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Bolivia: Request for Stand-By Arrangement—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Bolivia

In the context of the request for Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the request for Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **February 4, 2003,** with the officials of Bolivia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on March 24, 2003**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **April 2, 2003** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its March 2, 2003 discussion** of the staff report that completed the request.

- a statement by the Executive Director for Bolivia.

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Bolivia*
Memorandum of Economic and Financial Policies by the authorities of Bolivia*
Technical Memorandum of Understanding*

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

BOLIVIA

Request for Stand-By Arrangement

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by Eliot Kalter and Michael T. Hadjimichael

March 24, 2003

- **Background.** Fund missions visited Bolivia on November 4–23, 2002 and February 4–12, 2003 to negotiate an economic program that could be supported by a PRGF arrangement and conduct Article IV discussions. Joint Bank-Fund missions under the Financial Sector Assessment Program (FSAP) took place in November 2002 and January 2003.

- **SBA.** Following serious civil unrest in February and a sizable withdrawal of U.S. dollar deposits from the banking system, the Bolivian authorities refocused their efforts on putting in place a program to stabilize the economy, in support of which they request a Stand-By Arrangement (SBA) from the Fund. The authorities intend to continue advancing in their preparation of a medium-term economic program, for which they soon plan to seek support from the PRGF.

- **Fund Relations.** Bolivia's last PRGF arrangement, which was approved on September 18, 1998, expired on June 7, 2002. The third year program, approved on June 8, 2001 together with the conclusion of the last Article IV consultation, went off track. Board discussion of the 2003 Article IV consultation is expected to take place with the second review of the SBA, together with the Financial Sector Stability Assessment (FSSA).

- **Mission.** The Fund team in the November and February missions comprised Messrs. Lewis (Head), Cueva, García Pascual (all WHD), Mr. Monroe (PDR) and Ms. Guin-Siu (FAD). The mission was assisted by Mr. Peraza, the Resident Representative in La Paz. Mr. Kalter (WHD) joined the mission in February. Further discussions were conducted at headquarters during December 16–20 and February 19–24. The mission met with the President of Bolivia, the Ministers of Sustainable Development, the Presidency, Finance, Financial Services, and Foreign Trade, and the President of the Central Bank.

- **Financial Support.** Fund support would be accompanied by lending from the World Bank, Inter-American Development Bank (IDB), and the Andean Development Corporation (CAF) that, in addition to easing financing pressures on the budget, will support the deepening of the social safety net and institutional reforms. The role of the other multilateral institutions would parallel that of the Fund, turning to programs with longer time horizons as a new PRGF arrangement for Bolivia is approved.

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Executive Summary

Context: Following serious civil unrest in February and a sizable withdrawal of U.S. dollar deposits from the banking system, the Bolivian authorities have focused their efforts on restoring economic and social stability, strengthening the banking and corporate sectors, and establishing the basis for sustained growth. In support of their economic program for 2003, the authorities have requested an SBA equivalent to 50 percent of quota (SDR 86 million). At the same time, the authorities continue to develop a broader set of medium-term structural reforms, for which they plan to seek support through an arrangement under the PRGF as soon as possible.

Main elements of the program for 2003:

- Fiscal policy is aimed at a phased reduction of the fiscal deficit, starting with a 2 percentage point decrease in 2003, to 6½ percent of GDP, while allowing some increase in social spending. Key congressional leaders will have supported the 2003 budget by the time of the Board meeting and full approval is expected by end-March.

- A modern tax procedures code, to help strengthen tax administration (submission to congress by end-April and approval by end-September).

- Monetary policy aims at a buildup of US$65 million in net international reserves to US$875 million, raising the coverage of dollar-denominated bank deposits by disposable gross reserves to 35 percent.

- The crawling peg exchange rate system will continue in 2003. The central bank will undertake a study in the months ahead that would develop future options for external policies to maintain Bolivia's competitiveness.

- The first stage of financial and corporate sector restructuring will be implemented. The strategy envisages developing an informal, out-of-court workout mechanism, coupled with modern formal bankruptcy proceedings (submission to Congress by end-April and approval by end-September).

- Plans to strengthen financial regulation over the next several months are also part of the program. This includes putting into place a framework for bank resolution and issuing a decree clarifying the institutional responsibility for the broad oversight over the financial sector (by end-April).

Risks: Significant risks to the program leave no room for slippages in policy implementation. The authorities need to gain broad public and congressional support to sustain the fiscal policy actions that are key to achieving program objectives. Even with ambitious fiscal adjustment, the nonfinancial public sector debt relative to GDP will not begin to decline until 2006. Also, stress tests indicate high vulnerability to economic and financial shocks.

I. Background

A. Social and Political Context

1. **Bolivia remains one of the poorest and least developed Latin American countries.** It is landlocked and has the highest share of indigenous people in its population in Latin America. Almost two thirds of the population lives below the poverty line, with a concentration in rural areas of the highlands (altiplano) and among indigenous people. Income inequality is high in the context of deep social and ethnic divisions and the marked regional disparities.

2. **After years of sporadic economic reform, recent declines in real per capita income and employment have heightened social tensions.** This has fueled feelings of disenfranchisement and resentment against the government among a growing share of the population. Tensions are particularly high among the indigenous communities and the coca farmers whose situation has been deeply affected by the drug eradication campaign.

3. **President Sánchez de Lozada assumed office in August 2002 based on a pact between his party, the Revolutionary National Movement (MNR), and the Revolutionary Left Movement (MIR) (Box 1).** The ruling coalition controls a thin majority in both the lower and upper houses of congress and faces strong opposition from its main rival in the presidential elections, Evo Morales, who represents the indigenous communities—and in particular the coca farmers—and is a vocal opponent of economic reforms that were started during the previous term (1993–97) of the current President. The government's position has been weakened further by the recent social unrest.

B. Economic and Financial Developments

4. **Despite a rapid increase in natural gas production, real growth has been weak for the last four years** (1½ percent on average). Adverse shocks included the impact of coca eradication on incomes; the impact of low metal export prices on mining output and foreign direct investment; and contagion from the regional financial and economic developments. The economy's vulnerabilities have been heightened by large fiscal imbalances (Table 1) and weak and highly dollarized financial and corporate sectors.

5. **The external current account deficit remained relatively high at 4 percent of GDP in 2002 despite stagnant economic activity**—owing partly to exceptional imports to build a new gas pipeline (Figure 1 and Table 2). Foreign direct investment—largely related to hydrocarbon projects—was also very high at more than 7 percent of GDP, although it has been declining since 1999.

6. **The fiscal deficit more than doubled over the last two years to 8.7 percent of GDP in 2002 (Table 3).** Revenue was restrained by weak domestic demand, delays in tax reforms, and a freeze on domestic fuel prices. At the same time, expenditure surged,

Box 1. Political Context

The government's success in implementing the economic program will depend on its ability to make progress in building consensus within congress and to gain the cooperation of a wide range of civil society. The coalition led by President Sánchez de Lozada controls a thin majority in both the lower and upper houses of congress, and faces vocal opposition from Evo Morales, a close runner-up in the presidential elections who represents the indigenous communities, particularly the coca farmers whose situation has been deeply affected by the drug eradication campaign. Mr. Morales has sought to rally widespread popular opposition to market-oriented policies both inside and outside Congress, appealing also to landless farmers and labor unions. The government, already facing strong opposition from political and social groups, was weakened by the recent serious social unrest that followed the government's initial submission of the budget to congress.

During the first several months of the current administration, the government has yielded on a number of occasions to demands of diverse social groups. In January, the government reached an agreement with Morales—aimed at stopping road blockades and protests—that called for working groups to discuss: a halt to plans for routing a pipeline for the liquefied natural gas (LNG) project through Chile and for furthering regional trade agreements; a freeze in coca eradication; and increased expenditure for social issues in the 2003 budget. The government also agreed, in response to retirees' demands, to retain most of the indexation of pensions to the U.S. dollar during 2003—with the December 2002 shift in indexation of pensions to inflation having full effect in 2004—following a protest march that led to loss of life. Late last year, the central bank backed down from a decision to widen the spread between the buying and selling exchange rates, at the government's request, following widespread criticism.

By not fostering a more participatory debate in Congress, the government has faced difficulty in forestalling mounting opposition. The President withdrew the 2003 budget proposal and the tax increase the authorities had designed (Appendix Box 3), following two days of rioting, before it had been considered in the chamber of deputies. The new budget proposal has been developed through a process of consensus-building that should enhance its acceptability. The President has announced a more balanced fiscal program, with cuts in low priority spending, reduced the number of ministries and introduced austerity measures for the central administration. However, the public's perception of limited progress in fighting corruption, controlling tax evasion, and improving governance may make it difficult to build the alliances with parties outside the coalition that would facilitate the passage of key legislation in Congress.

The program is subject to significant implementation risks to the extent that the consensus remains weak. To minimize these risks will require further progress in the participatory process that the government has embarked upon, so as to enhance the overall political support for the program.

reflecting increased real wages (with a cumulative 14 percent real increase in the wage bill) and a stepped-up public investment program (Appendix Box 1). Pension costs—already sizable after the 1997 pension reform—rose further.[1]

7. **Monetary policy in 2002 was accommodative of a large government financing need (Figure 2 and Table 4).** In addition, the central bank had to contend with two rounds of deposit instability—in mid–2002 and in February 2003—that left the dollar deposit base 17 percent below its level at end–2001. In both cases, the central bank increased rediscounts to meet the liquidity needs of financial institutions and raised interest rates (Box 2). With NDA rising sharply, the central bank's net international reserves fell by US$275 million in 2002 and by a further US$123 million so far in 2003, to a level of US$687 million as of March 12. Correspondingly, the coverage of dollar-denominated deposits of commercial banks by disposable reserves has fallen from 39½ percent at end–2001 to 31½ percent at end–2002, and to 28¼ percent as of March 12, 2003.[2]

8. **The central bank stepped up the pace of nominal depreciation against the U.S. dollar to 10 percent in 2002, in response to the domestic and external shocks.**[3] However, because of the sharp depreciations of the Argentine peso and Brazilian *real*, the boliviano still appreciated in real effective terms by more than 4 percent during 2002. The gradual appreciation of the real effective exchange rate and the lackluster performance of nontraditional exports in recent years suggest growing competitiveness concerns.

9. **Financial vulnerabilities in the highly dollarized financial system have increased significantly.**[4] In the aggregate, banks recorded losses in two out of the last three years and

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[1] The increase in the pension-related deficit is attributable to a higher number of early retirees, fraud, preferential treatment to specific sectors, and increases in the minimum pension following social unrest.

[2] Disposable reserves include central bank gross reserves, except holdings of gold, and commercial banks' liquid asset requirements held abroad. As of March 12, gross reserves were US$731 million (of which US$273 million in gold holdings). If needed, the central bank could rapidly repatriate about US$208 million of commercial banks' liquid asset requirements held abroad in a trust fund (RAL) and the central bank could have access to a liquidity credit from the Latin American Reserve Fund (FLAR) for up to US$190 million.

[3] Under the existing crawling peg regime, the rate of depreciation is determined annually on the basis of projected inflation differentials, but is not announced; the central bank decides on short-term variations in the rate of crawl in response to external developments or changes in demand at the daily auctions.

[4] Standard & Poor's lowered on February 26 its long-term ratings on the Republic of Bolivia to B from B+ and lowered its short-term ratings to C from B, noting that increased social

(continued)

the average nonperforming loan ratio more than doubled to almost 19 percent in this period, although all banks in the system report capital adequacy ratios in excess of the minimum requirement.[5] Credit to the private sector has contracted by one third since 1999, reflecting tensions "weaken the government's already narrow base of support and capacity to introduce and implement policies."

BOX 2. THE DEPOSIT RUN EPISODES OF MID–2002 AND FEBRUARY 2003

The Bolivian banking system has contracted over the last four years since 1999, with a cumulative 22 percent fall in deposits and 36 percent reduction in the loan portfolio (in U.S. dollar terms). In this context, bank liquidity has generally been ample (see Figure 4). However, during the last year the system faced two episodes of accelerated deposit withdrawals, following political uncertainty: first, during the political transition period starting a few weeks ahead of the June 2002 general elections, until a new government coalition was announced on August 4, 2002; and second, following the intense social unrest the week of February 10. Events followed similar patterns in both cases:

(i) **Deposit runs were sizable** (18 percent of the financial system deposits in mid–2002, and almost 5 percent in a few days in February 2003). They were reflected in the balance of payments as capital outflows, even though a large proportion of withdrawn deposits were held in cash.

(ii) **Withdrawals were spread across all categories of financial institutions**, including foreign and local banks, with a proportionately larger impact on savings and loans (that have a large number of small depositors), and in mid–2002 also on mutual funds (SAFIs).

(iii) **The central bank (BCB) met the liquidity needs of financial institutions** through repo operations and liquidity credits backed by the banks' liquid asset requirements. Reflecting the high degree of financial dollarization, these operations were mainly in U.S. dollars and prompted large reductions in the international reserves.

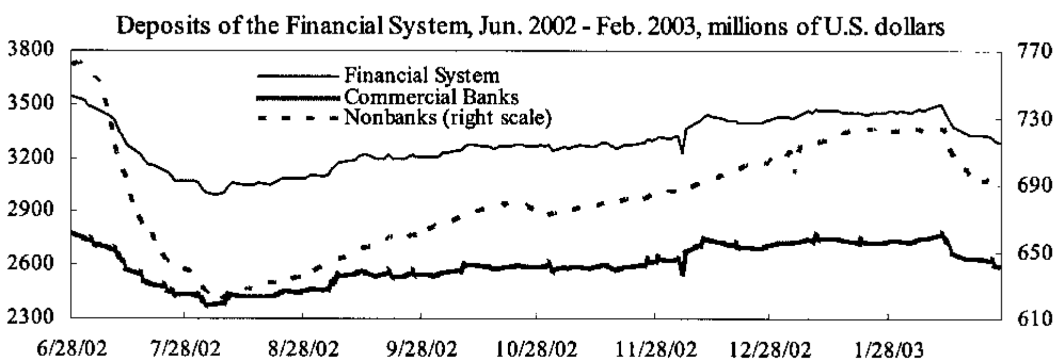
(iv) **The monetary authorities raised the benchmark interest rates** to encourage efficient liquidity management by financial institutions and the placement of short-term deposits with the central bank for those institutions with excess liquidity.

(v) **The exchange rate policy was kept broadly unchanged**, in part to keep from igniting depositors concerns in view of the high level of dollarization.

(vi) **The BCB repatriated the commercial banks' liquid asset requirements** (RAL) in U.S. dollars, which are usually held abroad and are not part of the BCB balance sheet. The central bank also secured a contingent credit line with the Latin American Reserve Fund (FLAR) in July 2002. However, no disbursement was made, since the deposit outflow stopped before the credit was needed.

(vii) **Daily monitoring was intensified** with respect to the liquidity situation of individual banks.

(viii) **In mid-2002, once political tensions abated, the deposit outflow slowly returned** to the system and the RAL fund was gradually transferred back overseas.



[5] The recorded increase in nonperforming loans is likely to understate the deterioration in the quality of banks' loan portfolios, owing to a relaxation of loan classification criteria during the period. A detailed assessment of the banking system and of the banks' capital situation will be presented in the forthcoming FSSA report, together with the Article IV staff report.

more conservative bank lending practices, and more prudent loan provision regulations, combined with a sluggish economy and a persistent decline in broad money (Figure 3, Tables 5 and 6).

10. **Private corporations are afflicted with unproductive assets, operational inefficiencies, and currency mismatches.** At the same time, dysfunctional bankruptcy arrangements and weak capital markets complicate the process of corporate restructuring. A recent FSAP mission found that firms' capacity to generate cash flow to service debt collapsed during 1998–2001 under the weight of weak sales, operational inefficiencies, and the depreciation of the boliviano against the U.S. dollar. The FSAP mission concluded that a coordinated approach dealing with the weaknesses of both the banking and corporate sectors is required to address satisfactorily existing vulnerabilities.

11. **Nonfinancial public sector debt rose sharply in 2002 to 62¼ percent of GDP.** Both domestic (mainly in U.S. dollars) and nonconcessional external debt have increased rapidly to finance the large fiscal deficits.[6] As a result, debt indicators have deteriorated significantly from the path envisaged in June 2001 when Bolivia reached the completion point under the enhanced HIPC Initiative; at end–2002, the ratio of the NPV of external debt to exports increased to 117 percent and the ratio of budgetary debt service to revenue increased to 38 percent.[7]

II. Policies Under The Stabilization Program for 2003[8]

12. **The economic program for 2003, in support of which the authorities are requesting an SBA, focuses on stabilizing the economy after the recent civil disturbances and resulting financial instability and laying the basis for a return to growth.** Fiscal policy is aimed at a phased reduction of the public sector deficit while

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[6] Bolivia's external public debt (US$3.7 billion after HIPC and beyond-HIPC relief) is almost exclusively to bilateral and multilateral creditors; domestic public debt amounts to US$1.5 billion (mostly U.S. dollar-denominated, of which more than half is held by private pension funds).

[7] Bolivia is seeking to finalize agreements delivering relief under the enhanced HIPC Initiative from Brazil, China, Japan, and Taiwan Province of China.

[8] The economic program for 2003 is described in the attached Letter of Intent (LOI) and Memorandum of Economic Policies (MEP). Attachments I, II, and III contain the LOI, MEP, and the Technical Memorandum of Understanding (TMU), respectively. Annexes I, II, and III refer to relations with the Fund, the World Bank, and the IDB.

allowing some increase in social spending. Financial policies aim to put in place the first stage of financial and corporate sector restructuring. The authorities also expect to make progress with other institutional and structural reforms to begin addressing factors that may inhibit growth and economic efficiency. In the coming months, a broader set of medium-term structural reforms will be developed, for which the authorities plan to seek support through a successor arrangement under the PRGF.

A. Macroeconomic Framework

13. **The program projects a gradual economic recovery led by the hydrocarbon sector, with real GDP growth reaching about 3 percent in 2003, and rising to 4–5 percent in the medium term (Table 7).** Inflation would remain low. The external current account deficit would narrow, reflecting the impact of programmed fiscal adjustment on external savings. International reserves would be rebuilt, while public sector debt indicators would be stabilized. This relatively optimistic framework is subject to considerable downside risks and depends upon a swift restoration of economic and social stability.

Table A. Macroeconomic Framework, 2002–05

(In percent of GDP, unless otherwise indicated)

	2002	2003	2004	2005
Real GDP growth (in percent)	2.5	2.9	4.3	4.7
Excluding hydrocarbons	1.8	2.0	2.8	3.6
Inflation (in percent; end of period)	2.4	2.8	3.5	3.5
External current account	-4.0	-3.2	-3.5	-3.3
Gross official reserves (US$ million)	854	992	1,071	1,137
Combined public sector balance	-8.7	-6.5	-4.3	-3.1
Nonfinancial public sector debt	62.3	70.2	72.9	74.0

14. **Growth in 2003 will be fostered by** (i) increased output in the hydrocarbon sector; (ii) the boost to manufacturing, in particular textiles, from expanded preferential access to the U.S. market for the Andean countries (since August 2002); and (iii) agricultural growth benefiting from improved irrigation systems and road infrastructure. Regarding domestic demand, private consumption and investment are expected to recover only gradually as confidence is restored and some progress is made with corporate and financial restructuring.

B. Fiscal Policy

15. **The fiscal program aims to reduce the combined public sector deficit from 8¾ percent of GDP in 2002 to 6½ percent of GDP in 2003.** The authorities intend to sustain the adjustment over 2004–05, so that the deficit can fall to 3–3½ percent of GDP by 2005. This adjustment path would be protective of the debt dynamics, although it would leave debt indicators higher than envisaged at the HIPC completion point. The path remains

highly sensitive to risks, with five out of seven stress tests leading initially to rising debt ratios (Annex IV) and will be reassessed at the program reviews.

16. **The 2003 program is based on the budget presently before Congress, which the authorities expect to be passed by end-March.** The Finance Committee has approved the budget, and a statement of strong support from the President of the Lower House (Chamber of Deputies) is a prior action for Board discussion.

17. **The size of the fiscal adjustment now budgeted to take place in 2003 is lower than envisaged in the original budget submitted to Congress in early February (and modified after the civil unrest).** The slower adjustment path is more in line with the country's ability to reduce its fiscal imbalance, given the magnitude of the social tensions in the wake of successive declines in per capita income. The budget includes increased social spending financed by higher external funding from multilateral and bilateral sources (Appendix Box 2 and Table 8). Moreover, the budget no longer relies on increased revenues from the politically sensitive payroll tax, while earlier plans to reduce the VAT rate and the transactions tax have been postponed (see Appendix Box 3). The authorities emphasized that their revised budget submission emerged from consensus-building efforts with key groups of public sector employees and within the legislative branch.

Table B. Bolivia: Operations of the Combined Public Sector, 2000–03

(In percent of GDP)

				2003		
	2000	2001	2002	Passive	Measures	Program
Current revenue	22.9	23.1	22.4	22.3	1.8	24.1
Capital revenue	0.6	0.1	0.0	0.0	0.2	0.2
Official grants	2.2	2.4	2.3	2.4	0.5	2.8
Current expenditure	22.3	24.1	24.6	25.5	-0.5	25.0
Interest	2.3	2.6	2.7	3.0	-0.1	2.9
Other	20.0	21.4	21.9	22.5	-0.4	22.1
Capital expenditure	7.1	8.5	8.8	8.6	-0.1	8.6
Overall balance (deficit -)	-3.7	-7.0	-8.7	-9.4	2.9	-6.5
Memorandum items:						
Poverty-related spending	10.8	12.2	12.4	...	...	12.9
Overall balance excluding pensions	0.7	-2.2	-3.7	-4.0	2.4	-1.6

18. **The fiscal program for 2003 depends on a combination of revenue and expenditure measures (Box 3).**

- **Revenue measures**. These rely on changes in the structure of oil sector taxation, elimination of some tax exemptions, and a broadening of the base of some taxes (¶6).[9]

[9] ¶ denotes paragraph numbers in the MEP.

Box 3. Fiscal Measures for 2003 [1/]

	Percent of GDP
Revenue measures	**1.9**
Tax revenues from the hydrocarbons sector: (i) a decree issued in January 2003 increases fuel excise tax revenues through a closer alignment of ex-refinery prices with international prices of petroleum products (reducing refinery margins); and (ii) broadening of the taxable base of hydrocarbon products (i.e., to include blends of gasoline)	1.0
Tax regularization scheme to clear tax arrears in dispute	0.4
Strengthening of the two tax administration agencies (increasing their enforcement power following the implementation of the new tax procedures code); increasing and/or broadening some taxes (alcoholic beverages, travel, all business services provided by nonresidents), and eliminating loopholes and tax exemptions on the income tax of nonfinancial institutions and utilities	0.4
Capital revenues related to the sale of assets of complementary pension funds that were transferred to the public sector during the pension reform (primarily real estate)	0.2
Expenditure measures	**0.6**
Reduce pension costs through administrative efforts, control fraudulent claims, and strictly enforce of streamlined eligibility criteria	0.5
Reduce the size of the government by eliminating or merging five ministries; and reduce selective central government current expenditure (including the Legislative and Judicial branches) by at least 10 percent; but increase some transfers to key sectors	0.0
Increase in wage bill: maintain the minimum wage in real terms but allow for selective bonuses in key sectors	-0.2
Lower interest payments on bonds held by the pension funds (change from dollar-denominated to inflation-indexed bonds)	0.1
Other expenditure measures: [2/] - Prioritize public investment, maintaining projects financed by grants or concessional loans; - Protect poverty related programs	0.1
Total impact of measures	**2.5**
Additional grants	0.4
Total impact of measures plus additional grants	**2.9**

1/ Measures needed to reduce the passive deficit in 2003 (equivalent to 9.4 percent of GDP), to the active deficit of 6.5 percent of GDP (see Text Table B). See Table 14 for quarterly fiscal projections.

2/ Also, to strengthen budget execution and reporting, the status of implementation of earlier measures needs to be verified, including: the mechanism to align budgeting and execution of expenses at all levels of the government with the classification of poverty-related expenses; progress to improve the internal and external audit system; implementation of the Financial Management Information System (SIGMA) at the municipal level; and the introduction of a functional classification as part of the budgetary classification system.

Moreover, passage of the tax procedures code by September 2003 would provide the basis for a substantial strengthening of tax administration.

- **Expenditure measures.** These rely on holding the line on real wage increases,[10] controlling transfers to universities, steps to reduce the size of government, and savings in pension costs (¶ 8).

