EBS/86/263
Supplement 3

CONFIDENTIAL

December 22, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Bolivia - Structural Adjustment Arrangement

Attached for the records of the Executive Directors is the text of the structural adjustment arrangement for Bolivia agreed at Executive Board Meeting 86/197, December 15, 1986.

Att: (1)

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 December 15, 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 Sânchez 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

ATTACHMENT I
ANNEX I

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.

ATTACHMENT I
ANNEX I

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. Fiscal policy	(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.

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 is expected to begin to circulate on January 1, 1987 at a rate of one new unit equivalent to $b1,000,000 and all contracts and financial claims will be redenominated 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.