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CONFIDENTIAL

December 12, 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

The attached supplement to 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 has been prepared on the basis of additional information.

Mr. Flickenschild (ext. 8621) is available to answer technical or factual questions relating to this paper prior to the Board discussion on Monday, December 15, 1986.

Att: (1)

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--Supplementary Information

Prepared by the Western Hemisphere Department

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

Approved by E. Wiesner and Manuel Guitián

December 12, 1986

The purpose of this supplement is to report briefly on information about Bolivia's performance under the stand-by arrangement and about recent economic and financial developments that has become available since the issuance of the staff report (EBS/86/263) on November 26, 1986.

1. Performance under the stand-by arrangement

All quantitative performance criteria for September 30, 1986 were observed except for the criterion on external arrears (Table 1), which was exceeded by a small amount and for whose nonobservance the authorities are requesting a waiver. The arrears covered by the limit are believed to be owed to foreign creditors without guarantee from the respective creditors' governments or official agencies. The Bolivian authorities are examining whether some of these arrears are in respect of debts that fall under the purview of the Paris Club agreement or whether the private creditors are willing to agree to restructuring their claims. As mentioned in EBS/86/263, page 16, the authorities have set aside US\$300,000 to pay these arrears in the event that they cannot be restructured.

Available information indicates that the program remains on track in the fourth quarter of 1986. At the end of October 1986, the Central Bank's net international reserves were US\$64.7 million above the target for the end of December 1986, and the net domestic assets of the Central Bank were \$b 106 trillion below the continuous limit for the fourth quarter of 1986. According to preliminary data, the margins with respect to the two performance criteria increased further by the end of November 1986. At the end of October 1986, the public sector had improved its net creditor position with the Central Bank by \$b 123 trillion more than required under the continuous limit for the fourth quarter of 1986. Finally, the premium on the U.S. dollar in the parallel exchange market remained well within the limit of 5 percent at all times and amounted to 0.3 percent on November 30, 1986.

Table 1. Bolivia: Performance Under the Stand-By Arrangement

	June 30, 1986	Sept. 30, 1986	Dec. 31, 1986
(In trillions of Bolivian pesos)			
<u>Cumulative changes in net domestic assets of the Central Bank 1/</u>			
Limit	94.7	198.9	35.3
Actual	24.7	-42.6	...
Margin	70.0	241.5	...
<u>Cumulative changes in the net position of the nonfinancial public sector with the Central Bank 1/</u>			
Limit	30.3	71.4	-43.8
Actual	-46.1	-114.7	...
Margin	76.4	186.1	...
<u>Borrowing requirement of the nonfinancial public sector 2/</u>			
Limit	144.4	314.8	457.8
Actual	117.3	196.7	...
Margin	27.1	118.1	...
(In millions of U.S. dollars)			
<u>Loss in net international reserves of the Central Bank</u>			
Limit	-38.0	-70.9	13.6
Actual	9.5	48.5	...
Margin	47.5	119.4	...
<u>Increase in public and publicly guaranteed external debt 3/</u>			
Limit	25.0	55.0	20.0
Actual	-15.0	-29.5	...
Margin	40.0	84.5	...
<u>Payments arrears on public and publicly guaranteed external debt 4/</u>			
Limit	11.1	6.1	0.7
Actual	21.5	6.3	...
Margin	-10.4 5/	-0.2	...
(In percent)			
<u>Premium on U.S. dollar in parallel exchange market 6/</u>			
	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/ Tested continuously. Limit is 5 percent for the five-day moving average.

2. Recent economic and financial developments

The rate of price increase has continued to subside; consumer prices declined slightly in November after increasing by 0.6 percent in October. The cumulative increase in consumer prices in the first eleven months of 1986 amounted to 64.9 percent, compared with the authorities' revised inflation target of 66 percent for the twelve months ending December 1986. In the first week of December 1986, the consumer price index declined by 0.6 percent because of lower food prices.