19. **The fiscal program for 2003 is subject to a number of risks.**

- The envisaged yield of several measures may be affected by future legal rulings: (i) the decree that reformed petroleum taxation might be contested in foreign courts; (ii) some measures to reduce the pension costs—notably the planned repeal by mid-2003 of a ministerial resolution that reduced the retirement age—could be subject to legal challenge.

- There could be delays in the congressional approval of the tax procedures code.

- There can be political pressures to transform the tax regularization scheme into a tax amnesty (a pardon of tax obligations, including principal, interests and penalties).[11]

- Sustained high oil prices would undercut revenues.[12]

- Tax administration improvements might raise less revenue than expected.

- Some revenue measures are "one-off" (tax regularization, higher grants, and capital revenue) and are not expected to yield additional revenue beyond 2003.

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[10] Including wage drift, the average nominal wage would increase by 6½ percent in 2003.

[11] Although an amnesty might boost revenue collection in the short run, it could undermine tax compliance by introducing moral hazard, generating a negative (and permanent) effect on tax revenue.

[12] Retail prices of gasoline and diesel have been fixed in local currency since June 2001. Following a January 2003 decree, international oil price and exchange rate fluctuations are absorbed by oil producers and refineries, as long as a reference price (the 365–day moving average of market prices) for hydrocarbon products remains within a 5 percent band. If the reference price goes beyond the band limits, the excise tax paid by consumers on hydrocarbon products would be adjusted to leave unchanged the retail price. Accordingly, the excise tax was reduced on February 25, and another reduction would occur in April based on current WEO projections.

20. **The authorities are taking steps to reduce risks to the fiscal program.** The fiscal program for 2003 includes a contingency plan for raising domestic fuel prices, if international prices persist at high levels and result in fiscal revenue shortfalls.[13] This would be politically sensitive. Also, the authorities are planning to delay some investment projects until it is clear that public revenue is at budgeted levels, and have prepared a contingency plan for reducing low-priority public investment, if needed to achieve the fiscal targets.[14] The authorities also intend to monitor more closely spending by subnational governments.

21. **Net external financing of US$480 million would cover virtually all of the nonfinancial public sector's financing needs in 2003 (see Table 9 and ¶11).**

- **Net external financing to the nonfinancial public sector** would come from the World Bank (US$178 million), the IDB (US$58 million), and the CAF (US$112 million) (Table 9). (These amounts include US$90 million of gross balance of payments support from the World Bank and US$70 million from the IDB.) In addition, US$131 million would come mainly from bilateral sources.

- In addition, the program provides for **external grants** to the budget of US$146 million (excluding HIPC assistance), including US$30 million additional grants in response to the unrest in February.

- **Central bank credit** to the Treasury would be reduced during the year, while the issuance of inflation-indexed long-term bonds to the private pension funds would allow the government to redeem in net terms up to 1.3 percent of GDP in U.S. dollar-denominated bonds and bills held by the financial sector (see Table 3).

C. Monetary and Exchange Rate Policy

22. **The monetary program in 2003 will be conducted through control of the central bank's net domestic assets and targets a small buildup of US$65 million in net international reserves.**[15] The accumulation of reserves would raise the disposable reserve coverage of dollar-denominated bank deposits to 35 percent by end–2003. Some increase in

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[13] The 2003 economic program incorporates an automatic price adjustment mechanism that would imply a change in retail prices if the band for hydrocarbon prices were to be adjusted four times this year and other compensatory fiscal measures were not in place, as detailed in Table 2 of the TMU. The authorities are planning to introduce a fully automatic adjustment mechanism for domestic fuel prices in 2004.

[14] The authorities indicated their commitment to protecting poverty-reducing or employment-generating expenditure and investment projects financed with concessional loans or grants.

[15] This implies an increase of US$188 million from March 12 to end-December.

broad money in U.S. dollar terms can be expected to take place as confidence returns to the economy and bank deposits recover, providing room for a gradual resumption of private credit. However, the program takes a cautious view of the pace at which real money demand would recover.

23. **The central bank is committed to meet the system's liquidity needs in case deposit withdrawals resume.** However, there are clear limits to its available resources. In line with recent experiences, the central bank, if faced by a renewed deposit outflow, would try to provide the needed liquidity to the system while raising its repo rate so as to induce banks to find alternative financing sources while making domestic deposits more attractive. The central bank has enhanced its daily monitoring of individual banks and would have access to back-up lines from FLAR. Staff stressed that to limit moral hazard problems, weaker institutions seeking access to central bank credit on the basis of lower quality collateral should be subject to appropriate regulatory oversight.

24. **The crawling peg exchange rate system will continue in 2003**. The rate of depreciation against the dollar (currently around 8 percent a year) will seek to reverse the real effective exchange rate appreciation during 2002. The staff pointed to the risks of a crawling peg exchange rate regime, especially its limited ability to resist shocks. The authorities agreed on the benefits of moving to a flexible exchange rate regime, but stressed that a rapid real depreciation against the U.S. dollar could result in potentially large adverse effects on corporate and bank balance sheets, given the high degree of financial dollarization (Figure 4). In their view, such a move should take place when the financial system is stronger and actions to encourage a gradual process of de-dollarization are further along.[16] Thus, exchange rate policy and its capacity to absorb shocks remains a risk in the program.

25. **The central bank will undertake a study in the months ahead, with the assistance of Fund staff, to assess the adequacy of the exchange rate level and to explore ways of increasing exchange rate flexibility.** This study should guide the choice of future options for external policies that would maintain Bolivia's competitiveness.

D. Financial and Corporate Sector Strategy

26. **The authorities' approach to the difficult task of strengthening the corporate and banking sectors is in line with the recommendations of the FSAP mission (¶19–¶21).** (The authorities' strategy and the main findings of the FSAP mission are presented in Box 4 and Annex V, respectively.) A crisis management team will be appointed in the next

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[16] Recently approved legislation is designed to encourage a gradual process of de-dollarization, by promoting the use of the new inflation-indexed unit of account (UFV) for public sector transactions, pension benefits (starting in 2004), the tax base for certain taxes, and some accounting norms.

few weeks to coordinate the strategy for the corporate and financial sectors and will coordinate closely with the World Bank in implementing the strategy.

BOX 4. FINANCIAL AND CORPORATE SECTOR STRATEGY

Short-term plans to address the weaknesses of banks have been accelerated:

- By end-March 2003, banks will have completed their provisioning requirements.
- A decree will be issued, by end-April, to clarify the roles of institutions with oversight responsibilities for the financial system and their supervisory authority. General norms in accordance with existing laws will be issued by the Executive Branch while the banking superintendency will issue prudential regulations and standards consistent with its supervisory role.
- Regulations for bank resolution and prompt corrective action mechanisms, together with consistent rules on the provision of central bank liquidity to banks—including those under intensified supervision—will be drafted in consultation with Fund staff by end-April.
- Other legal changes—needed to clarify the legal powers of different institutions to generate and issue financial sector regulations—will be undertaken during 2003.

Strengthening of financial institutions over the next several months:

- Contingency plans for potential solvency problems of individual financial institutions are expected to be developed in coordination with the Bank and the Fund in the coming months.
- By end-June, the soundness of each bank will be evaluated, based on audited accounts, and related action plans will be developed to maintain banks' soundness.
- Stress tests will determine the potential impact on banks of corporate restructuring, given the need for debt relief from creditor banks (see next topic).

Medium-term comprehensive strategy for the financial and corporate sectors:

- A high level management team will be appointed, to develop and coordinate the strategy for the financial and corporate sectors within a set of principles to guide the scheme, to be undertaken in the framework of a voluntary, private, and decentralized decision-making process. The strategy will be formulated by June 2003.
- This team will analyze the systemic risk in the corporate sector, with a view to analyzing the impact of potential debt relief on banks' balance sheets; and assessing whether there is room to extend regulatory forbearance to banks that provide debt relief to private firms.
- Draft laws on bankruptcy procedures and informal workout mechanisms, to be drafted in consultation with World Bank and Fund staffs, will be submitted to Congress by end-April. They are expected to be approved before the third program review.
- The framework under which any public or publicly guaranteed funds might be provided—only after any previously existing losses have been recognized by private shareholders of distressed firms or financial institutions—will be designed in consultation with Fund staff by the second review.

It will be guided by the following set of general principles:

- Temporary regulatory forbearance to financial institutions[17] or the provision of debt relief on liabilities to the public sector beyond the envisaged tax regularization scheme[18] will be granted, if necessary, only in the context of corporate restructuring;
- Such debt restructuring would be undertaken in the framework of a voluntary, private, and decentralized decision process;
- Any upgrade in the status of a restructured loan (for purposes of calculating provisioning requirements) would be only allowed once the loan has been regularly serviced; and
- Any public or publicly guaranteed funds would be provided only after losses have been fully recognized by private shareholders of distressed firms or financial institutions. In this context, care will be taken to minimize the cost of corporate workouts within a transparent process.

27. **As part of this strategy, the authorities have committed to putting in place the legal framework, mechanisms, and instruments needed to carry forward the corporate restructuring process.** A flexible out-of-court workout mechanism will be introduced, centered on creditor committees, coupled with modern formal bankruptcy proceedings as an important part of the incentive structure to be used when the informal approach fails.

28. **The challenges facing the authorities in tackling these complex tasks are daunting.** The staff has emphasized the importance of: (i) quickly advancing in the implementation of the corporate restructuring framework, coordinated by a high-level team; (ii) moving in parallel to deal with distressed corporate firms and individual financial institutions, so that the interaction between the two—including the impact of potential relief from banks to viable firms—is fully reflected in restructuring plans; (iii) dealing with potential weaknesses in the banking system that could otherwise distort the proper functioning of the restructuring framework; and (iv) quickly putting in place all regulations and plans for prompt corrective action and bank resolution mechanisms.

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[17] While loan-loss provisions should be made upfront by financial institutions providing debt relief to private firms to ensure the transparency of their balance sheet, a revised minimum capital adequacy ratio could be established, with a schedule for a return to normal levels.

[18] The aim would be to prevent the legal precedence of private firms' liabilities to the public sector (including the tax agencies and the old public pension system) from becoming an obstacle in the restructuring process.

E. Medium-Term Policy Framework

29. **The authorities are developing a medium-term policy strategy, aimed at raising growth and reducing poverty on a sustained basis.** This strategy will build on the current stabilization program in restoring fiscal sustainability and ensuring financial system stability and development. The authorities have prepared a draft PRSP progress report that will be discussed with the donor community, civil society, the political parties, and Congress in the coming months.

30. **Efficient exploitation of Bolivia's vast reserves of gas and oil will be key to Bolivia's medium-term prospects for growth and a viable balance of payments.** The authorities plan to move forward with the project to export liquefied natural gas (LNG) to North America on the most efficient basis. However, if there should be protracted delays in reaching agreement on the LNG project, Bolivia's opportunity to enter the market for natural gas in California could be jeopardized.[19] Also, there is a risk that a choice on purely economic grounds to route the gas pipeline to the Pacific coast through Chile could provoke strong popular opposition due to long-standing political tensions.

31. **The authorities are designing structural reforms as part of their medium-term program to address the key constraints to growth.** Particular emphasis will be paid to raising the tax contribution of the wealthy and enabling the poorer regions of the country to gain benefits from international trade. Attention also will be placed on improving inadequate infrastructure, and reducing labor market rigidities and high nonwage labor costs.

32. **The government aims to reduce the fiscal deficit to 3–3½ percent of GDP in 2005, and further in subsequent years.** Achieving this reduction would depend on fiscal reforms, including improvements in tax administration (with ongoing reforms of the two tax agencies, and a new tax code), a second generation of reforms to make fiscal decentralization more effective, and changes in the structure of expenditure following a public expenditure review in the coming months by the World Bank.

33. **Medium-term policies for the financial and corporate sectors will center on the implementation of an integrated strategy for restructuring the financial and corporate sectors and reducing the system's vulnerability to exchange rate risk.** Progress in this area will depend on achieving a stable macroeconomic environment. In addition, prudential regulations are needed that adequately reflect risks related to exchange rate movements and

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[19] A well designed project could involve around US$1.5 billion of foreign investment in Bolivia, increasing Bolivia's natural gas exports by roughly 50 million cubic meters per day by 2008—representing 5½ percent of GDP—from a level in 2002 of 13.5 million cubic meters per day, and could generate fiscal revenues of about 4 percent of GDP.

that encourage alternative inflation-indexed financial instruments. This would induce a gradual and voluntary shift back to use of the domestic currency without compromising the public's ability to choose between domestic and foreign currency assets.

F. Debt Sustainability and Capacity to Repay

34. **The program would limit the increase in net nonconcessional external debt to US$150 million (about 2 percent of GDP) in 2003,** primarily from the CAF and the International Bank for Reconstruction and Development (IBRD) (¶12). The ceiling includes room for disbursements of US$70 million from the IBRD and the CAF to support financial and corporate restructuring, with a downward adjuster in case the operation is delayed. These loans will be used for social sector budget support, road-building, rural infrastructure, and an employment project.

35. **Bolivia's external debt indicators are higher than projected in 2001 at the completion point under the Enhanced HIPC Initiative, although the ratio of the NPV of debt to exports remains below 150 percent.** Under the program projections, this ratio peaks at 145 percent in 2004 and falls to 137 percent by 2007 (Annex IV Table 1).

36. **Bolivia's public debt would be sustainable if the government's ambitious fiscal adjustment path is achieved and economic growth revives.** Nonfinancial public sector debt would increase by 8 percentage points of GDP to 70 percent of GDP in 2003 (partly due to the exchange rate) and begin to fall after 2005 (Annex IV Figure 1). Nevertheless, the ratio of dollar-denominated external and domestic public debt[20] to exports of goods and services would remain well above the threshold of 200 percent (227 percent at end–2002).

37. **Stress tests show that the projected improvement in debt ratios is subject to substantial risks (see Annex IV for details)**:

- **The projected improvement in the external debt to exports ratio is based upon rapid export growth**, which depends on the successful development of natural gas exports to Brazil, the LNG project for the United States, and other projects.

- **If the targeted fiscal consolidation is not achieved, the fiscal position is unsustainable.** A stress test indicates that if the fiscal program goes off track by only one standard deviation (1.8 percent of GDP), the public debt to GDP ratio continues to increase.

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[20] Bolivia's domestic debt, which is almost all denominated in U.S. dollars, has also grown sharply since the completion point.

- **Because 95 percent of public debt is denominated in foreign currencies, a stress test involving a 30 percent real depreciation has a large impact on the debt to GDP ratio.**

38. **Capacity to repay the Fund**. The program is subject to a range of risks (described in Section H) stemming from political and social tensions, which could adversely affect the authorities' ability to maintain the budget in line with the fiscal program, and to implement the legislative agenda associated with the program. The weaknesses in the financial and corporate sectors also present risks. However, the debt service due to the Fund would constitute a small proportion of Bolivia's exports of goods and services and gross official reserves (Table 10). Bolivia should be able to meet its obligations to the Fund in a timely manner, given its commitment to prudent financial and macroeconomic policies, strong track record, and low level of outstanding credit from the Fund. Nevertheless, given the political situation, risks clearly remain.

39. **A full safeguards assessment is underway, as required under the Fund's safeguards assessment policy.** The required documentation was received from the Central Bank of Bolivia on January 14, 2003. The previous external audit assessment—under the transitional procedures with respect to the PRGF arrangement that has now expired—was completed on October 19, 2000; it concluded that the central bank's external audit mechanism is adequate, as reported in EBS/01/80.

G. Access and Monitoring

40. **Access and phasing**. Access is being proposed in an amount equivalent to SDR 85.75 million (50 percent of quota). This level of access reflects Bolivia's balance of payments need (Table 11) from pressures on the capital account. Despite Bolivia's high debt level, the proposed access is consistent with Bolivia's capacity to repay (see paragraph 38). The initial purchase corresponds to the first credit tranche and accounts for the frontloading of purchases; the subsequent four purchases are equivalent to SDR 10.7 million each, following a first review within two months, and three quarterly reviews thereafter (Table 12).

41. **Performance criteria** have been established for end-March and end-June, and indicative targets for end-September and end-December 2003 as indicated in Table 1 of the MEP. Adjusters are as specified in Table 1 of the TMU. Continuous performance criteria have been established for the nonaccumulation of external arrears. Structural performance criteria and benchmarks are presented in Table 2 of the MEP.

H. Program Risks

42. **There are risks to the economic program for 2003.** Economic growth prospects and financial stability depend heavily on the authorities' ability to handle these risks. Failure to put in place convincing measures to ensure that the fiscal position is sustainable, and to allow corporate and financial restructuring, would imply continued economic stagnation.

- **Broad public and congressional support will be needed for the fiscal program.** Social pressures pose significant risks that could hinder consistent policy implementation, as reflected in the recent civil conflict (see Box 1).

- **There is limited scope for exchange rate policy to respond to exogenous shocks to the program given high dollarization and weak corporate balance sheets.** Full exchange rate flexibility is a medium-term objective.

- **A viable restructuring plan for the financial and corporate sectors must be based on a sound set of general principles.** Otherwise, uncertainties related to the fragility of the financial system could impede policy implementation.

43. **The authorities recognize that there is no room for slippages in policy implementation.** They emphasized their resolve to gain a consensus across social groups about the need for fiscal discipline and to maintain a monetary policy stance consistent with program objectives. The authorities also stressed their commitment to undertake promptly the financial and corporate sector restructuring process in line with FSAP recommendations.

III. Staff Appraisal

44. **Following the recent civil disturbances, the Bolivian authorities are implementing an economic program for 2003 that focuses on stabilizing the economy and laying the basis for a return to income growth.** Fiscal policy is set to achieve a phased reduction of the public sector deficit while financial policies aim to put in place the first stage of financial and corporate sector restructuring. In the meantime, the authorities are developing a broader set of medium-term structural reforms, for which they plan to seek Fund support under a new Poverty Reduction and Growth Facility in the coming months.

45. **The government is seeking the cooperation of a wide range of civil society and Congress to achieve the program objectives.** It is well aware that, in the absence of this cooperation, there are significant risks to the country's social and financial stability. The staff strongly supports the authorities' efforts to increase the level and efficiency of social spending and their resolve not to accede to the demands of selected interest groups at the expense of the rest of the country. An improvement in Bolivia's medium-term economic outlook depends on the government's ability to take decisions based on a long-term perspective rather than short-term demands.

46. **The size of the fiscal adjustment now budgeted to take place in 2003 is lower than envisaged in the original budget submitted to Congress in early February.** The slower adjustment path reflects a more realistic assessment of the country's ability to reduce quickly its fiscal imbalance following four years of economic stagnation. It is important that

the reduction of the fiscal deficit this year be part of a sustained effort to lower the deficit progressively in the next few years to a level that is consistent with a sustainable debt profile.

47. **Implementing the fiscal program will be a considerable challenge.** The fiscal program for 2003 depends greatly on increasing revenue, but the envisaged yield of several measures may be affected by future legal rulings, and there could be delays in congressional approval of the tax procedures code. The staff urges the authorities to hold steadfast in their determination to control expenditures tightly and welcomes their commitment to delay some planned investment spending until it is clear that revenue is at budgeted levels. The authorities also plan to react quickly with additional revenue measures if international oil prices persist at high levels and result in fiscal revenue shortfalls. The authorities' contingency plan for reducing low-priority public investment, if needed to achieve the fiscal targets, is of great importance. In this regard, careful attention will need to be given to protect poverty-reducing expenditure.

48. **The central bank has demonstrated its readiness to react appropriately to market uncertainties.** In the event of renewed deposit outflows and in line with recent experiences, the staff supports the central bank's intention to provide the system with needed liquidity and raise the lending rate, so as to encourage banks to find alternative financing sources and make domestic deposits more attractive. However, there are clear limits to the ability of the central bank to provide dollar liquidity and the authorities will need to be careful to ensure that weaker institutions seeking access to central bank liquidity are subject to appropriate regulatory oversight. Over time, the authorities need to build reserve coverage to more comfortable levels.

49. **Exchange rate policy under the program will be kept under close review.** Developing a more flexible mechanism is, in the staff's view, a priority. However, the authorities believe that increased flexibility of the exchange rate system should take place when the financial system is stronger and mechanisms for dealing with corporate distress are better developed. Actions to establish a sound macroeconomic framework, encourage a gradual process of de-dollarization, and implement prudential norms that penalize exposure to exchange risks would facilitate the transition to a more flexible regime. Successful implementation of these actions is key to reducing the economy's vulnerabilities to external shocks and achieving sustained growth.

50. **The authorities have made an important commitment to restructure the corporate and financial sectors in line with recommendations of the FSAP mission.** It is critical that this strategy—coordinated by a high-level team—follow a sound set of principles—especially that the restructurings be undertaken within the framework of a voluntary, private, and decentralized decision process and that any regulatory forbearance be carefully tailored to ensure that it is in the context of a viable restructuring plan. The staff welcomes the authorities' commitment to a flexible out-of-court workout mechanism, as a useful complement to modern bankruptcy proceedings.

51. **The authorities also need to strengthen the regulatory framework.** This will require swift actions to tighten prudential norms and ensure the operational autonomy of the banking superintendency. In parallel, actions need to be taken to improve the financial health of viable firms. Detailed contingency plans for banks should be developed that take into account the impact of potential debt relief that may be provided by banks to viable firms. It will be important that the soundness of each bank is evaluated, based on the audited accounts and related action plans developed to maintain banks' soundness.

52. **Exploitation of Bolivia's vast reserves of gas and oil will be key to Bolivia's medium-term prospects for growth and a viable balance of payments.** Staff welcomes the authorities' intention to move forward on the most efficient basis with the project to export liquefied natural gas to North America.

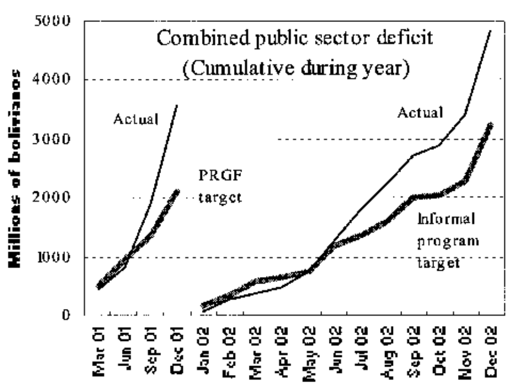
53. **The proposed program with Bolivia is subject to a number of risks but deserves support from the Fund.** These risks mainly stem from political and social tensions, which will test the authorities' ability to maintain the budget in line with the fiscal program, and to implement the legislative agenda associated with the program. The weakness in the financial and corporate sectors also presents risks, leaving the economy vulnerable to shocks. The authorities' commitment to a sustained implementation of the economic and structural policies under this program, including important fiscal and financial measures that reduce existing risks, should help set the stage for a resumption of sustained growth. On the basis of the authorities' strong commitment to implement their economic program for 2003, the staff recommends approval of Bolivia's request for a Stand-By Arrangement, and look forward to its replacement as soon as possible by a Poverty Reduction and Growth Facility.

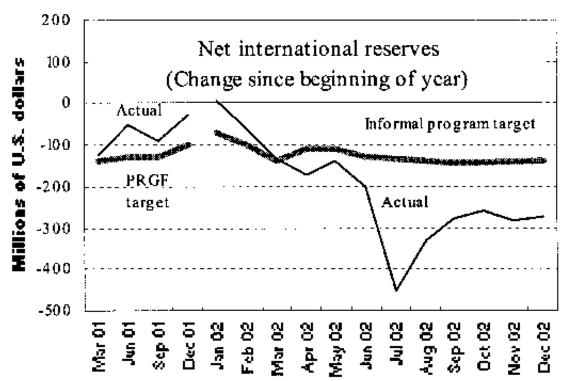
BOX 1. PERFORMANCE UNDER THE THIRD-YEAR PRGF (JUNE 2001–JUNE 2002) AND UNDER THE INFORMALLY MONITORED PROGRAM FOR 2002

- The third-year PRGF arrangement that expired in June 2002 went off track in the second half of 2001. The fiscal targets were missed by large margins mainly because of revenue shortfalls due to the much-weaker-than-expected growth, but also a loss in tax efficiency and a freeze of retail fuel prices. The higher deficit was financed through additional domestic bond sales to private pension funds (which must finance annually up to 2 percent of GDP in government long-term bonds, following the 1997 pension reform) and to the financial system; and foreign financing. Meanwhile, approval of the tax code—a critical structural reform under the program—stalled in Congress due to strong opposition from special interest groups.

- The authorities adopted a financial program for 2002 to reinforce prudent economic management in the run-up to elections in mid–2002. Staff agreed to monitor the authorities' program on an informal basis.

