies in the Period January 1, 1987-December 31, 1989

1. The Government of Bolivia has decided to implement an economic and financial program in the three-year period starting January 1, 1987 that consolidates the stabilization effort undertaken since late August 1985 while shifting the thrust of economic and financial policies toward the achievement of a sustainable rate of growth and balance of payments viability. The structural problems of the Bolivian economy and the policies to be followed to resolve them are described in the document entitled "Medium-Term Economic and Financial Policy Framework, 1987-89."

2. The Government's principal objectives under the three-year program are real GDP growth of about 3 1/2 percent a year, the reduction of consumer price increases from about 65 percent in 1986 to about 5 percent in 1989, and overall balance of payments equilibrium, with the current account deficit financed entirely by concessional assistance. Indications are that the current account deficits, which are projected to decline in relation to GDP from about 9 1/2 percent in 1987 to less than 8 percent in 1989, can be financed with concessional loan disbursements and the restructuring on favorable terms of debt service falling due to official bilateral creditors and foreign commercial banks. As a result, debt service will decline in relation to exports of goods and nonfactor services during the three-year period. The principal program objectives depend crucially on the pursuit of a fiscal policy that implements annual public investment programs of 7 1/2-8 percent of GDP while avoiding the emergence of inflationary pressures. Concessional foreign resources are likely to be available on a scale sufficient to finance nonfinancial public sector deficits of 6 percent of GDP in 1987 and of 5 1/2 percent of GDP in 1988 and 1989. Such deficits, however, will be reduced should concessional financing prove to be lower. For 1988 and 1989, the Government will discuss with the Fund policies to raise public sector savings and lower the deficits further so as to release some of the concessional resources to the rest of the economy.

3. To achieve the principal objectives over the three-year program period, major policy reforms will supplement and strengthen the policy framework adopted since late August 1985. The major policy areas are (i) the pursuit of a flexible exchange rate policy, (ii) the maintenance of a liberal external trade and payments system with a moderate, uniform level of tariff protection and a nonsubsidizing export promotion system, (iii) improved public investment planning and project execution capacity, (iv) the provision of incentives for private investment, (v) specific sectoral policies, (vi) improvements in the public finances, especially through the implementation of the recently approved tax reform, (vii) reorganization and decentralization of the state enterprises, and (viii) institutional reform of the financial system and the increase in domestic resource mobilization.

4. The annual program for 1987 (the first year under the structural adjustment arrangement) will consist of the objectives and policy measures that relate to the final 12 months of the 18-month program (July 1, 1986-December 31, 1987) described in the letter of the Minister of Planning and Coordination, the Minister of Finance, and the President of the Central Bank of Bolivia dated October 30, 1986 and the Memorandum of Understanding on Economic Policy Through the End of 1987 attached thereto. For purposes of monitoring progress under the first annual program under the structural adjustment arrangement the Government will follow closely developments in (i) the borrowing requirement of the nonfinancial public sector, (ii) the net domestic assets of the Central Bank, (iii) the net central bank credit to the nonfinancial public sector, (iv) the net international reserves of the Central Bank, (v) the net disbursement of public and publicly guaranteed external debt with maturities of more than 1 year and up to 10 years, and (vi) external payments arrears, for which quantitative benchmarks have been established (Table 1). Policy implementation will also be followed closely with reference to (i) the reorganization of the state mining company (COMIBOL), (ii) the implementation of all taxes under the tax reform law of May 1986, and (iii) a public sector investment program that is endorsed by the World Bank.

Bolivia: Quantitative Benchmarks Under the Structural Adjustment Facility, 1987

	Calendar Quarter Ending			
	March 31	June 30	Sept.30	Dec.31
	(Cumulative flows from March 31, 1986 in trillions of Bolivian pesos)			
Borrowing requirement of the nonfinancial public sector	529.3	661.5	774.6	966.7
Net domestic assets of the Central Bank	61.7	63.3	96.7	113.2
Net position of the nonfinancial public sector in the Central Bank	-41.4	-41.9	-48.6	-44.8
	(Cumulative flows from March 31, 1986 in millions of U.S. dollars)			
Minimum gain or maximum loss of net international reserves of the Central Bank	6.1	8.6	1.1	-4.9
Increase of public and publicly guaranteed external debt with maturities of more than 1 year and up to 10 years	35.0	50.0	75.0	100.0
	(In millions of U.S. dollars)			
Arrears on public and publicly guaranteed external debt	--	--	--	--
	(In percent)			
Maximum premium of the exchange rate in the parallel market over the exchange rate in the official market 1/	5.0	5.0	5.0	5.0

1/ Average of five consecutive business days.