Partly in reflection of payments for gas by Argentina, the net international reserves of the Central Bank rose by over US\$30 million in October 1986 to US\$262.4 million and are estimated to have increased further by about US\$20 million in November, in spite of the fact that demand for foreign exchange tends to increase for seasonal reasons in the latter month. In response to that demand, foreign exchange sales through the auction market were increased, from an average of US\$1.5 million a day in October to almost US\$3 million a day in November. In the first eleven months of 1986 the net international reserves of the Central Bank increased by about US\$140 million, compared with a revised target of US\$64 million for 1986 as a whole. However, a little more than US\$100 million of this increase represents the accumulation of U.S. dollar denominated balances in the Central Bank of Argentina that can only be used for payment of nontraditional imports from, or debt service obligations to, Argentina.

The favorable price and balance of payments developments so far in the fourth quarter of 1986 have reflected the maintenance of tight fiscal and credit policies and apparently stronger than expected demand for financial sector liabilities. The fiscal performance in the first eleven months of 1986 was better than projected, as the deficit of the nonfinancial public sector is estimated to have been 2.4 percent of projected 1986 GDP, compared with a revised program limit of 3.8 percent of GDP for 1986 as a whole; however, it should be noted that a thirteenth monthly salary is paid in December in the public sector. Data through the end of November 1986 indicate that tax collections were in line with projections while capital and current expenditures were below projections, except for outlays for severance payments in connection with the reduction of public sector employment. Guidelines for the implementation of the value-added tax, the complementary income tax, the tax on corporate net worth, and the taxes on rural land holdings and urban real estate were issued in early December 1986 and the authorities intend to implement these taxes at the beginning of 1987. This week, the authorities announced that a Ministry of Tax Collections would begin operations in the first half of 1987.

The Central Bank continued to limit its credit to the private sector (through the banking system) to a level slightly below the program level for November 1986. After taking into account a further increase in the net creditor position of the nonfinancial public sector, the net domestic assets of the Central Bank declined by more than

\$b 70 trillion from end-September to end-November 1986. At the same time, currency issue increased by \$b 19 trillion to \$b 243 trillion, bringing the increase since the beginning of 1986 to almost one-third. Private sector deposits with the commercial banks grew by some \$b 125 trillion to \$b 483 trillion in the two-month period ended mid-November, with local currency deposits accounting for most of the recent deposit growth. Lending activity expanded somewhat more slowly, raising the banks' loan portfolio by some \$b 93 trillion to \$b 675 trillion in the two-month period ended mid-November. In reflection of the brisk growth of deposits, lower inflation, and banks' efforts to reduce operating costs, interest rates and spreads declined further. At the end of October, monthly rates on loans and time deposits in local currency stood at 5.4 percent and 2.8 percent, respectively, compared with 5.8 percent and 3.1 percent at the beginning of the month.

Partly estimated trade data indicate that exports during the first nine months of 1986 amounted to about US\$485 million, exceeding the projections assumed under the program by about US\$40 million. The better than anticipated performance was attributable to higher exports of metals and nontraditional exports. The latter amounted to US\$73 million, or about 15 percent of total exports. Financed in part by unanticipated private capital inflows, imports in the first nine months of 1986 amounted to about US\$545 million, exceeding the projections by about US\$100 million.

To arrange the concessional financing flows required in 1987 and beyond, a Consultative Group meeting attended by 13 countries and 9 international organizations was held in Paris on December 3-4, 1986. In the meeting, Bolivia sought donor support for its public investment program, a drug eradication program, and an emergency social fund that was created in late November 1986 to provide temporary employment and establish social service programs in the areas of nutrition, health and education for the benefit of the groups most seriously affected by the recession.

The donors agreed to attend to the financing needs of the investment program for 1987, which still needs to be completed in its detail, by allowing a more rapid and flexible use of the existing loan pipeline. Financing for 1988 and beyond will be considered on the basis of detailed sectoral investment programs to be submitted to the next Consultative Group meeting in October or November 1987. Financing for the drug eradication program, which is estimated to require US\$300 million over a three-year period will be discussed in a meeting of a subgroup of the Consultative Group in early 1987. The coordination of contributions to the emergency social fund, which is estimated to require about US\$325 million over 3 years, will be handled by a special working group of the Consultative Group. The drug eradication program and the emergency social fund, which were conceived after the program review discussions, are to be financed essentially with foreign grants, with local counterpart requirements kept to an amount compatible with the agreed fiscal targets for 1987.