- Performance under the authorities' program was poor. Targets for international reserves and net domestic assets could not be met from the second quarter 2002, initially owing to a deposit run that required the central bank to provide liquidity to financial institutions, and later because of large domestic financing needs of the central government. Fiscal targets were missed from the third quarter, owing to lower royalties from gas exports to Brazil; delays in privatization plans; the continuing freeze of domestic fuel prices; above program wage increases; and large municipal investment outlays in December. Disbursements from the Andean Development Corporation (CAF) boosted nonconcessional financing.





BOX 2. THE SOCIAL SAFETY NET UNDER THE PROGRAM

The main elements of the social safety net are (Table 13 gives further details on costs and financing):

Program	Budgetary cost, 2003 (percent of GDP)
An emergency employment plan (PLANE), introduced in 2002, has been extended until December 2003. It will be phased out as the government's public works program (*Obras con Empleo*) becomes fully operational. PLANE includes programs to provide jobs for new investment projects of public interest, to generate employment in rural areas by funding jobs for transport maintenance, and to finance employment in technical activities of local governments. Private employment agencies manage the unemployment registry, allocate jobs, and provide administration and supervision services. This program is expected to create about 30,000 new jobs.	0.4
A universal health insurance program (SUMI) will provide full access to public health care to all children under five, and women during pregnancy and up to six months after delivery. Additional program objectives are to improve existing health facilities for the treatment of most children's and pregnant women's medical problems, and to facilitate access to health services across different departments.	0.3
Under a **school scholarship scheme** (*Beca Futuro*), families whose children attend school will receive Bs 50 per child, roughly half the average monthly wage for child labor. Coverage will be targeted according to regional indicators on the percentage of child labor, school attendance, indices of unsatisfied basic needs, population density of children, and availability of schools.	0.05
The **school-breakfast program,** aimed at solving child malnutrition and enhancing school performance, has effectively been implemented in a few municipalities and is planned to be expanded.	0.04
The new Bonosol law establishes a **lump sum payment to all citizens 65 years or older** of Bs 1,800 (the program started in January 2003 and its annual cost would be close to 1.3 percent of GDP). This payment will not be paid out of budgetary expenditures but out of the collective privatization fund (*Fondo de Capitalización Colectiva,* FCC), that comprises the population's minority shareholding of enterprises that were privatized in the 1990s.	---
Total	**0.8**

Box 3. The Payroll Tax and Fund Staff Advice

The budget submitted to congress in early February 2003 proposed changes to an existing payroll tax, the RC-IVA,[1] that would have significantly increased taxes paid by salaried workers. The budget proposal was followed by widespread social protests and by the tragic events of mid-February.

The authorities' proposal implied that: (i) taxpayers could no longer deduct any of their VAT receipts from their tax liability; (ii) the threshold for the tax would be reduced from four times, to two times, the minimum wage; and (iii) the RC-IVA rate would be cut from 13 percent to 12.5 percent.

A TA mission from the Fund recommended in 1999 to: (i) replace the RC-IVA with a full-fledged, broad-based personal income tax (PIT); (ii) maintain an exemption level for the PIT equivalent to four times the minimum wage, in order to protect low-income households; and (iii) allow taxpayers to present VAT receipts that could cut as much as half of the tax liability, thus maintaining the cross-checking role of the RC-IVA. More recently, Fund staff had advised the authorities to consider a slow transition from the RC-IVA to a conventional PIT while tax administration was being strengthened.

Prior to the budget submission, Fund staff had recommended that a more balanced fiscal adjustment be achieved through expenditure restraint—especially by reducing low-priority capital expenditure—and through alternative revenue measures, including a gradual increase in domestic retail prices for hydrocarbon products. However, the authorities, considering political constraints, chose to submit the modified payroll tax.

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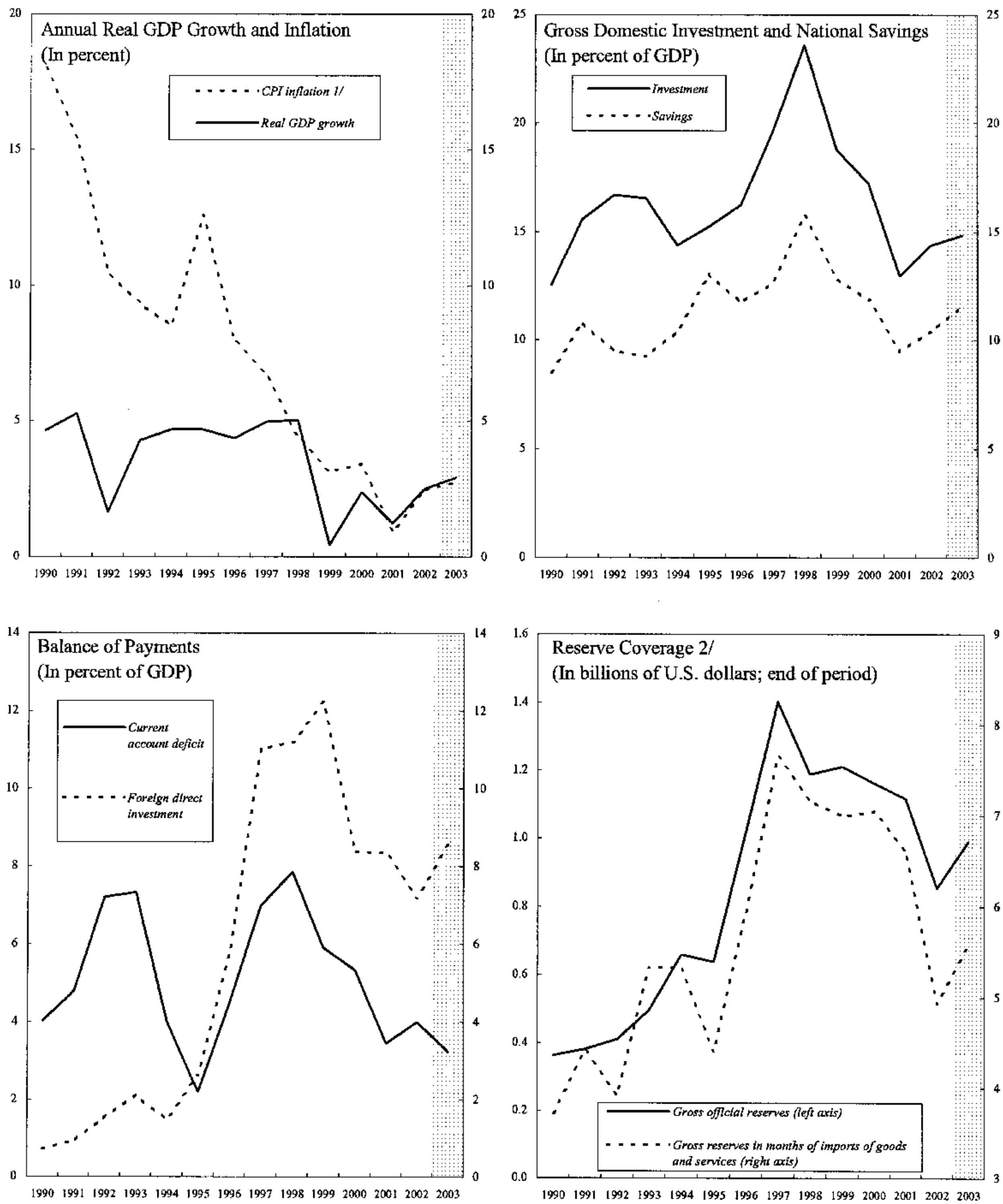
[1] The RC-IVA (in Spanish, complementary tax to the value added tax, VAT) is a withholding tax on wages and interest income of 13 percent, against which taxpayers can credit their VAT receipts to encourage taxpayer compliance with the VAT. By the mid–1990s, it had become clear that the tax was inefficient and inequitable, as it created a black market for VAT invoices.

Figure 1. Bolivia: Selected Economic Indicators, 1990-2003

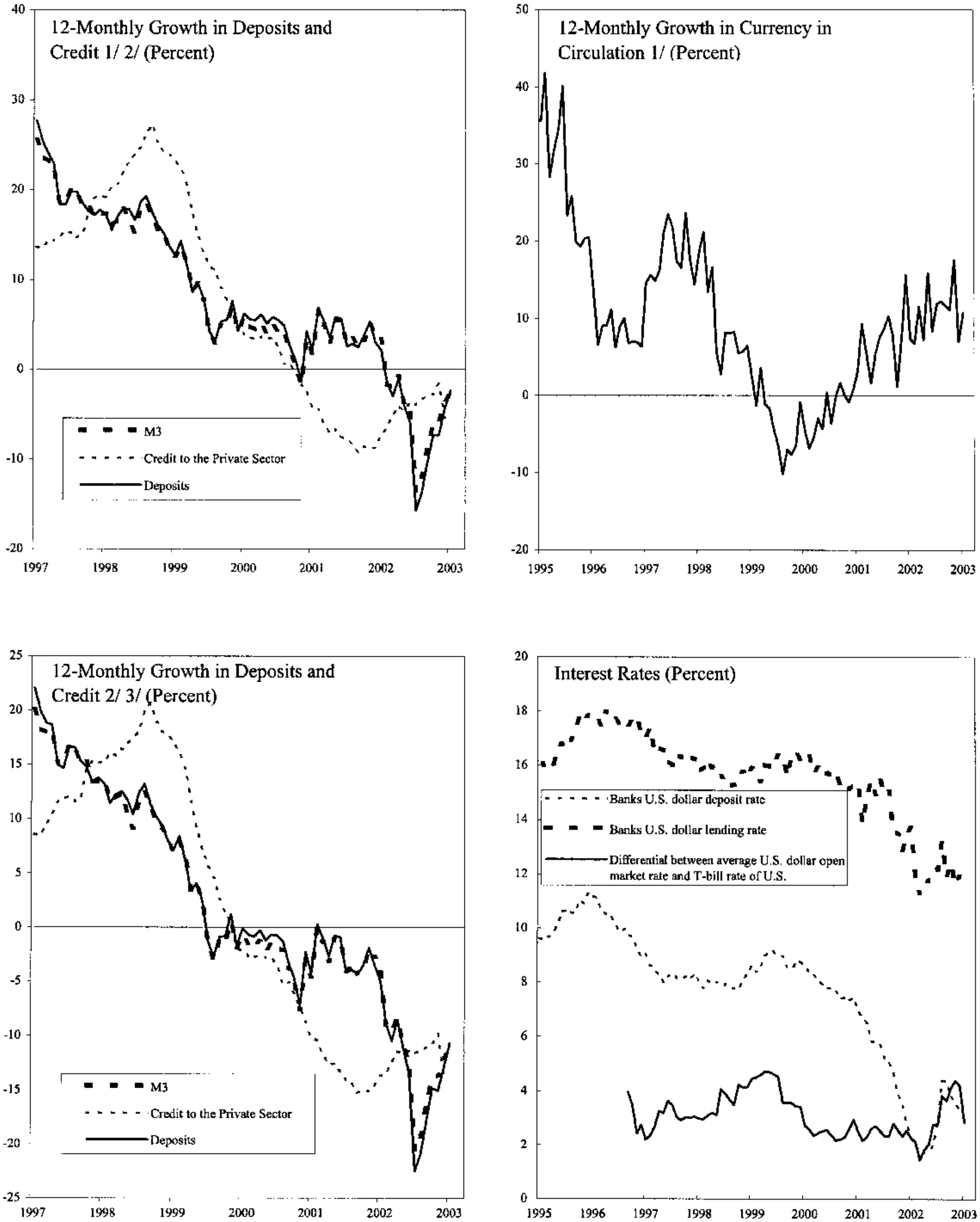


Sources: Central Bank of Bolivia; Ministry of Finance; and Fund staff estimates.

1/ December over December.

2/ Since 1997, includes reduced reserve requirements on foreign currency deposits and gold valuation of US$250 per troy ounce; for 2003, gold is valued at US$300 per troy ounce; excludes commercial banks' liquid asset requirement (RAL) held overseas.

Figure 2. Bolivia: Monetary and Financial Sector Indicators



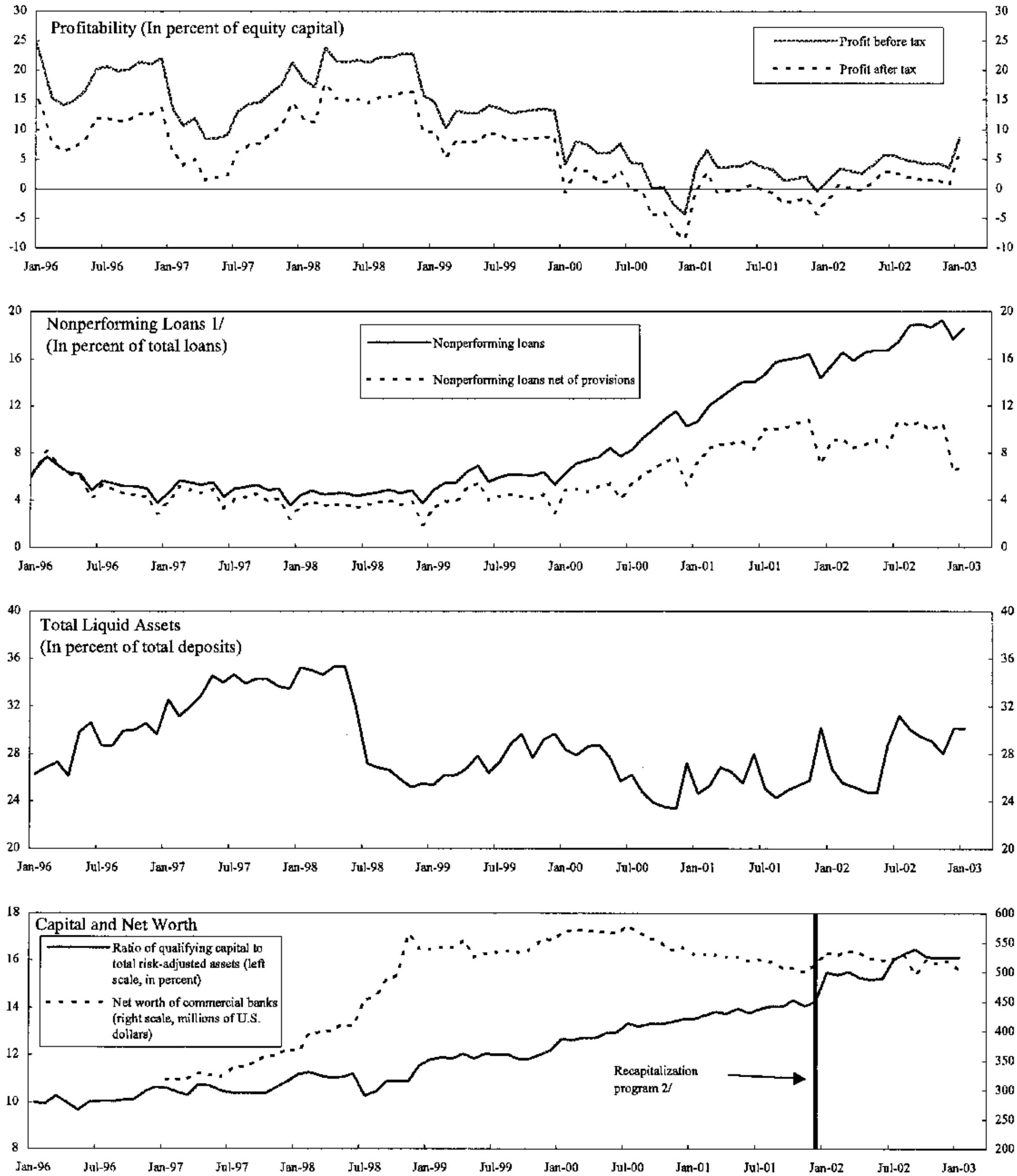
Sources: Central Bank of Bolivia, Superintendency of Banks; and International Monetary Fund, *International Financial Statistics*.

1/ In bolivianos, at current exchange rates.

2/ Deposits include accrued interest. Credit includes loan portfolio purchased by the central bank and FONDESIF, loans from banks in liquidation, and commercial banks' investments.

3/ In U.S. dollars at current exchange rates.

Figure 3. Bolivia: Commercial Bank Performance Indicators, 1996-2003

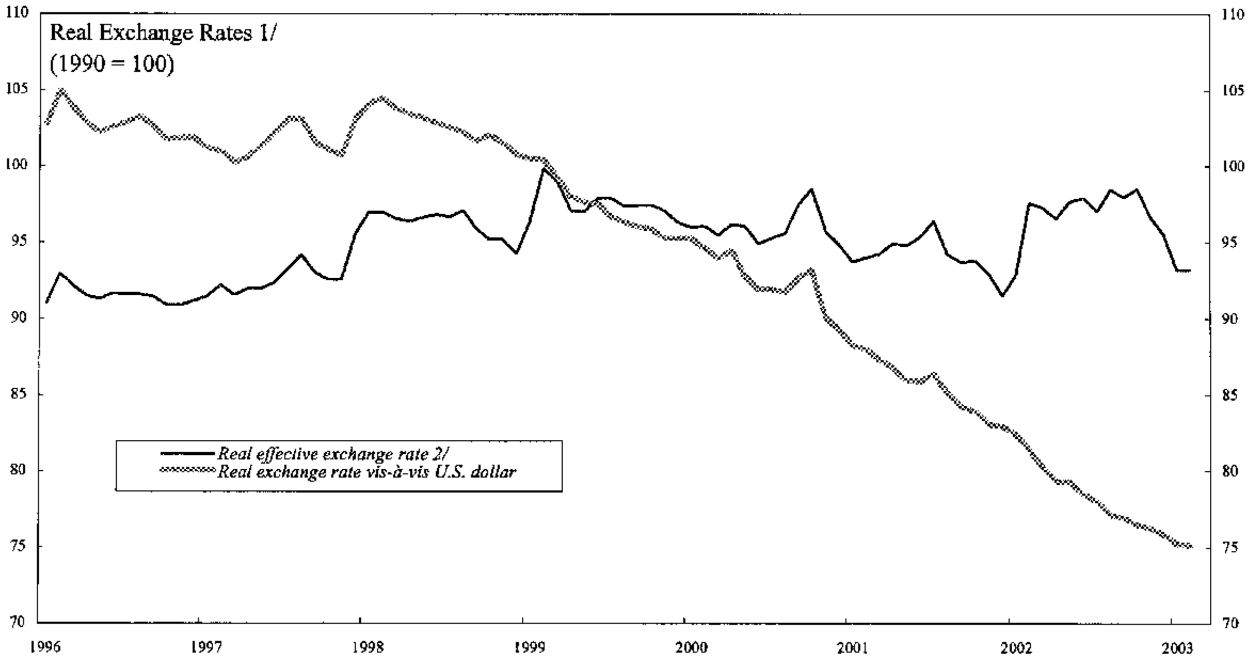


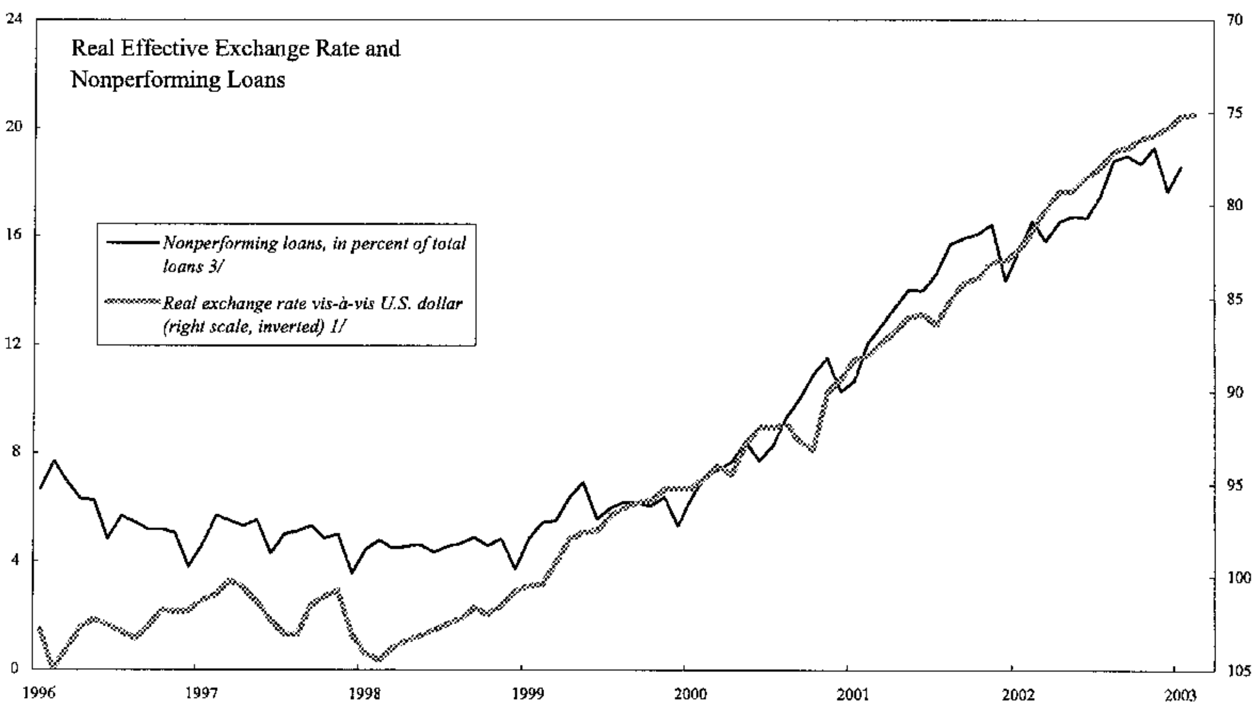
Source: Superintendency of Banks.

1/ Data prior to January 2000 have been adjusted to exclude loans that are less than 30-days past due, based on the average ratio of such loans to total past due loans during January-September 2000.

2/ In December 2001, three banks were recapitalized through public sector guaranteed subordinated loans under the PROFOP program.

Figure 4. Bolivia: Real Exchange Rate and Quality of Bank Portfolio, 1996-2003





Sources: International Monetary Fund, *International Financial Statistics;* and Fund staff estimates.

1/ Increase is an appreciation. Based on exchange rate data available as of end-February 2003, and staff projections for CPI.

2/ Weights based on trade with ten countries, excluding trade related to natural gas, in 1996-97.

3/ Data prior to January 2000 have been adjusted to exclude loans that are less than 30-days past due, based on the average ratio of such loans to total past due loans during January-September 2000.

Table 1. Bolivia: Selected Economic and Financial Indicators

	1999	2000	2001	2002 Prel.	2003 Prog. 1/
	(Annual percentage change)				
Income and prices					
Real GDP	0.4	2.4	1.2	2.5	2.9
Real domestic demand	-2.0	-0.1	-2.0	2.7	1.9
GDP deflator	2.4	4.8	0.7	2.0	3.0
CPI (period average)	2.2	4.6	1.6	0.9	2.6
CPI (end-of-period)	3.1	3.4	0.9	2.4	2.8
	(In percent of GDP)				
Investment and savings					
Gross domestic investment	18.8	17.2	13.0	14.4	14.8
Public	5.1	5.3	6.0	6.2	6.0
Private, including stockbuilding	13.7	11.9	6.9	8.2	8.8
Gross national savings	12.9	11.9	9.5	10.4	11.6
Public	2.9	2.8	1.4	0.1	1.9
Private	10.0	9.1	8.1	10.3	9.7
Combined public sector					
Overall balance	-3.5	-3.7	-7.0	-8.7	-6.5
External financing 2/	1.9	2.0	3.1	6.2	6.4
Domestic financing	1.6	1.8	3.9	2.5	0.1
Nonpension balance	0.6	0.7	-2.2	-3.7	-1.6
Pension-related balance	-4.1	-4.5	-4.8	-5.0	-4.9
Nonfinancial public sector debt 3/	59.1	58.9	53.9	62.3	70.2
External	49.1	47.3	36.2	42.9	50.4
Domestic	10.0	11.6	17.7	19.4	19.9
	(Annual percentage change, unless otherwise stated)				
Money and credit					
Broad money (in U.S. dollars at current exchange rates)	-1.8	-3.3	-3.1	-11.7	6.3
Credit to private sector (in U.S dollars at current exchange rates)	-2.0	-9.0	-13.6	-9.5	3.4
Interest rates (percent, end-of-period) 4/					
Commercial banks lending rate in U.S. dollars	16.3	15.3	13.5	11.9	12.2
Yield on treasury bills in local currency	13.6	14.7	12.9	17.2	13.9
Yield on treasury bills in U.S. dollars	8.9	9.1	5.6	4.9	4.8
External sector (US$ million) 2/					
Current account	-488	-446	-276	-307	-245
(In percent of GDP)	-5.9	-5.3	-3.5	-4.0	-3.2
Capital and financial account	515	408	255	15	294
Of which: foreign direct investment	1,014	701	666	553	647
Overall balance	26	-39	-21	-293	49
Exceptional financing 5/	16	15	9	17	16
Merchandise export volume, percent change	-1.2	13.2	6.0	7.5	4.5
Merchandise import volume, percent change	-6.8	3.1	-3.5	7.6	-0.8
Terms of trade, percent change (deterioration -)	1.4	3.6	0.5	0.5	1.3
Gross international reserves 6/					
(In months of imports of goods and services)	8.7	8.7	8.2	6.2	6.9
(In percent of broad money)	40.2	39.7	39.2	34.6	37.3
Disposable reserves in percent of dollar deposits 7/	37.7	39.5	39.4	31.6	35.1
Public sector external debt (US$ billion) 3/	4.6	4.5	3.3	3.7	4.3
Exchange rates					
Bolivianos/U.S. dollar (end-of-period) 8/	6.00	6.40	6.83	7.50	7.59
Real effective exchange rate (REER; percentage change during year) 9/	2.2	-1.5	-3.5	4.4	-2.4
REER, period average (percentage change) 9/	1.4	-1.6	-2.0	3.0	-2.1

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

1/ Proposed program for 2003.

2/ Includes actual and anticipated assistance under the HIPC Initiative, using the HIPC accounting conventions. External financing for 2002 includes a US$100 million (1.3 percent of GDP) transfer of foreign liabilities from the central bank to the central government in 2002.

3/ External debt reflects assistance under the original and enhanced HIPC Initiatives, and beyond HIPC relief; includes obligations to the Fund and debt with public guarantee. Domestic debt is the nonfinancial public sector debt, excluding bonds issued for the recapitalization of the central bank.

4/ Yields on treasury bills are those of the latest auction held; March 18 (March 6 for the lending rate in U.S. dollars) for 2003.

5/ Includes grants for debt-reduction operations in effect prior to July 2000 and rescheduling operations under the original HIPC framework.

6/ Equal to central bank's gross official reserves plus commercial banks' liquid asset requirement (RAL) held overseas; excludes reserves from the Latin American Reserve Fund (FLAR). End-2002 figures reflect an increase of US$45 million in the valuation of holdings of gold; import coverage for the following year.

7/ Ratio of central bank gross disposable reserves (excluding gold holdings) plus commercial banks' liquid asset requirement (RAL) held overseas to dollar deposits in the banking system.

8/ Official (sell) exchange rate; March 18 for 2003.

9/ Weights based on average trade, excluding trade related to natural gas, in 1996–97. Preliminary estimates for December 2002. Data for 2003 refer to February, based on exchange rate data available as of end-February, and Fund staff CPI projections. Positive variation is an appreciation.

Table 2. Bolivia: Summary Balance of Payments

(In millions of U.S. dollars, unless otherwise noted)

	1999	2000	2001	2002 Prel.	2003 Prog.
Current account	**-488**	**-446**	**-276**	**-307**	**-245**
Trade balance	-704	-584	-423	-426	-344
Exports, f.o.b.	1,051	1,246	1,285	1,320	1,435
Of which : gas	36	122	237	266	374
Imports, c.i.f. (-)	-1,755	-1,830	-1,708	-1,746	-1,779
Of which: capitalization and pipeline 1/	...	-161	-136	-184	-84
Services (net)	26	-24	-36	-44	-54
Income (net)	-196	-226	-210	-201	-224
Of which: interest due on external public sector debt 2/	-126	-130	-115	-98	-105
Of which: investment income (net)	-52	-146	-165	-177	-197
Transfers (net)	386	387	393	364	377
Of which: HIPC assistance from grants	62	57	65	80	68
Capital and financial account	**515**	**408**	**255**	**15**	**294**
Capital transfers	0	0	3	2	2
Direct investment (net)	1,014	701	666	553	647
Of which: from capitalization	506	194	171	49	46
Portfolio investment (net)	-61	55	-23	-83	-86
Public sector loans	113	112	189	321	452
Disbursements	280	292	364	577	733
Amortization 2/	-167	-180	-175	-256	-281
Banks' net foreign assets, excl. liquid asset requirement	-159	-369	-402	16	-142
Nonbank private sector loans	-12	-16	-49	125	180
Other, including errors and omissions	-380	-75	-128	-921	-759
Overall balance	**26**	**-39**	**-21**	**-293**	**49**
Exceptional financing	**16**	**15**	**9**	**17**	**16**
Of which: HIPC assistance from rescheduling	16	15	9	17	16
Net international reserves (increase -)	**-42**	**23**	**29**	**275**	**-65**
Memorandum items:					
Gross official reserves (end-of-period) 3/	1,211	1,162	1,116	854	992
(In months of imports) 4/	7.0	7.0	6.6	4.9	5.6
Gross international reserves (end-of-period) 5/	1,498	1,436	1,375	1,073	1,227
(In months of imports) 4/	8.7	8.7	8.2	6.2	6.9
Total HIPC assistance and beyond HIPC relief	85	80	99	159	157
Original HIPC framework	85	79	59	43	39
Of which: assistance from debt reduction	7	7	8	7	9
Enhanced HIPC framework	...	1	28	85	82
Of which: assistance from debt reduction	...	1	5	23	28
Beyond HIPC and other debt relief	...	0	12	32	35
(Annual percentage change)					
Export volume	-1.2	13.2	6.0	7.5	4.5
Import volume	-6.8	3.1	-3.5	7.6	-0.8
Nonexceptional import volume	...	...	-3.6	5.7	2.6
Terms of trade	1.4	3.6	0.5	0.5	1.3
(In percent of GDP)					
Current account	-5.9	-5.3	-3.5	-4.0	-3.2
Current account before HIPC assistance 6/	-6.7	-6.1	-4.4	-5.3	-4.5
Merchandise exports	12.7	14.9	16.1	17.2	19.0
Merchandise imports	21.2	21.9	21.4	22.7	23.6
Of which: capitalization and pipeline	4.9	1.9	1.7	2.4	1.1
Direct investment (net)	12.2	8.4	8.3	7.2	8.6
Grants and loans 7/	5.5	5.7	6.9	9.8	12.5
NPV of debt, in percent of exports of goods and services (3-year backward moving average)	221.0	199.3	100.2	117.3	136.5
External debt service, in percent of exports of goods and services	...	20.4	18.1	12.5	17.6

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

1/ Capitalized enterprises are formerly state-owned enterprises with foreign capital.
2/ Reflects lower scheduled debt service, owing to HIPC assistance in the form of stock-of-debt reduction (original HIPC starting in 1998, enhanced HIPC starting in 2001).
3/ Excludes reserves from the Latin American Reserve Fund (FLAR).
4/ In months of imports of goods and services in the following year.
5/ Equal to central bank's gross official reserves plus commercial banks' liquid asset requirement (RAL) held overseas.
6/ Before any assistance under the HIPC Initiative.
7/ Official transfers and loans to the public sector, excluding HIPC debt relief.

Table 3. Bolivia: Operations of the Combined Public Sector

(In percent of GDP)

	1999	2000	2001	2002 Prel.	2003 Prog.
Balance excluding pensions (deficit -)	**0.6**	**0.7**	**-2.2**	**-3.7**	**-1.6**
Current revenue	23.2	22.9	23.1	22.4	24.1
General government	23.1	22.4	22.2	22.2	23.9
Taxes	18.6	18.8	18.3	18.3	20.6
Hydrocarbons	5.3	5.1	5.2	4.7	5.5
Other	13.4	13.6	13.1	13.6	15.1
Nontax revenue	4.5	3.6	4.0	3.9	3.3
Public enterprise operating balance	-0.3	0.0	0.3	-0.3	-0.1
Central bank operating balance	0.4	0.5	0.5	0.5	0.3
Current expenditure of general government	18.1	17.8	19.3	19.6	20.1
Wages	8.6	8.4	8.9	9.2	9.4
Interest	2.0	2.3	2.6	2.7	2.9
Other	7.6	7.2	7.7	7.7	7.8
Official grants	1.8	2.2	2.4	2.3	2.8
Of which: HIPC assistance from grants	0.8	0.7	0.8	1.0	0.9
Capital revenue	0.8	0.6	0.1	0.0	0.2
Capital expenditure	7.1	7.1	8.5	8.8	8.6
General government	6.9	6.9	8.4	8.7	8.5
Public enterprises	0.2	0.2	0.2	0.2	0.0
Pension-related balance (deficit -)	**-4.1**	**-4.5**	**-4.8**	**-5.0**	**-4.9**
Revenue	0.0	0.0	0.0	0.0	0.0
Expenditure	4.1	4.5	4.8	5.0	4.9
Pensions	3.7	4.1	4.5	4.7	4.5
General government employer contributions	0.4	0.3	0.4	0.4	0.4
Overall balance (deficit -)	**-3.5**	**-3.7**	**-7.0**	**-8.7**	**-6.5**
Financing	**3.5**	**3.7**	**7.0**	**8.7**	**6.5**
External 1/	1.9	2.0	3.1	6.2	6.4
Of which: HIPC assistance from refinancing	0.2	0.2	0.1	0.2	0.2
Domestic	1.6	1.8	3.9	2.5	0.1
Central bank	-1.4	0.4	-0.5	1.7	-0.4
Commercial banks	-0.2	0.4	0.9	0.2	0.0
Pension funds	1.9	1.7	1.7	1.7	1.9
Other	1.3	-0.7	1.8	-1.0	-1.3
Memorandum items:					
Overall balance before grants (deficit -)	-5.3	-6.0	-9.4	-11.0	-9.3
Overall balance excluding grants and hydrocarbons (deficit -)	-10.6	-11.1	-14.6	-15.8	-14.8
Primary deficit (-)	-1.5	-1.5	-4.3	-6.1	-3.6
Savings	2.9	2.8	1.4	0.1	1.9
Poverty reducing expenditure 2/	10.6	10.8	12.2	12.4	12.9
Total assistance under the HIPC Initiative	1.0	1.0	1.1	1.6	1.6
Original framework	1.0	1.0	0.7	0.5	0.5
Enhanced framework	...	...	0.3	1.1	1.1
HIPC assistance from stock-of-debt reduction	0.1	0.1	0.2	0.4	0.5
On interest	0.1	0.1	0.1	0.2	0.2
On amortization	0.0	0.0	0.1	0.2	0.3
GDP (in billions of bolivianos)	48.2	51.7	52.7	55.1	58.4

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

1/ Includes a US$100 million (1.3 percent of GDP) transfer of foreign liabilities from the central bank to the central government in 2002.
2/ Preliminary estimates for 2002 and projections for 2003.

Table 4. Bolivia: Monetary Survey 1/

	1999	2000	2001	2002 Prel.	2003 Prog.
		I. Central Bank			
		(In percent of currency issue at beginning of period)			
Net international reserves	10.2	-6.0	-7.7	-71.7	16.5
(Flow in millions of U.S. dollars)	42.3	-23.4	-28.5	-275.4	65.0
Net domestic assets	-10.2	6.2	19.1	84.2	-8.1
Net credit to nonfinancial public sector	-28.0	8.5	-11.1	34.6	-8.5
Net credit to financial intermediaries	6.4	-20.6	3.7	11.9	-6.7
Of which: open market operations	-2.1	16.0	5.5	6.0	-4.4
Medium- and long-term net foreign liabilities	8.1	8.7	16.6	39.5	4.3
(Flow in millions of U.S. dollars, increase -)	33.3	33.9	57.1	151.8	16.1
Other	3.4	9.6	10.0	-1.9	2.8
Currency issue	0.0	0.2	11.4	12.5	8.5
		II. Banking System			
		(In percent of broad money at beginning of period)			
Net short-term foreign assets	5.9	6.6	9.1	-10.8	6.9
(Flow in millions of U.S. dollars)	221.5	244.4	329.4	-379.2	214.0
Net domestic assets	-6.6	-8.6	-11.1	0.7	0.6
Net credit to the public sector	-3.5	1.7	0.8	4.2	-1.1
Credit to the private sector	-1.9	-10.7	-15.2	-9.3	3.7
Medium- and long-term net foreign liabilities	0.7	3.3	1.5	4.8	0.9
(Flow in millions of U.S. dollars, increase -)	27.1	122.7	54.2	151.3	26.3
Other	-1.9	-2.9	1.8	1.1	-2.9
Broad money	-0.7	-2.0	-2.0	-10.1	7.5
		(12-month percentage change)			
Broad money 2/	-0.7	-2.0	-2.0	-10.1	7.5
Liabilities in bolivianos (M2)	-2.5	3.8	13.7	2.7	7.8
Foreign currency deposits 3/	-0.9	-2.6	-5.0	-12.8	7.5
Credit to private sector	-1.6	-8.8	-13.4	-9.2	3.6
Credit in bolivianos	-3.4	-2.3	-14.0	-9.2	3.6
Foreign currency credit 3/	-1.5	-9.0	-13.4	-9.2	3.6
Memorandum items:					
		(Average stock in percent of GDP)			
Currency issue	4.2	3.8	3.9	4.1	4.2
Broad money 2/	45.1	43.4	42.0	36.1	36.6
Credit to private sector	48.3	52.5	45.2	39.2	38.8
		(In percent of total deposits or credit at current exchange rates)			
Dollarization (end-period stocks)					
Foreign currency deposits 3/	92.9	92.6	91.5	91.9	92.6
Foreign currency credit 3/	96.3	96.3	97.0	97.3	97.5
		(12-month percentage change at current exchange rates)			
Broad money 2/	4.2	3.4	3.4	-3.0	13.4
Credit to private sector	4.1	-2.6	-8.8	-0.6	10.3
		(12-month percentage change in U.S. dollars at current exchange rates)			
Broad money 2/	-1.8	-3.3	-3.1	-11.7	6.3
Credit to private sector	-2.0	-9.0	-13.6	-9.5	3.4

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

1/ Flows in foreign currency are valued at the accounting exchange rate for the corresponding period. The banking system comprises the central bank, commercial banks, the National Financial Institution of Bolivia and FONDESIF, which are state-owned second-tier banks.

2/ Includes special certficates of deposits (CDDs) issued by the central bank during the liquidation of failed banks.

3/ Includes deposits and credits in bolivianos that are indexed to the U.S. dollar.

Table 5. Bolivia: Commercial Bank Performance Indicators

(In percent)

			2001				2002				2003
	1999	2000	Mar.	Jun.	Sep.	Dec	Mar.	Jun.	Sep.	Dec.	Jan. 1/
Profitability											
Ratios to total assets (period average) 2/											
Operating income	4.9	3.5	4.1	4.2	3.9	3.7	3.9	4.2	4.0	4.1	4.5
Profit before tax	1.2	-0.4	0.4	0.5	0.1	0.0	0.3	0.6	0.5	0.4	1.0
Ratios to equity capital (period average) 2/											
Profit before tax	13.2	-4.3	3.6	4.6	1.4	-0.5	3.0	5.7	4.5	3.5	8.6
Profit after tax	8.7	-8.6	-0.5	0.6	-2.4	-4.1	0.2	2.8	1.7	0.6	6.2
Asset quality											
Ratios to total loans (end-of-period)											
Past due loans up to 30 days	...	1.3	2.7	1.8	2.8	1.8	2.5	2.2	2.7	...	...
Nonperforming loans 3/	6.6	10.3	12.7	14.0	15.9	14.4	15.8	16.7	18.9	17.6	18.6
Nonperforming loans and nonperforming assets	8.6	13.7	16.9	18.9	21.4	20.6	22.4	23.6	26.5	25.7	26.6
Nonperforming loans net of provisions 3/	2.9	5.2	8.7	8.3	10.2	7.0	8.4	8.5	10.6	6.4	7.0
Liquidity											
Ratios to total deposits (end-of-period)											
Total loans	112.7	102.4	98.9	97.3	97.1	93.1	95.1	99.1	102.6	94.6	91.7
Total liquid assets	29.7	27.2	26.9	28.0	24.9	30.2	25.2	28.8	29.5	30.2	30.2
Capital adequacy											
Ratio of qualifying capital to total risk-weighted assets (end-of-period)	12.2	13.5	13.8	13.8	14.0	14.3	15.5	16.0	16.5	16.1	16.1

Source: Superintendency of Banks; and Fund staff estimates.

1/ Provisional data.

2/ Averages in 2001 and 2002 are cumulative from January of each year.

3/ Adjusted to exclude the estimated share of loans overdue by less than one month, which were included in official statistics prior to January 2000; since December 2002, reported nonperforming loans exclude loans overdue by less than a month.

Table 6. Bolivia: Financial and External Vulnerability Indicators

(In percent; end of period unless otherwise indicated)

	1999	2000	2001	2002	Proj. 2003
Financial indicators					
Public sector debt/GDP 1/	59.1	58.9	53.9	62.3	70.2
Of which : in domestic currency (percent of GDP) 1/	2.7	2.2	2.8	3.4	5.0
Lending rate in domestic currency 2/ 3/	15.4	18.0	15.8	12.7	13.3
Lending rate in U.S. dollars 2/ 3/	16.3	15.3	13.5	11.9	12.2
Velocity of money 4/	2.2	2.3	2.4	2.8	2.7
Credit to the private sector/GDP 5/	48.3	52.5	45.2	39.2	38.8
Share of foreign currency deposits in total deposits	92.9	92.6	91.5	91.9	92.6
Share of foreign currency loans in total credit	96.3	96.3	97.0	97.3	97.5
Nonperforming loans/total loans 6/ 7/	6.6	10.3	14.4	17.6	18.6
Loan-loss provisions/nonperforming loans 6/ 7/	55.8	61.4	63.7	63.7	62.5
Risk-based capital-assets ratio 6/	12.2	13.5	14.3	16.1	16.1
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	3,349	3,042	2,891	2,521	2,709
Commercial banks' net short-term foreign assets (in millions of U.S. dollars)	-15	252	610	506	655
Disposable reserves in percent of dollar deposits 8/	37.7	39.5	39.4	31.6	35.1
External indicators					
Exports, U.S. dollars (percent change)	-4.8	18.6	3.1	2.7	8.8
Imports, U.S. dollars (percent change)	-11.5	4.3	-6.7	2.2	1.9
Terms of trade (percent change)	1.4	3.6	0.5	0.5	1.3
Real effective exchange rate, (percent change) 9/	2.2	-1.5	-3.5	4.4	-2.4
Current account balance (percent of GDP)	-5.9	-5.3	-3.5	-4.0	-3.2
Capital and financial account balance (percent of GDP)	6.2	4.9	3.2	0.2	3.9
Total external debt (percent of GDP) 10/	...	59.5	46.9	52.8	60.3
Medium- and long-term public debt (percent of GDP) 1/	55.1	53.3	41.7	48.1	57.0
Medium- and long-term private debt (percent of GDP) 10/	...	4.2	3.4	2.7	2.4
Short-term public and private debt (percent of GDP) 10/	...	2.0	1.9	2.0	1.0
Total external debt (percent of exports of goods and services) 10/	...	338.7	246.2	261.4	271.8
Gross international reserves					
In millions of U.S. dollars 11/ 12/	1,498	1,436	1,375	1,073	1,227
In percent of short-term external debt 11/ 12/ 13/	...	44.7	45.2	40.1	44.1
In percent of broad money 11/ 12/	40.2	39.7	39.2	34.6	37.3
In months of imports of goods and services) 11/ 12/	8.7	8.7	8.2	6.2	6.9
Net international reserves (in millions of U.S. dollars) 12/	1,089	1,066	1,048	810	875

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

1/ Debt indicators reflect assistance under the HIPC Initiative, which first became available after September 1998, as well as the relief under the enhanced HIPC Initiative and beyond HIPC. Includes obligations to the Fund and debt with public guarantee. For 2003, new debt with the pension funds is issued in inflation-indexed units (UFVs).

2/ Financial sector effective interest rates.

3/ Data for 2003 correspond to March 6.

4/ Defined as the inverse of the annual average ratio of broad money to annual GDP.

5/ Annual average stock.

6/ Data for 2003 correspond to end of January.

7/ Nonperforming loans are adjusted to exclude the estimated share of loans overdue by less than one month, which were included in official statistics prior to January 2000.

8/ Ratio of central bank gross disposable reserves (excluding gold holdings) plus commercial banks' liquid asset requirement (RAL) held overseas to dollar deposits in the banking system.

9/ Weights based on average trade, excluding trade related to natural gas, in 1996-97. Positive variation is an appreciation.

10/ Staff estimate.

11/ Gross international reserves equal to central bank's gross official reserves plus commercial banks' liquid asset requirement (RAL) held overseas.

12/ Exclude reserves from the Latin American Reserve Fund (FLAR). Import coverage for the following year. From end-2002 on, figures reflect an increase of US$45 million in the valuation of holdings of gold.

13/ Short-term external debt by remaining maturity, added to foreign currency deposits at commercial banks.

Table 7. Bolivia: Medium-Term Macroeconomic Framework, 1999–2005

					Projections		
	1999	2000	2001	2002	2003	2004	2005
			(Annual percentage change)				
Economic growth and prices							
Real GDP at market prices	0.4	2.4	1.2	2.5	2.9	4.3	4.7
Of which: excluding hydrocarbons	0.7	1.8	0.8	1.8	2.0	2.8	3.6
Real domestic demand 1/	-2.0	-0.1	-2.0	2.7	1.9	2.5	3.2
GDP deflator	2.4	4.8	0.7	2.0	3.0	2.6	3.1
CPI (period average)	2.2	4.6	1.6	0.9	2.6	3.1	3.5
CPI (end of period)	3.1	3.4	0.9	2.4	2.8	3.5	3.5
			(In percent of nominal GDP)				
Gross investment	**18.8**	**17.2**	**13.0**	**14.4**	**14.8**	**15.6**	**16.1**
Public investment 2/	5.1	5.3	6.0	6.2	6.0	6.1	6.2
Private investment, including stockbuilding	13.7	11.9	6.9	8.2	8.8	9.5	9.9
Savings	**18.8**	**17.2**	**13.0**	**14.4**	**14.8**	**15.6**	**16.1**
Gross national savings	12.9	11.9	9.5	10.4	11.6	12.1	12.8
Public savings	2.9	2.8	1.4	0.1	1.9	4.4	5.7
Private savings	10.0	9.1	8.1	10.3	9.7	7.8	7.1
External savings	5.9	5.3	3.5	4.0	3.2	3.5	3.3
Combined public sector							
Non-pension balance	0.6	0.7	-2.2	-3.7	-1.6	0.7	1.6
Pension-related balance	-4.1	-4.5	-4.8	-5.0	-4.9	-4.9	-4.7
Overall balance	-3.5	-3.7	-7.0	-8.7	-6.5	-4.2	-3.1
Net domestic financing	1.6	1.8	3.9	2.5	0.1	0.6	0.8
Net external financing	1.9	2.0	3.1	6.2	6.4	3.6	2.3
External sector							
Current account balance	-5.9	-5.3	-3.5	-4.0	-3.2	-3.5	-3.3
Net foreign direct investment	12.2	8.4	8.3	7.2	8.6	11.3	13.4
Memorandum items:							
Nominal GDP (in millions of U.S. dollars)	8,298	8,370	7,981	7,690	7,549	7,635	7,885

Sources: Central Bank of Bolivia, National Institute of Statistics; and Fund staff estimates and projections.

1/ Based on balance of payments figures from the Central Bank of Bolivia, and Fund staff estimates and projections.

2/ Based on national income accounts.

Table 8. Bolivia: Poverty-Reducing Expenditure

	1999	2000	2001	2002	Prog. 2003
	(In millions of bolivianos)				
Current expenditure	**2,981**	**3,132**	**3,619**	**3,790**	**3,983**
Health 1/	1,150	1,249	1,415	1,465	1,588
Education (excluding university level) 1/	1,824	1,875	2,196	2,316	2,387
Other social expenditure 2/	7	9	8	8	9
Capital expenditure	**2,125**	**2,473**	**2,817**	**3,031**	**3,564**
Health	241	380	325	407	508
Education	446	521	706	827	878
Basic sanitation	577	568	490	355	443
Urban development	283	309	424	460	546
Rural development	578	694	873	982	1,188
Of which: rural roads	266	269	383	438	495
Total poverty-reducing expenditure	**5,106**	**5,605**	**6,436**	**6,821**	**7,547**
	(In percent of GDP)				
Current expenditure	**6.2**	**6.1**	**6.9**	**6.9**	**6.8**
Health 1/	2.4	2.4	2.7	2.7	2.7
Education (excluding university level) 1/	3.8	3.6	4.2	4.2	4.1
Other social expenditure 2/	0.0	0.0	0.0	0.0	0.0
Capital expenditure	**4.4**	**4.8**	**5.4**	**5.5**	**6.1**
Health	0.5	0.7	0.6	0.7	0.9
Education	0.9	1.0	1.3	1.5	1.5
Basic sanitation	1.2	1.1	0.9	0.6	0.8
Urban development	0.6	0.6	0.8	0.8	0.9
Rural development	1.2	1.3	1.7	1.8	2.0
Of which: rural roads	0.6	0.5	0.7	0.8	0.8
Total poverty-reducing expenditure	**10.6**	**10.8**	**12.2**	**12.4**	**12.9**
Memorandum items:					
Poverty-reducing expenditure (in percent of public sector expenditure	36.1	36.8	37.5	37.1	38.5
Poverty-reducing investment (in percent of public investment)	61.8	67.3	62.7	62.5	71.4
External financing of poverty-reducing expenditure (in percent of poverty-reducing expenditure)	10.2	14.3	15.2	36.2	40.3
Social expenditure (in millions of bolivianos) 3/	8,026	8,922	10,070	10,840	11,656
(in percent of GDP)	16.7	17.3	19.1	19.7	20.0

Source: Ministry of finance.

1/ Excluding health and education spending by the ministry of defense.

2/ Social spending by prefectures.

3/ Expenditure on health, education (including universities), and basic sanitation.

Table 9. Bolivia: External Financing, 2002–03
(In millions of U.S. dollars)

	2002 Prel.	2003 Prog.
Public sector 1/		
Gross disbursements	577	733
Nonconcessional	357	336
Concessional	220	396
Net disbursements	386	452
Nonconcessional	124	80
Concessional	261	372
Nonfinancial public sector		
Gross disbursements	570	720
Net disbursements	373	480
Of which		
World Bank 2/		
Gross disbursements 3/	104	204
Net disbursements	99	178
Inter-American Development Bank (IDB)		
Gross disbursements 4/	99	192
Net disbursements	34	58
Andean Development Corporation (CAF) 2/		
Gross disbursements	324	231
Net disbursements	195	112
Other (net)	45	131
Memorandum items:		
Public sector external grants (excluding HIPC assistance)	**175**	**214**
Of which : nonfinancial public sector 5/	148	146
Of which : new grants	...	30
Belgium	...	5
Canada	...	3
Denmark	...	2
Germany	...	2
Netherlands	...	5
Sweden	...	3
United Kingdom	...	3
United States	...	7
Public sector		
Nonconcessional borrowing, gross	**357**	**336**
CAF	324	231
IDB	5	4
IBRD	...	25
Other	28	76
Nonconcessional borrowing, net	**124**	**80**
CAF	195	112
IDB	-56	-60
IBRD	...	25
Other	-15	3

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

1/ Excludes Fund disbursements of US$102 million.
2/ The projection assumes that US$70 million in nonconcessional borrowing for financial and corporate restructuring takes place in 2004, although the program ceiling would allow it to take place in 2003.
3/ Includes US$90 million balance of payments support in 2003.
4/ Includes US$70 million balance of payments support in 2003.
5/ Includes US$28 million balance of payments support in 2003.

Table 10. Bolivia: Indicators of Fund Credit, 1999-2007 1/

	1999	2000	2001	2002	Projections 2003	2004	2005	2006	2007
Outstanding Fund credit									
In millions of SDRs	180.0	168.8	164.9	143.7	197.5	181.6	136.8	72.6	30.3
In percent of quota	104.9	98.4	96.1	83.8	115.2	105.9	79.8	42.3	17.7
In percent of GDP	3.0	2.6	2.6	2.4	3.6	3.2	2.4	1.2	0.5
In percent of exports of goods and services	18.8	15.0	13.8	11.9	16.0	13.6	9.5	4.9	1.9
Debt service due to the Fund									
In millions of SDRs	25.4	23.3	23.8	21.9	23.1	29.3	47.3	65.9	42.9
In millions of U.S. dollars	34.9	30.4	30.3	28.3	31.4	39.8	64.3	89.6	58.3
In percent of quota	14.8	13.6	13.9	12.8	13.5	17.1	27.6	38.4	25.0
In percent of exports of goods and services	2.7	2.1	2.0	1.8	1.9	2.2	3.3	4.5	2.7
In percent of gross service due	11.9	9.8	10.5	8.8	9.8	12.4	20.3	26.9	18.5
In percent of gross official reserves	2.9	2.6	2.7	3.5	3.2	3.7	5.7	7.4	4.5
Gross Fund financing									
In millions of U.S. dollars	23.1	14.6	24.2	0.0	102.0	14.6	0.0	0.0	0.0
In percent of Bolivia's gross financing needs 2/	3.0	1.5	2.5	0.0	6.4	0.9	0.0	0.0	0.0
Memorandum item:									
Quota (in millions of SDRs)	171.5	171.5	171.5	171.5	171.5	171.5	171.5	171.5	171.5

Sources: Central Bank of Bolivia; International Monetary Fund, Treasurer's Department; and Fund staff projections.

1/ Includes use of Fund resources under the proposed Stand-By Arrangement.

2/ Gross financing needs are defined as the sum of the external current account deficit, scheduled amortization, repayments to the Fund, changes in gross international reserves of the central bank, change in arrears, and net private capital flows.

Table 11. External Financing Requirements and Sources, 2000–05
(In millions of U.S. dollars)

	Actual			Staff Projection		
	2000	2001	2002	2003	2004	2005
1. Gross financing requirements	**-1,204**	**-1,108**	**-366**	**-907**	**-826**	**-829**
External current account deficit (excl. official transfers)	-688	-527	-562	-527	-487	-494
Debt amortization	-565	-626	-114	-243	-260	-269
Repayment of arrears	0	0	0	0	0	0
Accumulation of gross international reserves 1/	49	46	310	-138	-78	-66
IMF repurchases and repayments	-29	-29	-27	-29	-36	-61
2. Available financing	**1,204**	**1,108**	**366**	**907**	**826**	**829**
Foreign direct investment (net)	701	666	553	647	862	1,053
Official creditors and donors 2/	533	615	832	1,014	794	659
Disbursements	292	364	577	733	571	429
Official transfers	242	251	255	282	224	231
Original or enhanced HIPC assistance	57	65	80	68	69	64
Other official transfers	185	187	175	214	155	167
IMF	15	24	0	102	15	0
Financing gap	0	0	0	0	0	0
Other flows 3/	-45	-197	-1,019	-856	-845	-883

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

1/ Includes the Latin American Reserve Fund.
2/ Includes both loans and grants.
3/ Includes all other net financial flows, and errors and omissions.

Table 12. Bolivia: Schedule of Purchases Under the SBA

Date	Amount in US$ millions	Amount in SDR millions	In percent of quota	Conditions
2003	**102.0**	**75.04**	**43.8**	
April 7, 2003 1/	58.3	42.88	25.0	Board approval of SBA (purchase of first credit tranche)
May 15, 2003	14.6	10.72	6.25	First review; and end-March 2003 performance criteria
August 15, 2003	14.6	10.72	6.25	Second review; and end-June 2003 performance criteria
November 15, 2003	14.6	10.72	6.25	Third review; and end-September 2003 performance criteria
2004	**14.6**	**10.71**	**6.24**	
February 15, 2004	14.6	10.71	6.24	Fourth review; and end-December 2003 performance criteria
Total	**116.6**	**85.75**	**50.0**	
Memorandum items:				
Quota	233.2	171.5	100.0	
US$/SDR	1.35952			

Source: Fund staff estimates.

1/ Corresponds to the first credit tranche (25 percent of quota).

Table 13. Bolivia: Financing of the Social Safety Net 1/
(In millions of U.S. dollars)

	2002				2003			
	Domestic	External		Total	Domestic	External		Total
		Grants	Concessional financing			Grants	Concessional financing	
PLANE	0.0	13.6	14.8	28.4	0.0	30.0	0.0	30.0
SUMI 2/	9.2	0.0	0.0	9.2	16.6	5.3	0.0	21.9
Beca Futuro	0.0	0.0	0.0	0.0	0.0	3.5	0.0	3.5
School breakfast 2/	0.0	3.3	0.0	3.3	0.0	3.3	0.0	3.3
Bonosol	...	...	...	...	95.8	0.0	0.0	95.8
Total	9.2	16.9	14.8	40.9	112.4	42.1	0.0	154.5

Source: Economic Policy Analysis Unit (UDAPE).

1/ PLANE refers to an emergency employment program, SUMI to a health insurance program, Beca Futuro to a school attendance program, and Bonosol to privately financed transfers to the elderly (see Box 4).

2/ Corresponds to grants under the enhanced HIPC initiative.

Table 14. Bolivia. Quarterly Operations of the Combined Public Sector

	2002	2003				
		Q1	Q2	Q3	Q4	Year
	(In millions of bolivianos)					
Current revenue	12,311	3,047	3,657	3,605	3,737	14,046
Capital revenue	19	0	32	32	32	97
Official grants	1,268	441	484	334	394	1,652
Current expenditure of general government	13,549	3,389	3,542	3,561	4,107	14,598
Interest	1,468	374	480	393	436	1,683
Other	12,081	3,015	3,062	3,168	3,671	12,915
Capital expenditure	4,853	876	1,282	1,197	1,634	4,989
Overall balance (deficit -)	-4,804	-777	-652	-786	-1,578	-3,793
	(In percent of GDP)					
Current revenue	22.4	5.2	6.3	6.2	6.4	24.1
Capital revenue	0.0	0.0	0.1	0.1	0.1	0.2
Official grants	2.3	0.8	0.8	0.6	0.7	2.8
Current expenditure of general government	24.6	5.8	6.1	6.1	7.0	25.0
Interest	2.7	0.6	0.8	0.7	0.7	2.9
Other	21.9	5.2	5.2	5.4	6.3	22.1
Capital expenditure	8.8	1.5	2.2	2.1	2.8	8.6
Overall balance (deficit -)	-8.7	-1.3	-1.1	-1.3	-2.7	-6.5
Memorandum item:						
Overall balance excluding pensions	-3.7	-0.2	0.0	-0.2	-1.2	-1.6

Sources: Ministry of finance; and Fund staff estimates and projections.

BOLIVIA: FUND RELATIONS
(As of February 28, 2003)

I. **Membership Status:** Joined December 27, 1945; Article VIII.

II. **General Resources Account:**	**SDR Million**	**Percent Quota**
Quota	171.50	100.00
Fund holdings of currency	162.64	94.83
Reserve position in Fund	8.87	5.17

III. **SDR Department:**	**SDR Million**	**Percent Allocation**
Net cumulative allocation	26.70	100.00
Holdings	27.32	102.40

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent Quota**
ESAF/ PRGF arrangements	143.67	83.77

V. **Latest Financial Arrangements:**

Type of Arrangement	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
ESAF/PRGF	9/18/98	6/07/02	100.96	63.86
ESAF	12/19/94	9/09/98	100.96	100.96
ESAF	7/27/88	5/31/94	163.26	163.26

VI. **Projected Payments to Fund (without HIPC Assistance)**
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	21.23	26.60	24.68	22.65	19.50
Charges/Interest	0.68	0.56	0.43	0.31	0.20
Total	21.91	27.16	25.11	22.96	19.70

Projected Payments to Fund (with Board-approved HIPC Assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	14.31	15.48	15.21	17.71	19.09
Charges/Interest	0.68	0.56	0.43	0.31	0.20
Total	15.00	16.04	15.64	18.02	19.29

VII. Implementation of HIPC Initiative:

	Original Framework	Enhanced Framework	Total
I. Commitment of HIPC assistance			
Decision point date	Sep. 1997	Feb. 2000	
Assistance committed			
by all creditors (US$ Million) [1/]	448.00	854.00	
Of which: IMF assistance (US$ million)	29.00	55.32	
(SDR equivalent in millions)	21.25	41.14	
Completion point date	Sep. 1998	Jun. 2001	
II. Disbursement of IMF assistance (SDR Million)			
Assistance disbursed to the member	21.25	41.14	62.39
Interim assistance	--	--	--
Completion point balance	21.25	41.14	62.39
Additional disbursement of interest income [2/]	--	3.09	3.09
Total disbursements	21.25	44.23	65.48

[1/] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts can not be added.

[2/] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

VIII. **Safeguards Assessments:** Under the Fund's safeguards assessment policy, Banco Central de Bolivia (BCB) is subject to a full safeguards assessment. The required documentation was received on January 14, 2003; the assessment is underway. (The previous external audit assessment—under the transitional procedures with respect to the PRGF arrangement—was completed on October 19, 2000 and concluded that BCB's external audit mechanism is adequate, as reported in EBS/01/80.)

IX. **Exchange Rate Arrangement:** The Bolivian currency is the boliviano. The central bank holds a daily foreign exchange auction, accepting all bids that are at least equal to the central bank's minimum price. If acceptable bids exceed the amount offered for auction, the lowest acceptable bids are prorated so as to exhaust the amount offered. The minimum price is adjusted from time to time in light of the evaluation of Bolivia's real exchange rate with respect to Bolivia's key trading partners. The administration of the system has resulted in minimal spreads between the maximum and minimum bids (generally 2 cents of boliviano). On February 28, 2003, the official selling rate was Bs 7.57 per U.S. dollar.

X. **Article IV Consultation:** The previous Article IV consultation and request for the third annual arrangement under the Poverty Reduction and Growth Facility were concluded by the Executive Board on June 8, 2001 (EBS/01/80, SM/01/153). The completion point document for the enhanced Heavily Indebted Poor Countries Initiative (EBS/01/78) was also discussed on this occasion. Bolivia is on the standard 12-month consultation cycle.

XI. **Technical Assistance:**

Dept.	Purpose	Time
FAD	Tax policy	Jan. 1999
FAD	Modernization of customs administration	June 1999, ongoing
FAD	Tax administration	June 1999, Feb. 2000
FAD	Fiscal decentralization	Dec. 2000
MAE	Central bank operations and domestic capital markets	June 1999, ongoing
MAE	Vulnerability of the banking system	Oct. 1999, Apr. 2000, Dec. 2000
STA	Money and banking statistics	Jan. 1999, Sep. 2001
STA	Balance of payments statistics	Aug. 1999
MAE	Monetary operations, monetary and exchange rate policy	May 2002
STA	National accounts statistics	Aug. 2002
MAE	FSAP	Nov. 2002, Jan. 2003
FAD	Customs reform	Dec. 2002

XII. **Resident Representative:** Mr. Gerardo Peraza, since February 2001.

BOLIVIA: RELATIONS WITH THE WORLD BANK

Bolivia's development strategy

In addition to focusing on its proposed Bolivia Plan, the new government is making progress in defining its overall long-term strategy. To this end, the government has re-organized itself, giving a crucial role to the Ministry of Sustainable Development and Planning, underscoring the government's willingness to give social issues the same importance as economic sector issues.

In general, two strategies for the medium term have been outlined. The first strategy is *inward-looking* and is oriented at improving the productivity of labor-intensive activities—especially in rural areas—through improvements in a given product's productive chain. The objective of this strategy is to ensure social stability by attacking poverty through income-generation (with an emphasis on rural areas). Other aspects of this strategy include improved access to health, education and other basic services; and strengthening the institutional capacity of both the central government and the municipalities.

The second strategy is *outward-looking* and is oriented toward promoting and augmenting the competitiveness of Bolivian exports. The principal objective of this strategy is to take advantage of the recently renewed expansion of the Andean Trade Preference and Drug Eradication Act (ATPDEA, formerly ATPA), which could translate into a significant export boost for manufactures in the medium term.

Bank group strategy

In conjunction with the government's long-term strategic plans, the Bank is preparing Bolivia's Country Assistance Strategy (CAS), that is expected to be completed by October 2003. Like in previous CASs, the Bank's assistance program will be consistent with Bolivia's PRSP, with special emphasis on decentralization and competitiveness.

To support government efforts to deal with recent events in Bolivia, the Bank is considering two new adjustment operations intended to strengthen social safety nets and the financial sector and one investment operation in rural electrification. In addition, ready to be realized, are two disbursements (under the existing CAS) amounting to US$40 million.

Bank-Fund collaboration in specific areas

As part of its overall assistance to Bolivia, the Bank has strengthened its close collaboration with the Fund. Specific examples of joint work for the near future cover the following areas:

Overall Financial Sector Assessment: The missions of coordinated Bank/Fund teams for the Bolivia FSAP took place in mid-November 2002 and January 2003. As a complement, the Bank will prepare a Report on the Observance of Standards and Codes (ROSC) focusing on insolvency and creditor rights systems, contingent on government approval.

Corporate restructuring initiative: The government has solicited support in designing better mechanisms for corporate restructuring. In the context of the FSAP, bankruptcy legislation and mechanisms for corporate restructuring are being analyzed by a Bank-led Bank-Fund team. If there is a separate operation in this area, it will most likely take the form of technical assistance.

Public Expenditure Management (PEM)/Public Expenditure Review (PER): The Bank and the Fund have been addressing public sector management issues in the context of the HIPC initiative and intend to continue supporting the government with other instruments. The forthcoming PER Update will be delivered this year. It will support the development of a medium-term expenditure framework. Several key aspects of the PER that will be prepared underscore the importance of Bank-Fund collaboration, including the need to move forward in restoring fiscal discipline at the municipal level, promoting pro-poor programs, and improving the efficiency of public expenditure. The pension costs issue also needs to be specifically addressed.

Poverty and Social Impact Analysis (PSIA): The Bank and the Fund are supporting the completion of a PSIA through the government's economic policy analysis unit, UDAPE.

Joint Staff Assessment (JSA) of the Government's PRSP Progress Report. The Bank and the Fund have reviewed a draft of the authorities' PRSP progress report. The draft signals the authorities' commitment to the PRSP framework, their changes of emphasis and policy priorities for the poverty reduction strategy, and its consistency with the government's economic program. The JSA will be prepared on the basis of the final version of the PRSP progress report.

Governance issues: The transition from one government to another has put significant stress on the institutional reform process and there has been some concern with regard to future progress. Recently, the new government reassured the Bank that reforms will continue. Therefore, the Bank will continue to lead institutional reform efforts in close coordination with the Fund. The agenda states the need to consider starting reforms in the judicial area.

Medium-term strategy on dollarization and exchange rate policy issues: The Fund will take the lead in this area in close coordination with the Ministry of Finance and the Central Bank and with continuous dialogue with the Bank. A first MAE technical assistance report has already been completed and made available to the authorities.

Prepared by World Bank staff.
Questions may be addressed to Mr. Vicente Fretes-Cibils, Lead Economist at 473-1969.

BOLIVIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

Background

As of February 28, 2003, the Inter-American Development Bank (IDB) had approved loans to Bolivia amounted to US$2.9 billion, of which cumulative disbursements amounted to US$2.4 billion. Bolivia's outstanding debt to the IDB was US$1.5 billion.

The lending program

The IDB's lending program for Bolivia is aimed at supporting the government's efforts to reduce poverty, as reflected in the Poverty Reduction Strategy Paper presented to the IDB in June 2001. This strategy focuses on: (i) promoting sustained growth and increased employment opportunities in the productive infrastructure sectors, micro enterprise, and rural development; (ii) supporting direct actions to improve access to the basic social services; and (iii) governance. The impact of the regional crisis on Bolivia's economic performance since 1999 has weakened growth in labor intensive sectors, pushing unemployment up and increasing the incidence of poverty in urban and rural areas. The economic slowdown together with a higher than expected pension related fiscal deficit and increased fragility of the financial system, has amplified the exposure of the country to an extended period of economic, social and political distress. In this context, the Bank's assistance in 2003 will focus on supporting efforts to stabilize the economy, protect investments in key sectors from further deterioration (roads and basic infrastructure), continue programs that are needed to achieve the Millennium Development Goals and create better conditions for rural and urban development.

The proposed IDB lending program for Bolivia for 2003 consists of eight loans yet to be approved, for a total of US$217 million, of which US$100 million will support policies to promote fiscal sustainability and competitiveness. The IDB Board of Directors has assigned US$229 million in concessional resources for Bolivia for the period 2002–03, US$18.8 million of which were approved in the year 2002.

Recent economic and sector work

The Board of Directors approved the Country Paper for Bolivia, which outlines the Bank's strategy with the country, on June 9, 1999. The IDB is currently working on a new strategy for the period 2003–07.

IDB grants for technical cooperation and small projects

The IDB portfolio also includes active projects for US$27 million in nonreimbursable technical cooperation, and US$1.9 million in nonreimbursable small projects.

Bolivia: Relations with the Inter-American Development Bank

(In millions of U.S. dollars)

Reference	Projects	Number of Loans	Approved	Disbursed	Undisbursed
	I. Statement of IDB loans (as of February 28, 2003)				
Totally disbursed (less cancellations)			**1,964.8**	**1,964.8**	
Sectors		**32**	**933.6**	**376.6**	**557.0**
Roads		4	222.0	103.9	118.1
698/OC	Beni-La Paz Peruvian Border Corridor		55.0	50.1	4.9
893/SF	Cotapata - Santa Barbara		40.0	39.8	0.2
1039/SF	Ventilla-Tarapaya		52.0	14.0	38.0
1101/SF	Trade Corridor Sta. Cruz - Puerto Suarez		75.0	-	75.0
Tourism		1	10.0	-	10.0
1098/SF	Sustainable Tourism Development Program		10.0	-	10.0
Agriculture and Envrionment		5	78.6	31.8	46.8
1099/SF	Env-Soc. Protection Santa Cruz - Pto. Suarez		21.0	-	21.0
1116/SF	Emergency Attention Plan: Fire Cordillera Sama-Tarija		2.5	-	2.5
929/SF	Protection of environment		19.0	11.6	7.4
964/SF	Irrigation and drainage		25.6	15.1	10.5
1057/SF	Agricultural Services Program		34.0	5.1	28.9
Sanitation		2	110.0	43.0	67.0
987/SF	Urban Sanitation PRODURSA		70.0	40.8	29.2
1050/SF	Urban Sanitation Small Municipalities		40.0	2.1	37.9
Social sectors		7	254.0	140.1	113.9
931/SF	Education Reform		80.0	61.8	18.2
982/SF	Social management		3.0	2.2	0.8
995/SF	Programa de Atención al Menor		20.0	6.9	13.1
1006/SF	Apoyo a Política de Vivienda		60.0	16.4	43.6
1031/SF	Epidemiological Shield and Sector Reform		45.0	12.4	32.6
1097/SF	Support Poverty Reduction Strategy		40.0	40.0	-
1093/SF	Strengthening Technical Education		6.0	0.5	5.5
Institutional strengthening		10	112.0	36.0	76.0
976/SF	Governability Support		12.0	11.9	0.1
993/SF	Descentralization SNIPPRE		7.0	2.8	4.2
1038/SF	Loan TC Civil Society Access to Justice		2.7	2.9	(0.2)
1043/SF	Institutional Stregthening National Tax Agency		3.2	1.5	1.7
1046/SF	National Census Preparation Support		7.4	7.2	0.2
1056/SF	Customs reform and Modernization		5.0	2.8	2.2
1075/SF	Local Development and Fiscal Adjustment		47.0	3.4	43.7
1091/SF	Modernization Municipal Financial Administration		20.0	3.6	16.4
1121/SF	Disaster Prevention Program		2.7	-	2.7
1118/SF	Institutional Support to Strengthen Trade		5.0	-	5.0
Multisectoral onlending		1	35.0	21.9	13.1
1020/SF	Micro and Small Enterprises		35.0	21.9	13.1
Private Sector		2	112.0	-	112.0
1431/OC	Telecomunication Network Redibol		37.0	-	37.0
1444/OC	Transredes (Gas)		75.0	-	75.0
Technical assistance		**47**	**27.2**	**16.3**	**10.8**
Total			**2,925.6**	**2,357.8**	
Repaid				**865.2**	
Outstanding				**1,492.5**	

Bolivia: Relations with the Inter-American Development Bank (Continued)
(In millions of U.S. dollars)

	Amount	In Percent of Total
II. Proposed IDB Lending Program 2003		
Number of loans	**9**	
Total loan amounts	**217.0**	**100.0**
Human development and access to social services	**36.0**	**16.6**
Education Reform II	36.0	16.6
Growth and creation of opportunities	**111.0**	**51.2**
Rural Development Program	10.0	4.6
Saneamiento de Tierras y Catastro legal	20.0	9.2
Revitalization of the Center of La Paz	20.0	9.2
Support to Competitiveness	35.0	16.1
Support to Bolivian Competitiveness System	10.0	4.6
Roads maintenance and Rehabilitation	16.0	7.4
Governance and consolidation of reforms	**70.0**	**32.3**
Apoyo Sector Justicia	5.0	2.3
Support to Fiscal Sustainability	65.0	30.0

Source: Inter-American Development Bank.

DEBT SUSTAINABILITY ANALYSIS

Bolivia's debt indicators have deteriorated since the enhanced-HIPC completion point in mid-2001, owing mainly to a sharp rise in the fiscal deficit in 2001–02 (Annex IV Figure 1, top left panel). According to projections for the proposed program,[1] the ratio of the NPV of external debt to exports peaks at 145 percent in 2004 and declines thereafter (Annex IV Table 1). This ratio is higher (with a smaller proportion of concessional debt) than projected at completion point but remains below the HIPC target of 150 percent, helped by bilateral relief provided beyond the HIPC initiative. Domestic debt has also risen sharply since 2000.

In the program projection, the public debt to GDP ratio falls after 2005, and the ratios of debt service and interest to revenue improve (Figure 1, top right and bottom panels). Stress tests give the following results (Figure 2 and Table 2):

- A "GDP shock," which reduces the growth rate to the historical average minus two standard deviations in 2003 and 2004, has the least impact of any of the stress tests.

- Under a "fiscal shock," the fiscal program goes off track by one standard deviation (1.8 percent of GDP) in each year through 2007. In this case, the debt to GDP ratio continues to increase over time.

- In an "exchange rate shock" stress test, the exchange rate depreciates by 30 percent in 2003. Because 95 percent of public debt is denominated in foreign currency, this shock has a large impact on the debt to GDP ratio.[2] The ratio subsequently falls, assuming the program's fiscal adjustment path is achieved, but remains at 87 percent of GDP in 2007.

Stress tests were also done for the external debt projections (Annex IV, Table 1).

- If natural gas exports remain constant at the level of 2003, rather than expanding as projected in the baseline, the ratio of the NPV of debt to exports in 2007 would increase from 137 percent (Annex IV Table 1) to 149 percent, rather than falling to 137 percent under the program projection. The nominal external debt to GDP ratio would increase from only 57 percent in 2003 to 59 percent in 2007, reflecting the impact of lower exports on GDP.

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[1] As noted in the staff report, the export projection is subject to risks including Brazil's desire to renegotiate its contract to buy Bolivia's natural gas exports, and delays in reaching agreement over the project for exports of LNG to California.

[2] The assessment excludes the contingent liabilities related to the impact that a depreciation would have on the banking system.

- If interest rates, growth, inflation, the non-interest current account, and non-debt flows remain during 2003–07 at the average of the past five years, the nominal debt to GDP ratio increases from 55 percent in 2003 to 77 percent in 2007, with the increase due primarily to the assumed lack of current account adjustment. The impact is particularly large compared with the other external debt stress tests because the assumptions affect 2003–07 rather than only 2003–04.

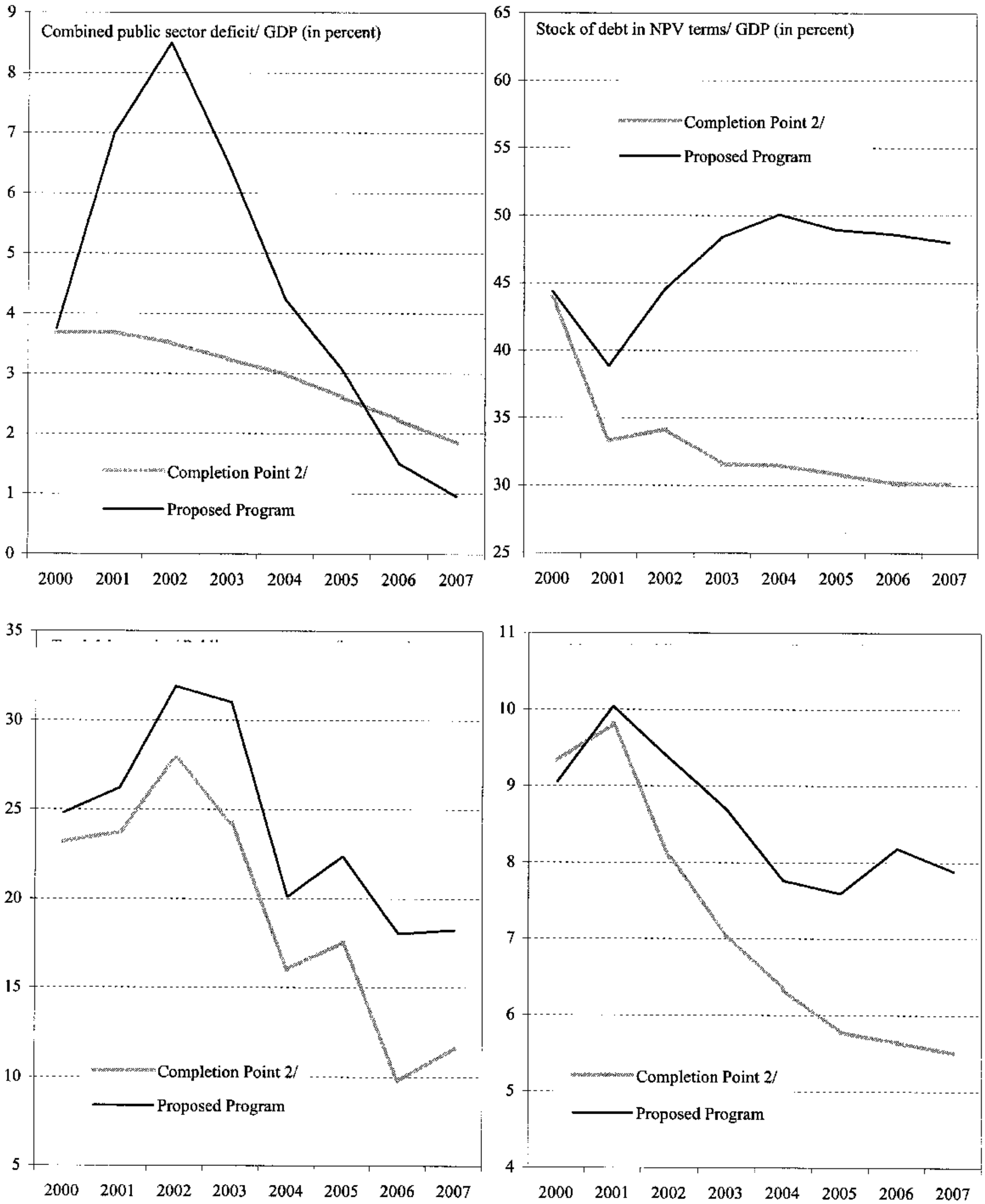
- If real GDP growth in 2003–04 is set to the average of the preceding five years (2.8 percent) minus two standard deviations (one standard deviation is 2.2 percent), the debt to GDP ratio increases from 59 percent to 63 percent.

- If the current account deficit excluding interest in 2003–04 is set to the program projection minus two standard deviations (one standard deviation is 1.4 percent of GDP), the debt to GDP ratio increases from 60 percent to 63 percent.

- A 30 percent depreciation in 2003 boosts the path of the debt to GDP ratio, which peaks at 78 percent in 2004.

These stress tests show that debt sustainability in Bolivia is particularly sensitive to the amount of fiscal and current account adjustment, to prospects for exports, and to exchange rate depreciation.

Figure 1. Bolivia: Public Sector Debt and Debt Service Indicators for Medium- and Long-Term Debt, 2000-07 1/

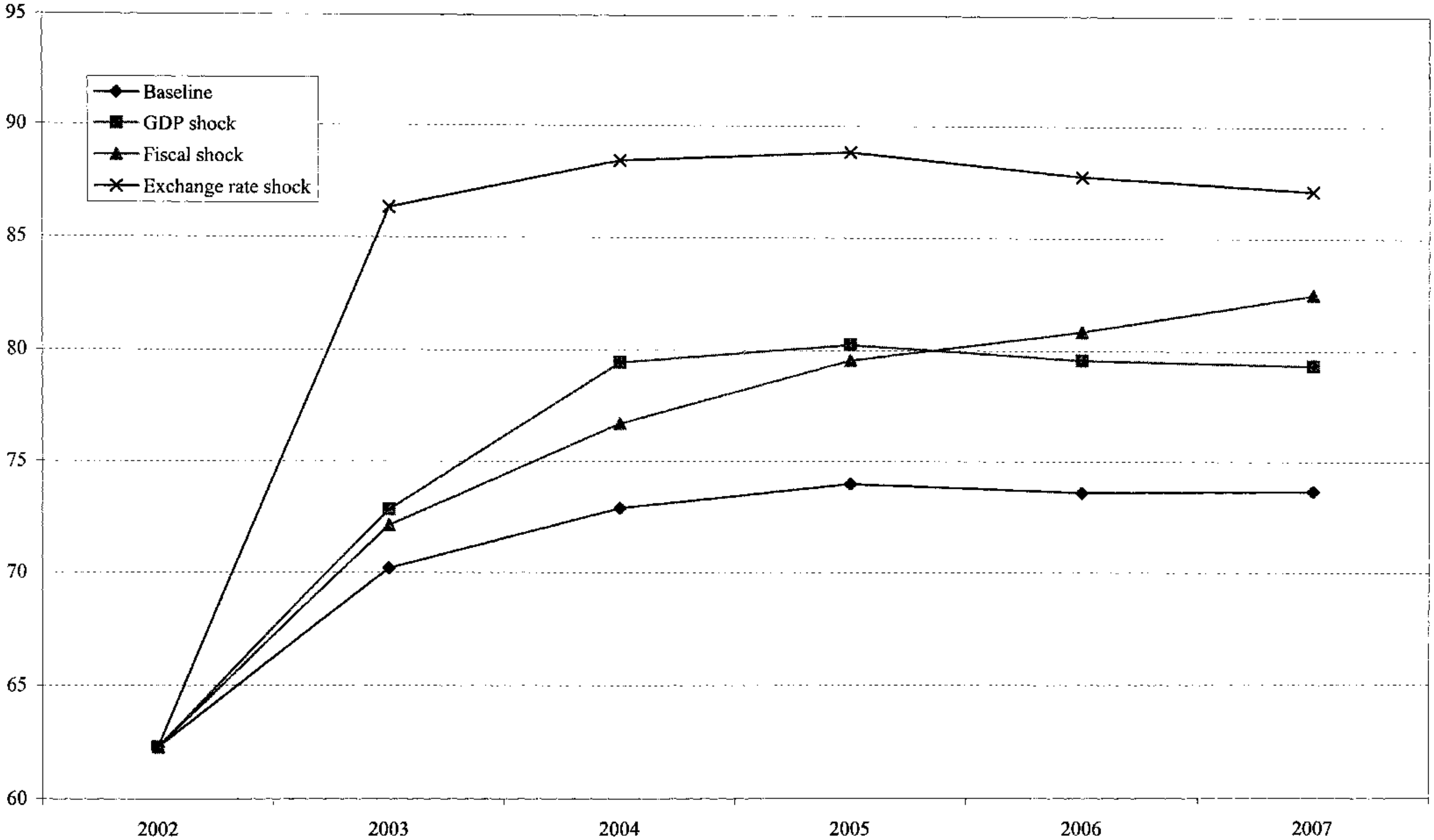


Sources: Central Bank of Bolivia; and Fund staff estimates and projections.

1/ Coverage consists of external and domestic debt of the nonfinancial public sector.

2/ From the debt sustainability analysis for the completion point under the HIPC Initiative (EBS/01/78). Numbers include HIPC and beyond-HIPC relief. The domestic debt projection at completion point is imputed.

Figure 2. Bolivia: DSA Stress Tests—Nominal Public Debt to GDP Ratio 1/



1/ See Table 2 for a definition of stress tests.

Table 1. Bolivia: External Sustainability Framework, 2000-07

	Actual			Projections				
	2000	2001	2002	2003	2004	2005	2006	2007
I. Baseline Medium-Term Projections				(Ratios in percent)				
1 Nominal external debt/Exports of goods and services (G&S)	303.4	218.7	238.0	256.5	255.4	245.3	243.9	233.4
2 Nominal external debt/GDP 1/	53.3	41.7	48.1	57.0	60.9	61.0	59.0	57.3
3 Change in external debt/GDP	-2.0	-11.6	6.5	8.8	3.9	0.1	-1.9	-1.7
4 Net debt-creating external flows/GDP (5+9+11)	-3.6	-2.5	-2.3	-3.5	-8.5	-11.9	-13.1	-9.2
5 Current account deficit, excluding interest payments/GDP	4.2	2.5	3.3	2.2	2.3	2.1	2.0	2.0
6 Deficit in balance of goods and services/GDP	7.3	5.7	6.1	5.3	4.2	3.2	3.7	2.4
7 Exports of G&S/GDP	17.6	19.1	20.2	22.2	23.8	24.9	24.2	24.6
8 Imports of G&S/GDP	24.8	24.8	26.3	27.5	28.0	28.1	27.9	27.0
9 Minus net non-debt creating capital inflows/GDP	-8.4	-8.3	-7.2	-8.6	-11.3	-13.4	-13.5	-9.4
10 Net foreign direct investment, GDP	8.4	8.3	7.2	8.6	11.3	13.4	13.5	9.4
11 (r-g-(ρ+gρ))/(1+g+ρ+gρ))debt/GDP (13/12)	0.5	3.4	1.6	2.9	0.5	-0.7	-1.6	-1.7
12 Adjustment factor: 1+g+ρ+gρ	1.0	1.0	1.0	1.0	1.0	1.0	1.1	1.1
13 (r-g-(ρ+gρ))debt/GDP (14+15+16)	0.6	3.2	1.6	2.8	0.5	-0.7	-1.7	-1.8
14 r (interest rate) times debt/GDP	1.2	0.9	0.7	1.0	1.1	1.3	1.4	1.3
15 minus g (real GDP growth rate) times debt/GDP	-1.2	-0.7	-1.0	-1.4	-2.5	-2.9	-3.1	-3.2
16 minus (ρ + gρ) (ρ = US dollar value of GDP deflator, growth rate) times debt/GDP	0.6	2.9	1.9	3.1	1.8	0.9	0.0	0.1
17 Residual, incl. change in gross foreign assets/GDP (3-4)	1.6	-9.1	8.8	12.3	12.4	12.0	11.2	7.5
Memorandum items: key macro and external assumptions								
Nominal GDP (in billions of bolivianos)	51.7	52.7	55.1	58.4	62.5	67.4	73.5	80.1
Nominal GDP (in billions of U.S. dollars)	8.4	8.0	7.7	7.5	7.6	7.9	8.3	8.7
Real GDP growth (in percent)	2.2	1.2	2.5	2.9	4.3	4.7	5.1	5.4
Nominal GDP deflator (in U.S. dollars, change in percent)	-1.0	-5.4	-4.5	-6.4	-3.0	-1.4	0.0	-0.1
External interest rate (percent per year)	2.1	1.8	1.7	2.1	2.0	2.1	2.3	2.3
Growth of exports of G&S (U.S. dollar terms, in percent)	12.2	3.4	2.2	7.8	8.6	7.7	2.4	6.9
Growth of imports of G&S (U.S. dollar terms, in percent)	4.5	-4.7	2.3	2.5	3.1	3.6	4.2	1.9
NPV of external debt (in billions of U.S. dollars)	2.7	1.4	1.8	2.2	2.4	2.6	2.7	2.8
NPV of external debt to exports of G&S (3-year backward moving average)	199.3	100.2	117.3	136.5	145.1	142.3	138.7	136.8
Debt service to exports ratio	20.4	18.1	12.5	17.6	16.4	17.6	20.7	16.6
II. Sensitivity Analysis for Nominal External Debt-to-GDP Ratio								
1. Natural gas exports remain at the level of 2003				57.0	60.9	61.7	60.3	59.1
NPV of external debt to exports (3-year backward moving average)				*136.5*	*145.0*	*144.7*	*145.3*	*149.4*
2. If interest rate, real GDP growth rate, US$ GDP deflator growth, non-interest current account, and non-debt flows (in percent of GDP) are at average of past 5 years				55.1	62.2	68.9	74.8	77.1
3. If real GDP growth rate in 2003 and 2004 is average minus two standard deviations, others at baseline				59.3	66.8	66.8	64.7	62.9
4. If current account is average plus two standard deviations for two years				59.7	66.4	66.4	64.4	62.5
5. One time 30 percent depreciation in year 2003 (-30% GDP deflator shock), others at baseline.				74.2	78.3	78.1	75.7	73.6
Memorandum items								
Current account deficit, excluding interest payments (percent of GDP, average of past 5 years, 1998–2002)			4.6					
Current account deficit, excluding interest payments (percent of GDP, standard deviation of past 5 years)			1.4					
Net non-debt creating capital inflows (percent of GDP, average of past 5 years)			10.3					
Interest rate (average of past 5 years)			2.5					
Interest rate (standard deviation of past 5 years)			0.8					
Real GDP growth rate (average of past 5 years)			2.8					
Real GDP growth rate (standard deviation of past 5 years)			2.2					
GDP deflator, U.S. dollar terms (average of past 5 years)			-1.1					
GDP deflator, U.S. dollar terms (standard deviation of past 5 years)			3.0					

1/ Coverage consists of medium- and long-term debt of the public sector. The projection assumes that US$70 million nonconcessional borrowing for financial and corporate restructuring takes place in 2004, although the program ceiling would allow it to take place in 2003.

Table 2. Bolivia: Public Sector Debt Sustainability Framework, 2000–07

	Actual			Projections				
	2000	2001	2002	2003	2004	2005	2006	2007
I. Baseline Medium-Term Projections				(Ratios in percent)				
1. Public debt (nominal)/revenues 1/	233.6	208.0	253.9	261.3	249.1	245.9	241.7	241.7
2. Public debt (nominal)/GDP 1/	58.9	53.8	62.3	70.2	72.9	74.0	73.6	73.7
3. Change in public debt/GDP	-8.3	-5.2	8.5	7.9	2.7	1.1	-0.4	0.0
4. Net debt-creating flows/GDP (5+6)	0.0	5.7	6.7	3.2	-0.7	-2.6	-4.3	-4.8
5. Overall deficit, excluding net interest payments/GDP (=primary deficit/GDP)	2.0	4.8	6.1	4.1	2.0	0.8	-0.8	-1.3
6. $((r - \pi) - g(1+\pi))/(1+g+\pi+g\pi)$)debt/GDP (8/7) 2/	-2.0	0.9	0.6	-0.9	-2.6	-3.4	-3.4	-3.5
7. Adjustment factor: $1+g+\pi+g\pi$	1.1	1.0	1.0	1.1	1.1	1.1	1.1	1.1
8. $((r - \pi) - g(1+\pi))$debt/GDP (9+10)	-2.1	0.9	0.7	-0.9	-2.8	-3.6	-3.7	-3.8
9. $(r - \pi)$ times debt/GDP	-0.6	1.7	2.0	0.9	0.3	-0.1	0.2	0.3
10. minus $g(1 + \pi)$ times debt/GDP	-1.5	-0.7	-1.4	-1.9	-3.1	-3.5	-3.9	-4.1
11. Residual, incl. asset changes and privatization receipts (negative)/GDP (3–4)	-8.3	-10.9	1.8	4.7	3.4	3.7	3.9	4.9
Memorandum items: key macro and external assumptions								
Nominal GDP (in billions of bolivianos)	52	53	55	58	62	67	74	80
Real GDP growth (in percent per year)	2.2	1.2	2.5	2.9	4.3	4.7	5.1	5.4
Exchange rate (bolivianos per U.S. dollar)	6.4	6.8	7.5	8.0	8.4	8.7	9.0	9.4
Nominal appreciation of boliviano against U.S. dollar	-8.8	-6.3	-8.9	-6.3	-4.8	-3.8	-3.4	-3.4
CPI (change, in percent per year)	4.6	1.6	0.9	2.6	3.1	3.5	3.2	3.0
Average interest rate on public debt (percent per year)	3.7	4.4	4.7	4.2	3.5	3.4	3.5	3.3
Average real interest rate (nominal rate minus change in CPI, percent)	-0.9	2.8	3.7	1.5	0.4	-0.1	0.3	0.3
Growth of revenues (deflated by GDP deflator, in percent per year)	-0.5	3.7	-2.7	12.7	13.6	7.7	6.4	5.5
Growth of noninterest expenditure (deflated by GDP deflator, in percent per year)	0.7	14.3	2.3	4.0	5.2	3.6	0.7	3.8
NPV of debt (in billions of U.S. dollars)	3.7	3.1	3.4	3.7	3.9	3.9	4.1	4.3
Budgetary debt service to revenue	28.3	31.0	38.0	35.6	22.9	25.8	19.4	19.3
II. Stress Tests								
1. If real interest rate, real GDP growth rate, and primary balance (in percent of GDP) in 2003–07 are at average of past 5 years				69.0	75.5	82.2	89.2	97.1
(In NPV terms)				*48.0*	*55.5*	*61.4*	*69.4*	*78.5*
2. If real interest rate in 2003 and 2004 is average plus two standard deviations, others at baseline				73.3	80.3	81.1	80.3	80.1
3. If real GDP growth rate in 2003 and 2004 is average minus two standard deviations, others at baseline				72.8	79.5	80.3	79.6	79.3
4. If primary balance (in percent of GDP) in 2003–07 is at baseline plus one standard deviation				72.1	76.7	79.6	80.8	82.5
5. Combination of 2, 3, and 4 using one-standard-deviation shocks				74.7	86.2	86.7	85.7	85.2
6. One time 30 percent real depreciation in 2003, others at baseline 3/				86.3	88.4	88.8	87.7	87.1
7. If debt ratio in 2003 rises by (additional) 30 percent of GDP, others at baseline				100.2	101.8	101.5	99.9	98.7
Memorandum items								
Primary deficit (percent of GDP, average of past 5 years, 1998–2002)			3.4					
Primary deficit (percent of GDP, standard deviation of past 5 years)			1.9					
Real interest rate (nominal rate minus change in GDP deflator, average of past 4 years)			1.9					
Real interest rate (nominal rate minus change in GDP deflator, standard deviation of past 4 years)			2.5					
Nominal interest rate (average of past 5 years)			4.3					
Nominal interest rate (standard deviation of past 5 years)			0.5					
Real GDP growth rate (average of past 5 years)			2.3					
Real GDP growth rate (standard deviation of past 5 years)			1.8					
GDP deflator (average of past 5 years)			3.4					
GDP deflator (standard deviation of past 5 years)			2.1					

1/ Coverage consists of the nonfinancial public sector including pensions, excluding bonds issued for the recapitalization of the central bank.

2/ Defined as: r = interest rate; π = GDP deflator, growth rate; g = real GDP growth rate.

3/ Real appreciation is approximated by nominal appreciation against U.S. dollar plus increase in domestic GDP deflator.

BOLIVIA: MAIN FINDINGS OF THE FINANCIAL SECTOR ASSESSMENT PROGRAM (FSAP)

A joint World Bank-IMF mission visited Bolivia last November and again in January 2003 to conduct an FSAP. The following is a brief summary of the main findings.[1]

- Bolivian banks—which, like in most countries in the region, dominate the financial system—became operationally more efficient and strengthened their capital position in recent years. However, the continued deterioration in their loan portfolio and losses recorded in two of the last three years, have put an increasing share of their capital at risk. Changes in regulations and an unfavorable macroeconomic environment, among other factors, led banks to sharply cut their credit exposure to the private sector and to increase the share of liquid assets during 1999–2002. While all banks reported capital adequacy ratios (CARs) in excess of minimum requirements at end-2002, dynamic stress tests highlight the vulnerabilities of the system after four years of stagnant domestic demand.

- Following a period of expansion that came to an end around 1998–99, the corporate sector has been immersed in a deep rooted crisis ever since, triggered by multiple factors including changes in banks' prudential regulations. While banks were able to react fairly quickly to changing circumstances, corporations have struggled to adapt saddled with unproductive assets, operational inefficiencies, dysfunctional bankruptcy arrangements, and weak capital markets. Analysis of corporate data shows a rapid erosion in their ability to generate cash flow to service debt, and in the profit margins leading to sharply lower return on equity. Past attempts at addressing these problems that focused only on debt relief have proven unsuccessful.

- The assessment of Bolivia's observance of the Basel Core Principles for Effective Banking Supervision has found important shortcomings. Uncertainties in the legal and institutional framework for bank supervision could adversely affect financial stability. Critical regulations making operational legal provisions for prompt corrective actions (bank regularization and intervention) are pending. The technical integrity of prudential norms and the operational autonomy of the Superintendency of Banks and Financial Institutions (SBEF) needs to be maintained. By contrast, observance of the Fund Transparency Code of Good Practices in Monetary and Financial Policies is generally strong, with room for improvements regarding the timeliness of explanation of monetary policy changes, the Central Bank discharge of its roles on payment system matters, and accountability vis-à-vis the public by the SBEF.

[1] A Financial System Stability Assessment report will be presented to the Executive Board jointly with the next Article IV consultation report.

- Assessments of Bolivia's observance of the Core Principles for Systemically Important Payment Systems (SIPS) found important shortcomings. The rules governing the operation of Bolivia's SIPS give rise to systemic risks that at present are being borne by the Central Bank and participants. There are also legal problems regarding finality, netting, and legal signature.

- Bolivia's capital markets are shallow and dominated by public securities, although institutional investors have played an increasing role, following the 1997 pension reform. There are certain shortcomings with the securities valuation rule, which tends to increase price volatility, and with design flaws in the mandatory car insurance. The Bolivian microfinance institutions—that are recognized to be among the world leaders in the field—play an effective role in the delivery of financial services to the poor and the informal sector. With stronger financial indicators than banks, they are faced with the challenge of having to diversify their sources of funding and to become more self-sustainable.

- Improving the way public debt is managed, beyond the sustainability analysis already done, is becoming more urgent in the light of the rapid rise in domestic debt and the reduction of access to concessional sources of financing. In particular, there is a need to establish and implement a strategy to systematically identify and manage risks, integrate the management of domestic and external debt, and reduce the segmentation of domestic issues.

- Monetary and exchange rate policies need to play a critical role in preserving financial stability, given the very high degree of financial system dollarization. The credibility of the central bank's lender-of-last-resort function lies largely with having substantial international reserves, and having other supporting macrofinancial policies in place. They also allow the BCB to continue implementing its crawling peg exchange rate regime in a judicious way that avoids sudden, and therefore disruptive, changes in the exchange rate.

La Paz, Bolivia
March 21, 2003

Dear Mr. Köhler:

1. The attached Memorandum of Economic Policies (MEP) describes the economic program and objectives of the Government of Bolivia for 2003. In support of this program, the Government requests a Stand-By Arrangement in the credit tranches from the Fund for a period of 12 months in an amount equivalent to SDR 85.75 million. We expect to request a new arrangement under the Poverty Reduction and Growth Facility from the Fund as soon as possible.

2. The Government believes that the policies set forth in the attached Memorandum of Economic Policies are adequate to achieve the objectives of its program, but it will take any additional measures that may become appropriate for this purpose. The Government will provide the Fund with such information as the Fund may request in connection with progress in implementing this program. Bolivia will consult with the Fund on the adoption of these measures, in accordance with the Fund's policies on such consultations, and it will consult with the Managing Director in advance of any revision to the policies covered by the MEP.

3. Reviews under the arrangement that assess overall performance under the program will be completed by May 15, 2003; August 15, 2003; November 14, 2003; and February 15, 2004. Quantitative performance criteria are being proposed for end-March 2003 and end-June 2003, with indicative targets for end-September and end-December 2003.

Sincerely yours,

/s/
Javier Comboni
Minister of Finance

/s/
Juan Antonio Morales
President, Central Bank of Bolivia

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D. C. 20431

Attachments:
Memorandum of Economic Policies
Technical Memorandum of Understanding

MEMORANDUM OF ECONOMIC POLICIES OF THE GOVERNMENT OF BOLIVIA

I. INTRODUCTION

1. The government that took office in August 2002 inherited a situation of prolonged economic stagnation. Economic growth averaged only 1½ percent a year in 1999–2002. The resulting fall in per capita income and employment, and the contraction of the informal economy owing in part to the coca eradication campaign, have contributed to rising social tensions that erupted recently. Moreover, the weak economy has undermined government revenues, raised the fiscal deficit, and placed a heavy financing burden on the public sector. The prolonged economic stagnation has also weakened the financial and corporate sectors.

2. Against this background, the government has formulated an economic program for 2003 aimed at stabilizing the economy, calming social tensions, and laying the foundation for comprehensive medium-term reforms that could be supported by a PRGF arrangement. The main components of the program are: (i) the 2003 budget aimed at containing the borrowing requirement of the public sector while increasing social expenditure; (ii) a monetary program to maintain low inflation and increase international reserves; and (iii) policies aimed at banking system stability and strengthening the financial and corporate sectors.

II. MACROECONOMIC POLICIES FOR 2003

A. Macroeconomic Framework

3. The macroeconomic framework for 2003 is presented below. Provided macroeconomic and social stability can be quickly restored and maintained, and the external environment remains supportive, GDP growth in 2003 could rise close to 3 percent. The medium-term economic strategy that is being developed will aim at raising growth subsequently to 4½–5 percent, while improving per capita income and social inequalities. The macroeconomic framework for 2003 also aims at maintaining low inflation, reducing the external current account deficit, and gradually rebuilding international reserves.

Macroeconomic Framework, 2002–03

	2002	2003
Real GDP growth (in percent)	2.5	2.9
Excluding hydrocarbons	1.8	2.0
Inflation (end-period; in percent)	2.4	2.8
External current account (in percent of GDP)	-4.0	-3.2
Gross official reserves (US$ million)	854	992

B. Fiscal Policy and the Social Safety Net

4. The government's program for 2003 aims to put Bolivia's fiscal accounts on a sustainable path. The public sector deficit (excluding pensions) would be reduced from 3.7 percent of GDP in 2002 to 1.6 percent of GDP in 2003. This implies a target for the public sector borrowing requirement (PSBR) of 6.5 percent of GDP in 2003 for the combined public sector (including pension costs). The medium-term strategy will aim at reducing further the fiscal imbalance and strengthening debt sustainability.

5. The fiscal targets for 2003 will be met through a balanced fiscal program that has emerged from an ongoing process of deliberations within the Congress. The budget, including revenue measures, was submitted to Congress, and has already received the support of the House Finance Committee. We expect explicit support shortly for the budget and the revenue package from the President of the Lower House and this will be a prior action under the program. We anticipate passage by Congress of the 2003 budget and supporting revenue measures by end-March, 2003, but in any case by April 15 as a performance criterion.

Combined Public Sector Accounts, 2002-03

	(In millions of bolivianos)		(Percent change)	(In percent of GDP)	
	2002	2003	2003	2002	2003
Overall balance, excluding pensions	-2,026	-952	-53.0	-3.7	-1.6
Total revenue	12,329	14,142	14.7	22.4	24.2
Grants	1,268	1,652	30.3	2.3	2.8
Current expenditure	10,770	11,758	9.2	19.6	20.1
Of which:					
Wages	5,058	5,503	8.8	9.2	9.4
Interest payments	1,468	1,683	14.6	2.7	2.9
Capital expenditure	4,853	4,989	2.8	8.8	8.6
Pension-related balance	-2,779	-2,840	2.2	-5.0	-4.9
Overall balance, including pensions	-4,804	-3,793	-21.0	-8.7	-6.5
Memorandum item:					
Poverty-reducing expenditure	6,821	7,547	10.6	12.4	12.9

6. Total revenue is targeted to increase by almost 2 percent of GDP to 24.2 percent of GDP through measures designed to share more fairly the burden of adjustment across the economy. The emphasis will be on restructuring petroleum sector taxation, eliminating many tax exemptions, strengthening administration, and minimizing the reliance on new taxes at this stage. The main measures are as follows:

- A decree was issued on January 25, 2003 that restructures the basis for petroleum sector taxation. This decree increases revenues from the hydrocarbons sector by better aligning ex-refinery prices and international prices of oil refined products (with a yield of 0.9 percentage point of GDP in 2003).

- A new tax procedures code will be submitted to Congress by the end of April (performance criterion) and is expected to be in place by the end of the third quarter (benchmark). It will have several features that should strengthen the tax agencies' enforcement power, providing for more rapid resolution of disputes over tax liabilities and more effective prosecution of tax fraud. Also under preparation is a special facility for the restructuring of arrears to the public sector (Ley de Acreencias); it will be approved at the same time as the new tax code. Our assessment is that these measures should improve revenues by a total of 0.4 percent of GDP in 2003.

- With the budget, we expect Congress to approve a tax law that eliminates tax exemptions benefiting a few sectors, related to business services, hydrocarbon products, and income taxation of nonbank financial institutions (yield of 0.1 percent of GDP in 2003).

- The same law will also adjust excise taxes on alcohols and the travel tax (yield of 0.2 percent of GDP in 2003).

- Tax administration will be strengthened through improved coordination between the two tax agencies to combat tax fraud schemes, especially in the VAT.

7. The government is preparing a more comprehensive tax reform that will improve the revenue base over the medium term. For the design of this program, which will aim at broadening the base of taxation, we will request technical assistance from the IMF. We expect to prepare this reform by midyear and seek its implementation in time for the 2004 fiscal year. Vulnerable groups will be protected.

8. Total noninterest spending would decline somewhat to 30.7 percent of GDP in 2003, while leaving room for enhanced and better targeted social spending.

- Following the sharp increases in real wages during the last few years, public sector real wages will be generally maintained in 2003 (including the minimum wage). Taking into account the full-year impact of last year's wage increases, the total wage bill would increase by 0.2 percent of GDP to Bs 5.5 billion. This limit will still allow selective increases to address distortions in some sectors.

- We are addressing the problem of the large increase in pension costs that followed the 1997 pension reform. The first steps in 2003 include control of fraudulent claims, and streamlining and enforcing strictly eligibility requirements. Strengthened procedures for eligibility have already been implemented and any additional regulations that may be needed will be issued before end-April. These steps should allow a saving of about 0.5 percent of GDP in 2003.

- The budget includes steps to reduce low priority current expenditure. Effective February 20, the government has reduced the number of ministries by five, with commensurate budgetary savings, and has decided on a reduction of at least 10 percent in all current spending of the central administration excluding the wage bill for health, education, security, and tax and customs agencies. Our assessment is that savings from current expenditures should total about 0.1 percent of GDP in 2003.

- Fixed investment is being reduced modestly (by about 0.2 percentage point of GDP) from its high level of last year, with careful attention to maintaining investment financed by grants or concessional loans.

Social safety net

9. The social safety net will be strengthened further. We have decided to reinstate Bonosol payments (providing payments from the Collective Capitalization Fund to all citizens over the age of 65); continue with the emergency employment program (PLANE)—with assistance from the World Bank—and orient the public investment program toward employment creation; launch an income transfer program to encourage secondary school attendance; and provide universal health coverage for pregnant women and children under five (SUMI). Also, debt relief from the enhanced HIPC initiative is helping to finance social spending in the areas of schools and lunch programs, and basic sanitation. As a result, poverty-reducing expenditure is expected to rise by 0.5 percentage point of GDP to 12.9 percent of GDP.

Contingency plans

10. We have contingency plans for the fiscal program that will be applied if revenues and grants, or external financing are lower than projected. If cumulative quarterly revenues plus grants fall below programmed levels, then public investment would be streamlined, with priority given to protecting projects financed by external concessional loans or grants, and poverty-reducing expenditure. Also, as a contingency, retail fuel prices would be adjusted in the event that international oil prices are significantly higher than projected unless there is an offsetting overperformance of non-oil revenues or reductions in other expenditures.

C. Financing and External Policies

11. We expect that virtually all of the PSBR of the combined public sector of about 6.5 percent of GDP will be met from external sources (shown below), mainly on a concessional basis. In addition, bilateral grants projected at US$146 million will help to limit the fiscal deficit. We have finalized these financing assurances as a prior action under the program. Net domestic financing will be reduced to only 0.1 percent of GDP, compared with 2.5 percent of GDP in 2002. Looking ahead, we will schedule a meeting of the consultative group of donors in the second half of 2003.

Budgetary External Financing
(In millions of U.S. dollars)

Loans	**480**
World Bank (net)	178
Inter-American Development Bank (net)	58
Andean Development Corporation (CAF) (net)	112
Other	131
Grants	**146**
Of which:	
United States	57
Netherlands	15
European Union	14
Germany	15
Japan	17

12. The increase in nonconcessional external debt of the public sector will be limited (on a net basis) to US$150 million (2 percent of GDP) in 2003, with a downward adjuster for delayed disbursements in public borrowing earmarked to fund the public sector's possible contribution to bank restructuring or corporate workouts, as described below. This limit takes account of Bolivia's phased graduation from IDA and the budget financing plans summarized in the above table; and it is consistent with external debt sustainability criteria. At the time of the second review, in parallel with the government's efforts to define the role and nature of any public support to the bank and corporate restructuring process, we will reassess the likely financing need and the timing of any additional nonconcessional external borrowing by the public sector to cover the costs of public financial support for the restructuring process, taking account of the plans of multilateral development banks for additional lending to Bolivia. Consistent with prudent external debt management, external short-term borrowing would be limited to zero, on a net basis, for the year as a whole.

Nonconcessional External Financing
(In millions of U.S. dollars)

	Gross	Net
IDB	4	-60
IBRD	60	60
CAF	266	147
Other	76	3
Total	**406**	**150**

13. The government is actively pursuing several large projects that could come on stream over the next several years. The liquefied natural gas (LNG) project for exports to North America is expected to move forward this year on the most efficient basis.

14. We intend to maintain a liberal trade policy. In addition, we are negotiating with our trading partners to improve market access for our exports, including the removal of barriers to

soybean exports to Colombia, and the design of a possible free trade agreement with Chile. Regarding trade with the United States, exporters are already taking advantage of the benefits of the recent regional trade package, and we expect this trade to expand rapidly.

15. We have signed agreements with almost all creditors that deliver relief under the enhanced HIPC Initiative, while still pursuing agreements with Brazil, China, Japan, and Taiwan Province of China.

D. Monetary and Exchange Rate Policies

16. We remain committed to a strong and independent central bank, which will continue to keep inflation low. The monetary program for 2003 will be conducted through control of the central bank's net domestic assets (NDA). This program will reduce NDA in 2003 by 7 percent (December-over-December). It incorporates a decline in central bank credit to the central government.

17. The monetary program anticipates strengthening the central bank's net international reserves, by US$65 million, to a level of US$875 million—thereby raising coverage of dollar deposits in the banking system from the end–2002 level of 31½ percent of disposable international reserves (excluding gold holdings but including banks' liquid asset requirement held abroad) to 35 percent at end–2003. Broad money in U.S. dollar terms is assumed to recover gradually; at end–2003, it would still remain somewhat lower than at end–2001.

18. In recent years, we have been making exchange rate policy more flexible within the crawling-peg exchange rate regime, and this policy will continue in 2003. Our aim will be to maintain and preserve competitiveness. Looking ahead, the central bank will undertake a study, in consultation with IMF staff, on recent trends in the real effective exchange rate, external debt sustainability, and competitiveness. This study will be completed by September 2003; it should allow us to consider additional options for external policies designed to maintain Bolivia's competitiveness, and to consider a possible move to an inflation targeting framework over the medium term.

III. Financial and Corporate Sector Policies

19. The government is committed to taking all steps needed to maintain and enhance confidence in the domestic banking system. Recently, the central bank responded promptly to deposit outflows by assuring banks of necessary liquidity support and raising dollar interest rates. These measures have helped stabilize the situation and central bank liquidity support is almost fully unwound. Thus, recent episodes of instability have clearly demonstrated the central bank's capacity to respond effectively and quickly restore more normal conditions. If necessary, central bank reserves could be supplemented through access to lines of credit from the Latin American Reserve Fund (FLAR) and other sources.

20. Nevertheless, we recognize the need to strengthen the banking system and have adopted key measures to improve the regulatory framework for bank supervision and advance

plans for bank resolution. The main steps to be implemented during 2003, in consultation with Fund staff and in line with the recent FSAP mission's findings, are as follows:

- Under a decree already issued, banks are required to have met their provisioning requirements against problem loans by end-March 2003. There will be no further forbearance extended to banks, except for temporary forbearance that may be allowed under the government's policy, in the context of a viable corporate restructuring program.

- A decree will be issued by end-April that clarifies the financial oversight responsibilities of different institutions (performance criterion). General norms in accordance with existing laws will be issued by the Executive Branch, while the banking superintendency—which is responsible for policy implementation—will issue prudential regulations and standards.

- Consistent with these principles, regulations will be issued for bank resolution and prompt corrective action mechanisms by end-April (performance criterion).

- Timely bank reporting of their financial condition will be key to assessing the soundness to the banking system. Based on the audited balance sheets for December 2002 and the official balance sheets as of end-March 2003, the situation of each bank will be analyzed in the first half of 2003, and a plan of action will be developed to maintain banks' soundness.

- The basis for central bank liquidity support of banks, including those undergoing restructuring, will be clarified. The appropriate regulations are expected to be issued by end-April 2003.

21. In addition, the government is developing a comprehensive strategy for the financial and corporate sectors, since the strengthening of both sectors needs to be addressed at the same time. The aim is to restore the profitability of viable private firms while ensuring the financial system's stability and development. The strategy will be formulated by mid-2003, consistent with the findings of the recent FSAP mission. Meanwhile, the initial steps, prepared in consultation with Fund staff and consistent with the recent FSAP mission's findings, are as follows:

- A high level management team will be appointed to coordinate the relevant public sector agencies regarding the overall strategy for the financial and corporate sectors.

- Draft laws on bankruptcy procedures and informal workout mechanisms will be submitted to Congress by end-April (performance criteria). These laws are expected to be approved by end-September (benchmarks).

- The management team will deepen the analysis of the situation in the corporate sector. The impact of potential restructuring of viable enterprises on banks' balance sheets will be identified, and a timetable will be developed for any needed actions to enhance the financial soundness of banks that provide debt relief to the corporate sector. A framework for the use of public funds for bank restructuring or corporate workouts will be developed and fitted into the fiscal framework during the first half of the year, with any funding extended only under strict conditions of an agreed restructuring plan.

IV. MEDIUM-TERM OBJECTIVES AND POLICIES

22. Our medium-term strategy aims at real GDP growth of 4–5 percent in the medium term, with the main sources of growth being the following: (i) gas and oil exploitation; (ii) exports of manufactures that should benefit from expanded U.S. trade preferences for the Andean region; (iii) some large mining projects; (iv) development of the tourism sector; and (v) a gradual recovery of domestic demand based on increased employment and investment opportunities.

23. The medium-term program will aim at a significant further reduction in the fiscal deficit through fiscal reforms. Ongoing reforms of the two tax agencies are designed to, inter alia, improve coordination between the agencies and overhaul support for key tax administration systems, including through an update of the registry of taxpayers in the National Tax Service that will help enhance revenue buoyancy. Public investment will focus on poverty-related and priority areas identified in the government's program, Plan Bolivia. The government's plans for enhancing the efficiency of expenditure include better tracking of pro-poor spending, developing a medium-term expenditure framework, cutting inefficient capital expenditure, and reducing pension costs. These reforms will be developed in close consultation with the IMF, the World Bank, the IDB, and the CAF.

24. Other elements to the government's medium-term strategy are as follows:

- A strategic plan to promote exports and investment will be developed that will rely on improvements in the economic and business environment.

- Improvements in the legal framework to give full assurances of the rule of law and to improve the business environment.

- A second generation of reforms at the municipal level that should result in greater accountability of municipalities while also providing for their fiscal autonomy.

- Improvements in governance, including institutional reform of public sector entities, a new procurement law, and improved public sector financial information management, and an action plan to combat corruption.

- A strategy will be developed to increase the share of intermediation in local currency.

25. We aim to complete the formulation as soon as possible of a medium-term economic program, based on our poverty reduction strategy. In this light, we expect to replace the stand-by arrangement by an arrangement under the Poverty Reduction and Growth Facility.

V. Program Monitoring

26. Implementation of the program supported by the Stand-By Arrangement will be monitored through quarterly reviews that should be completed by May 15, August 15 and November 14, 2003 and February 15, 2004. Quantitative performance criteria for end-March and end-June 2003, and indicative targets for end-September and end-December 2003, are shown in Table 1. Prior actions and structural performance criteria and benchmarks are listed in Table 2 and described in detail in the technical memorandum of understanding.

Table 1. Bolivia: Quantitative Performance Criteria and Indicative Targets, 2003

	2003			
	Performance Criteria		Indicative Targets	
	End-Mar.	End-June	End-Sep.	End-Dec.
(Cumulative amounts from December 31, 2002 in millions of bolivianos)				
Deficit of the combined public sector	800	1,450	2,250	3,793
Net domestic financing of the combined public sector	500	-200	-25	73
(Cumulative changes from December 31, 2002 in millions of bolivianos)				
Net domestic assets of the central bank	725	250	-500	-245
Of which : central bank net credit to the nonfinancial public sector	350	175	-325	-82
(Cumulative changes from December 31, 2002 in millions of U.S. dollars)				
External debt of the public sector with maturities up to one year	15	10	10	0
Nonconcessional external debt of the public sector (net)	15	50	100	150
Net international reserves of the central bank	-170	-90	0	65
External arrears, stock at end of period (continuous performance criterion)	0	0	0	0

1/ The Technical Memorandum of Understanding provides further details on definitions and adjusters to the program.

Table 2. Bolivia: Prior Actions and Structural Conditionality Under the Stand-By Arrangement, 2003 1/

Condition	Policy Measure	Timetable for Implementation 1/
	Public Sector Reform and Financing	
Prior Action	Finalization of financing assurances	Before Board approval of SBA
Prior Action	Submission to congress of 2003 budget which, together with the proposed revenue measures described in para. 11 of the TMU, is consistent with a combined public sector deficit equal to or less than 6.5 percent of GDP; support of the budget from the President of the Lower House of Congress	Before Board approval of SBA
Performance Criterion	Approval of 2003 budget, which together with the proposed revenue measures described in para. 11 of the TMU is consistent with a combined public sector deficit equal to or less than 6.5 percent of GDP	April 15, 2003
Performance Criterion	Submission to congress of a tax procedures code consistent with para. 12 of the TMU	April 30, 2003
Benchmark	Approval by congress of a tax procedures code consistent with para. 12 of the TMU	September 30, 2003
	Financial Sector and Corporate Sector	
Performance Criterion	Issuance of the final regulations for the bank resolution and prompt corrective action mechanisms introduced by the financial sector law of 2001 consistent with para. 14 of the TMU	April 30, 2003
Performance Criterion	Issuance of supreme decree(s) (i) clarifying the roles of the different institutions with oversight over the financial sector (includes ensuring a technical basis for issuing prudential norms), and (ii) defining certain areas of banking regulation that should be determined by the superintendency consistent with para. 13 of the TMU	April 30, 2003
Performance Criterion	Submission to congress of draft bankruptcy law and draft law for corporate debt workout mechanism, prepared in consultation with Fund staff and consistent with paras. 15 and 16 of the TMU	April 30, 2003
Benchmark	Approval by congress of law on corporate workout mechanism consistent with para. 16 of the TMU	September 30, 2003
Benchmark	Approval by congress of bankruptcy law consistent with para. 15 of the TMU	September 30, 2003

1/ References in the table are to the relevant paragraphs of the Technical Memorandum of Understanding (TMU).

BOLIVIA—TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This technical memorandum sets forth the definitions of the performance criteria referred to in the Memorandum of Economic Policies under the Stand-By Arrangement. The quantitative targets and limits described below for 2003 will be measured as cumulative flows from December 31, 2002 (Table 1). Monthly updates for fiscal and monetary information will be provided at most 25 calendar days after the end of each month. Further definitions of quantitative performance criteria and adjusters are provided in Table 2.

Quantitative performance criteria

2. The **deficit of the combined public sector** (CPS) is the sum of the net external financing of the nonfinancial public sector (NFPS) and the net domestic financing of the CPS (see definitions in Table 2). The domestic floating debt of the NFPS comprises the liabilities incurred for goods and services received but not yet paid for, excluding claims on and liabilities to other entities within the NFPS. The floating debt with respect to public sector wages at the end of each month will include (i) unpaid wage increases and (ii) wages for work performed in a previous month but not yet paid. Floating debt will include the floating debt of the departmental capitals, El Alto and those municipalities having subscribed an adjustment program (PRF) with the government as of December 31, 2002; will be reported semiannually, with at most a 90–day lag; and will be included in the floating debt figures as soon as available.

3. The **net domestic assets of the central bank (BCB)** are defined as the currency issue less the net international reserves (NIR) of the BCB (defined in Table 2). Medium- and long-term external liabilities of the BCB and net credit to the NFPS from the BCB exclude net disbursements of foreign loans administrated by the BCB as trust funds for the NFPS. NIR and external liabilities will be valued at the accounting exchange rate of Bs 7.73 = US$1 in 2003.

4. **External debt** has the meaning set forth in point No. 9 of the Fund's Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000, and will include any public debt instruments held by foreign official institutions. The amounts of nonconcessional and short-term external debt will be evaluated at the end–2002 U.S. dollar exchange rates of 0.9536 Euro = US$1,119.90 Japanese yen = US$1, and for other currencies according to the corresponding end–2002 exchange rates published in the IMF's International Financial Statistics.

5. The **BCB assets and liabilities** denominated in foreign currencies other than U.S. dollars will be converted to U.S. dollars at the market exchange rates for the respective currencies in effect at the date of measurement except for: (i) gold, to be valued at the accounting rate of US$300 per troy ounce; and (ii) SDR holdings and the net Fund position which will be converted into US$1.35952 = SDR1. The change in NIR of the BCB will be

measured by differences in stocks. In consolidating the BCB cash operating result (see Table 2) with the NFPS accounts, transfers to the treasury in lieu of operating profits will be excluded from expenditures.

Adjusters to the program

6. **HIPC debt relief** includes that provided under the original and enhanced initiatives from the reduction in amortization arising from stock of debt reduction operations and rescheduling. As indicated in Table 1, the limit on the deficit of the CPS shall be reduced (increased) by the shortfall (excess) between actual and projected HIPC debt relief. The limits on the net domestic financing of the NFPS will be adjusted upward by the difference between projected and actual cumulative net external financing to the NFPS, excluding HIPC debt relief, up to the designated ceiling. Beyond HIPC refers to debt relief granted by HIPC creditors beyond that agreed within the enhanced HIPC framework.

7. The limits on the net domestic financing of the CPS and on the net domestic assets of the BCB will be adjusted downward, and the target for NIR of the BCB will be adjusted upward, by the amount of any **overdue obligations to foreign official creditors**. The target for NIR of the BCB will be adjusted downwards for shortfalls relative to the projected currency issue, up to the designated ceiling indicated in Table 1.

8. Loans for financial and corporate restructuring for purposes of the adjuster to the **limits on net nonconcessional foreign debt** indicated in Table 1 comprise CAF credits of US$35 million and IBRD credits of US$35 million for restructuring that are included in the financing figures in the table in para. 12 of the MEP. The limit on net nonconcessional foreign debt shall be reduced by the amount of the shortfall between actual and projected external financing for financial and corporate restructuring, up to the designated ceiling.

9. **External financing for social spending** for purposes of the adjuster indicated in Table 1 comprises: a Poverty Reduction and Social Credit from IDA (US$50 million); an IBRD loan to support the social safety net (US$25 million); a social sector credit from the IDB (US$20 million); and a loan to support the employment program (US$25 million) from the CAF. One or more of these loans could be replaced by alternative loans with similar financial conditions and for similar purposes, after consultation with Fund staff. The limit on the deficit of the CPS shall be reduced by the amount of the shortfall between actual and projected external financing for social spending, up to the designated ceiling.

10. An **automatic adjustment mechanism for the prices of oil refined products** will be implemented on January 1, 2004. Domestic retail prices of refined petroleum products would be increased during 2003 if the three conditions detailed in Tables 2 and 3 hold. In such a case, the price adjustment will be implemented within the following seven days. The amount of the adjustment will be determined in a way that leaves the excise tax rate no lower than the level existing after the first three adjustments of the reference price effected after January 25, 2003.

Other issues

11. **The 2003 budget** that has been submitted to Congress will be supplemented by a draft tax law that increases the taxation of certain alcoholic beverages, travel, and business services. The consistency of the draft legislation with the limit on the combined public sector deficit indicated in Table 1 will be confirmed with Fund staff. The consistency of the 2003 budget approved by Congress as a performance criterion for the first review will be confirmed with Fund staff in view of any other fiscal legislation that may have been approved by Congress.

12. The **new tax procedures code** will provide that (i) disputes over tax liabilities will proceed through an administrative procedure prior to the final recourse of judicial review; (ii) tax fraud and similar violations will be subject to criminal penalties; (iii) sworn tax declarations will be a sufficient legal basis for pursuing tax collection; and (iv) the rules for applying the statute of limitations (*interrupción del periodo de prescripción*) will be specified.

13. **The roles of the different institutions with oversight over the financial sector will be clarified by supreme decree.** In particular, (i) the CONAPFI (*Consejo Nacional de Política Financiera*) shall formulate its recommendations for general norms and regulations for the financial system on the basis of technical and legal reports prepared for this purpose by the relevant superintendency; (ii) the Superintendency of Banks and Financial Institutions (SBEF) shall have the authority to issue regulations including accounting rules for the proper valuation of assets, conduct onsite inspections, take corrective or emergency actions contemplated by Law 2297 of December 2001, and take actions consistent with the resolution mechanisms established by this law and its regulations; and (iii) consistent with the policies established by the executive branch, the areas of banking regulation that will remain under the purview of the SBEF include the fields of liquidity, risk diversification, market risks, securities, interest rate risk, equity investments, loan classification and provisioning, and internal control systems. Limits on open foreign exchange positions will be set by the central bank.

14. **Regulations to be issued for bank resolution and prompt corrective action** mechanisms should include, in particular, (i) the triggers and procedures for regularization, voluntary liquidation, and intervention of financial institutions (Articles 112–123 of the Banking Law amended by the Law 2297 of December 2001) ; and (ii) the resolution procedures for financial institutions (Articles 124–132 of the Banking Law amended by the Law 2297 of December 2001).

15. **The bankruptcy law** to be submitted to Congress will provide a legal framework for corporate insolvency, which will include in particular the following principles: (i) a swift liquidation system for nonviable firms designed to maximize recoveries; (ii) the rehabilitation of viable enterprises to minimize economic losses; and (iii) an efficient system for enforcing both unsecured and secured credit claims. Important progress has already been made in incorporating comments to the draft law from World Bank staff on earlier versions.

16. **The law on corporate workout mechanisms** to be submitted to Congress will provide a legal framework for a debtor enterprise to reach an out-of-court agreement with its creditors on a restructuring plan, including a business reorganization plan and a restructuring of claims on the debtor enterprise. The main principles of the mechanism include: (i) the agreement would be between the debtor enterprise and its creditors; (ii) a group of creditors would decide whether to accept a plan, following an independent review of the debtor's proposal and prospects; (iii) creditors would be treated no worse under the agreement than in a formal bankruptcy proceeding; and (iv) there would be recourse to formal bankruptcy proceedings if a qualified majority of creditors do not reach agreement on a plan.

Table 1. Bolivia: Quantitative Performance Criteria and Indicative Targets, 2003

	2003			
	Performance Criteria		Indicative Targets	
	End-Mar.	End-June	End-Sep.	End-Dec.
(Cumulative amounts from December 31, 2002 in millions of bolivianos)				
Deficit of the combined public sector 1/	800	1,450	2,250	3,793
Net domestic financing of the combined public sector 2/ 3/	500	-200	-25	73
(Cumulative changes from December 31, 2002 in millions of bolivianos)				
Net domestic assets of the central bank 2/	725	250	-500	-245
Of which: central bank net credit to the nonfinancial public sector	350	175	-325	-82
(Cumulative changes from December 31, 2002 in millions of U.S. dollars, unless otherwise indicated)				
External debt of the public sector with maturities up to one year 4/	15	10	10	0
Nonconcessional external debt of the public sector (net) 4/ 5/	15	50	100	150
Net international reserves of the central bank 6/ 7/	-170	-90	0	65
External arrears, stock at end of period (continuous performance criterion)	0	0	0	0
Projections for calculation of adjusters to the program 8/				
(Cumulative change from December 31, 2002 in millions of bolivianos)				
Adjuster for currency issue				
Currency issue (program)	-611	-473	-501	258
Maximum adjustment to net international reserves target	0	25	50	75
Adjuster for the deficit of the combined public sector				
External financing for social spending (programmed disbursements)	348	348	541	928
Maximum adjustment to the limit on the deficit of the combined public sector	0	60	120	175
(Cumulative amounts from December 31, 2002 in millions of U.S. dollars, unless otherwise indicated)				
Adjuster for net external financing of the nonfinancial public sector				
Net external financing of the nonfinancial public sector (program) 9/	26	199	262	433
Maximum adjustment to limit on domestic financing of combined public sector (Bs millions)	150	500	500	500
Adjuster for nonconcessional external debt of the public sector				
Maximum adjustment to the nonconcessional external debt limit	0	0	35	70
Financing through HIPC and beyond-HIPC debt relief (program) 10/	14	31	45	64

1/ The deficit limit will be reduced (increased) by the amount of the shortfall (excess) between actual and projected financing through HIPC and beyond HIPC debt relief. The financing from HIPC relief comprises refinancing and the amortization component of stock of debt reduction operations. The deficit limit will also be reduced by the amount, if any, of the shortfall between actual and projected external financing for social spending, subject to the maximum adjustment shown in this table.

2/ The limits will be adjusted downward by the amount of any overdue obligations to foreign creditors.

3/ This limit will be adjusted upward by the shortfall, if any, of the actual cumulative net external financing to the nonfinancial public sector from the projected cumulative external financing, subject to the maximum adjustment shown in this table.

4/ Subject to the exclusions indicated in Table 2 of the Technical Memorandum of Understanding. The term "debt" has the meaning set forth in point No. 9 of the Fund's Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000.

5/ The debt limit will be reduced by the amount, if any, of the shortfall between actual and projected disbursements of loans for financial and corporate restructuring, subject to the maximum adjustment shown in this table.

6/ This target will be adjusted upward by the amount of any overdue obligations to foreign official creditors.

7/ The targets will be adjusted downward by the shortfall, if any, of currency issue from the projected change shown in this table, subject to the maximum adjustment shown in this table.

8/ For the first three adjusters, the first line shows the projected levels under the program, that will be used for the calculation of the adjuster, up to a ceiling defined in the second line.

9/ Does not include the HIPC debt relief through rescheduling or the amortization component of stock of debt reduction operations under HIPC Initiative and beyond HIPC.

10/ Comprises refinancing and the amortization component of stock of debt reduction operations under the HIPC Initiative and beyond HIPC, both for the financial and nonfinancial public sector.

Table 2. Bolivia: Definitions and Adjusters of Quantitative Performance Criteria

I. Definitions

Nonfinancial public sector (NFPS), comprising:

(i) General government (central administration, public sector social security, prefectures, municipalities, and other decentralized agencies); and
(ii) Nonfinancial public enterprises.

The public sector is defined to include:

(i) Nonfinancial public sector; and
(ii) the Central Bank of Bolivia (BCB) and other financial public sector entities, including NAFIBO and FONDESIF.

Net domestic financing of the combined public sector, sum of:

(i) Increase in the net claims of the domestic financial system on the NFPS (excluding deposits in the BCB related to foreign loans administered as trust funds;
(ii) Cash operating results before distribution to the treasury's account of the BCB;
(iii) Change in the NFPS liabilities to the private sector in the form of fiscal certificates;
(iv) Increase in the domestic floating debt of the NFPS (liabilities incurred for goods and services received but not yet paid for, excluding claims on and liabilities to other entities within the NFPS); and
(v) All domestic borrowing from the nonfinancial private sector; including the net increase in any new domestic debt instruments issued by the government and held outside the NFPS.

Net external financing of the NFPS comprising:

(i) External disbursements to the sector;
(ii) Total HIPC debt relief from refinancing operations;
(iii) Net disbursements of funds for the NFPS administered by the BCB as trust funds;
(iv) Unpaid current interest obligations;

less

(v) Amortization due by the NFPS after HIPC debt relief for the amortization component of the stock of debt reduction operations, and
(vi) Net payments in settlement of the external arrears of the NFPS.

Net international reserves of the central bank:

(i) BCB liquid foreign assets;

less:

(ii) BCB liabilities to nonresidents (including swaps and the net position under the Latin American Integration Association, LAIA, clearing mechanism) with an original maturity of at most one year;
(iii) Outstanding purchases and disbursements from the Fund (excluding disbursements from the trust fund); and
(iv) BCB net liabilities to the Latin American Reserve Fund (FLAR), including bridging loans (even those obtained by the NFPS) and those obtained by pledging gold.

The definition excludes:

(i) Gains resulting from the conversion of monetary gold into foreign exchange;
(ii) Gains resulting from the acquisition of domestically produced gold; and
(iii) Any of the commercial banks' liquid asset requirement holdings, whether or not included in the BCB balance sheet.

Table 2. Bolivia: Definitions and Adjusters of Quantitative Performance Criteria (Continued)

External debt of the public sector with maturities up to one year excludes:

(i) Normal import credits;
(ii) Reserve liabilities of the central bank; and
(iii) The use of Fun resources.

Nonconcessional external debt of the public sector, defined as:

(i) Outstanding external debt of the public sector,

excluding:

(ii) Concessional loans with a grant element—based on the interest rate and repayment schedule of each loan and any grants or other external concessional loans in connection to the loan in question—of at least 35 percent using the OECD commercial interest reference rates as of January 15, 2003;
(iii) Changes in BCB liabilities included in the definition of NIR;
(iv) Debt reprogrammed with official creditors;
(v) The use of Fund resources;
(vi) The effect of any stock-of-debt operations under the enhanced HIPC Initiative or beyond-HIPC relief.

Cash operating result of the BCB, calculated as:

Current receipts from:

(i) Interest on deposits abroad;
(ii) Earnings on the BCB portfolio with the NFPS and the financial system;
(iii) Interest payments by the treasury on government paper held by the BCB;
(iv) Interest on LAIA accounts;
(v) Commissions and realized foreign exchange gains; and
(vi) Other current receipts, excluding any sale of fixed assets, including gold.

Minus current payments to:

(i) The IMF, excluding repurchases and SAF, ESAF and PRGF loan repayments;
(ii) Other international organizations, excluding amortization and interest on loans administered by the BCB as trust funds for the NFPS;
(iii) The domestic commercial banks on account of reserve requirements;
(iv) Interest on certificates of deposit and treasury bills B and D; and
(v) Administrative and other current expenditures.

Table 2. Bolivia: Definitions and Adjusters of Quantitative Performance Criteria (Concluded)

Revenue and grants of the combined public sector, calculated as the sum of the following items:
From the general government accounts prepared by the Fiscal Programming Unit of the Ministry of Finance (UPF):

(i) Tax revenue (*Ingresos corrientes*);
(ii) Capital transfers from public enterprises (*Transferencias de Empresas*);
(iii) Grants (*Donaciones*);
(iv) Operating balance of the central bank (*Cuasifiscal*);

Minus:

(v) Issuance of public fiscal certificates (*Emisión de Cert. Fisc. Pub.*);
(vi) Other transfers to public enterprises (*Ots. Transf. a Empr.*);

Plus, from the public enterprises accounts prepared by UPF:

(vii) Current revenue (*Ingresos corrientes*);
(viii) Grants (*Donaciones*);
(ix) Public enterprises surpluses (*Excedentes de Emp. Pub.*);
(x) Interest payments on domestic debt (*Intereses Deuda Interna*);
(xi) Interest payments on external debt (*Intereses Deuda Externa*);

Minus:

(xii) Current expenditures (*Egresos Corrientes*).

II. Adjusters

The limits on the change to the NIR of the BCB shall be increased by overdue obligations to:

(i) Multilateral organizations;
(ii) Bilateral official creditors excluding debts covered under Paris Club or other bilateral reschedulings or debts under negotiation including service on rescheduling but excluding old debts to countries in the region;
(iii) Supplier's creditors without official guarantee excluding already rescheduled debt service; and
(iv) Holders of private bonds excluding zero-coupon bonds used in debt conversion schemes.

Conditions for increasing domestic retail prices of refined petroleum products in 2003:

(i) The 365-day moving average Platts price for gasoline or diesel—including projected prices for the next 60 days—implies, from January 25, 2003 on, at least 4 upward revisions of the reference prices under the supreme decree 26926 (the projected prices for gasoline and diesel will result from a daily linear projection based on the monthly future contracts' prices for NYMEX unleaded gasoline and IPE gasoil, respectively, published by the Platts Oilgram Price Report);
(ii) Cumulative monthly revenues plus grants of the combined public sector are at least 2 percent lower than projected (see Table 3); and
(iii) The cumulative deficit of the CPS exceeds the projected level under the fiscal program (see Table 3) by at least 2 percent. For the periods ending in March, June, or September, this condition would apply if the cumulative CPS deficit exceeds the limit in Table 1.

Table 3. Bolivia: Revenue and Deficit Projections for the Combined Public Sector
(Cumulative amounts from December 31, 2002 in millions of bolivianos)

	Revenue and grants	Deficit
2003		
January	1,072	330
February	2,088	731
March	3,488	777
April	5,184	833
May	6,471	883
June	7,660	1,429
July	9,042	1,682
August	10,352	1,738
September	11,632	2,215
October	13,132	2,407
November	14,471	2,792
December	15,795	3,793

Statement by the IMF Staff Representative
April 2, 2003

This statement provides information that has become available since the staff report was issued on March 24. This information does not require a change in the staff appraisal.

1. Prior actions

The budget process. The President of the Lower House (Chamber of Deputies) issued a statement of support for the budget on March 24. This completed the prior actions for the program. On March 28, the Lower House approved the 2003 budget, consistent with the fiscal program. Approval by the Upper House is expected later this week, and it would be signed into law shortly afterwards.

2. Recent Economic and Financial Developments

Economic activity and inflation. GDP data for the first three quarters of 2002 and the newly released index of economic activity through December 2002 are consistent with the estimate of 2.5 percent real GDP growth for the year. The 12–month CPI inflation rate dropped to 2.4 percent in February.

Fiscal performance. Available information through February is in line with meeting the end-March fiscal performance criteria. March fiscal revenues were expected to benefit from seasonally large tax collections in the second half of the month and a US$10 million bilateral grant from the United States received on March 20.

Financial system. Deposits have continued to decline, but at a more moderate pace in March, following the sharp drop in February. The total reduction from January 1 to March 28, 2003 was US$160 million (4.7 percent of total deposits). In March, the fall of deposits took place entirely in the foreign banks, reflecting withdrawals by the foreign oil companies. Nonbank institutions have seen their deposits increase slightly in recent weeks. The banks' nonperforming loan ratio rose to 19½ percent at the end of February.

Bolivia: Gross Official Reserves and Financial System Deposits
(In millions of U.S. dollars)

	12/31/02	2/11/03	2/28/03	3/28/03
Gross official reserves	854	866	724	744
Financial system deposits	3,429	3,495	3,280	3,270
Banks	2,725	2,771	2,582	2,563
Local banks	1,847	1,889	1,772	1,780
Foreign banks	877	883	810	783
Non-banks	704	724	698	706

Source: Central Bank of Bolivia.

International reserves. Gross official reserves have remained broadly stable after the large deposit withdrawals in mid-February, with a cumulative reduction of US$110 million from end–2002 to March 28. The end-March target for international reserves is expected to have been met.

3. Policy Developments

Congress has approved the Law on the Organization of the Executive Power (LOPE). This new law provides for downsizing the Cabinet from 18 to 13 ministries.

As indicated above, the budget for 2003 is expected to be passed in the next few days. We have been informed by the authorities that taxation of alcoholic beverages is likely to be scaled back somewhat, lowering projected revenue by an estimated Bs 20 million. However, the impact would be offset by an equivalent cut in current expenditure that is expected to be approved in the final budget.

The end-March deadline for banks to fully meet their provisioning requirements was maintained, as expected. However, two changes have been made:

- The rules for calculating the provisioning requirements for loans with real estate collateral have been simplified and somewhat relaxed, but remain prudent compared to regional practice.

- As a one-off exception, the banking superintendency is allowing banks to not reflect in their income statement the provisions needed to meet the end-March deadline. Provisioning requirements will be fully reflected in the capital adequacy ratios and documented in appropriate notes in the banks' auditing statements.

The staff understands these decisions allow needed breathing room for banks until the authorities put in place a comprehensive strategy for bank restructuring. A joint Bank-Fund mission is currently in La Paz as part of the follow-up to the recent FSAP mission, and is looking into this issue.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 03/46
FOR IMMEDIATE RELEASE
April 2, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves One-Year US$118 Million Stand-By Arrangement for Bolivia

The Executive Board of the International Monetary Fund (IMF) today approved a one-year SDR 85.75 million (about US$118 million) Stand-By Arrangement for Bolivia to support the country's economic program through April 2004. The approval opens the way for the immediate release of SDR 42.88 million (about US$59 million).

Following the Executive Board discussion, Anne Krueger, First Deputy Managing Director and Acting Chair, said:

"The Bolivian authorities are putting in place a program to stabilize the economic situation in 2003 and lay the basis for sustained economic growth and poverty reduction. The core elements of the economic program are fiscal consolidation, a strengthening of the banking and corporate sectors, and protecting and making more efficient social safety net spending.

"The 2003 budget begins a phased reduction in the fiscal deficit consistent with putting the public finances on a sustainable basis over the medium term. The program relies on a balanced package of measures, especially higher taxation of the hydrocarbon sector, introduction of a new tax procedures code, collection of tax arrears, and control of public spending. If needed, the government stands ready to rephase low-priority public investment, while protecting the social safety net and other poverty-reducing expenditures, in order to achieve the fiscal targets under the program.

"The authorities are introducing a coordinated strategy to strengthen the corporate and banking sectors and, thereby, help restore economic growth. The main elements of this strategy are the appointment of a high level management committee; modernization of the bankruptcy law; introduction of a framework for voluntary, out-of-court corporate restructuring agreements; and strengthening of the regulatory framework for the banking sector. The strategy should improve the corporate sector's financial position and thereby also strengthen the banking sector.

"The government has carefully sequenced reforms to address social tensions and restore public confidence. It is working with Congress and civil society to help advance its fiscal and legislative agenda, and to develop the medium-term structural reforms that could be supported as soon as possible by a successor arrangement under the Poverty Reduction and Growth Facility. The participatory approach is necessary to build broad popular support for the government's economic reforms and stabilization measures. These reforms and measures are crucial for raising Bolivia's economic growth prospects, creating job opportunities, and reducing poverty.

"In the context of the difficult economic and political challenges ahead, the Fund stands ready to work in close cooperation with the Bolivian authorities as they take firm steps to ensure the success of the economic program supported by the Stand-By Arrangement, and as they develop their medium-term structural reform program," Ms. Krueger said.

Recent economic developments

Real growth in Bolivia has been weak for the last four years at 1½ percent on average. Adverse shocks included the impact of coca eradication on incomes, the impact of low metal export prices on mining output and foreign direct investment, and contagion from the regional financial and economic developments. The economy's vulnerabilities have been heightened by fiscal imbalances and highly dollarized financial and corporate sectors.

The external and current account deficit remained relatively high at 4 percent of GDP in 2002 despite stagnant economic activity. Foreign direct investment was also very high at more than 7 percent of GDP, although it has been declining since 1999.

The fiscal deficit more than doubled over the last two years to 8¾ percent of GDP in 2002. Revenues were restrained by weak domestic demand, delays in tax reforms, and a freeze on domestic fuel prices. At the same time, expenditure surged reflecting increased real wages and a stepped-up public investment program.

Monetary policy was accommodative of a large government financing need. In addition, the central bank had to contend with two rounds of deposit instability, in mid-2002 and in February 2003, that left the dollar deposit base 17 percent below its level at end-2001.

Financial vulnerabilities in the highly dollarized financial system have increased significantly. Banks recorded losses in two out of the three last years and the average nonperforming loan ratio more than doubled in this period, although all banks in the system report capital adequacy ratios in excess of the minimum requirement.

The nonfinancial public sector debt rose sharply in 2002 to 62¼ percent of GDP. Both domestic and nonconcessional external debt have increased rapidly to finance the large fiscal deficits. As a result, debt indicators have deteriorated significantly from the path envisaged in 2001.

Program Summary

The economic program for 2003 focuses on stabilizing the economy after the recent civil disturbances and resulting financial instability, and laying the basis for a return to growth. The program projects a gradual economic recovery led by the hydrocarbon sector, with real GDP growth reaching about 3 percent in 2003, and rising to 4-5 percent in the medium term. Growth will also be fostered by the boost to manufacturing, in particular textiles, from the expanded preferential access to the US market for the Andean countries; and by agricultural growth benefiting from improved irrigation systems and road infrastructure.

The **fiscal program** aims to reduce the combined public sector deficit from 8¾ percent of GDP in 2002 to 6½ percent of GDP in 2003. The authorities intend to sustain the adjustment over 2004-05, so that the deficit can fall to 3-3½ percent of GDP by 2005. The program is based on the 2003 budget and will allow for an increase in social spending financed by higher external funding from multilateral and bilateral sources. The authorities have emphasized that the budget emerged from consensus-building efforts with key groups of public sector employees and within the legislative branch. The fiscal program depends on a combination of revenue measures, such as the elimination of some tax exemptions and a broadening of the base of some taxes, and expenditure measures that involve the reduction of the size of government and savings in pension costs.

The **monetary program** in 2003 will be conducted through control of the central bank's net domestic assets and targets a small buildup of US$65 million in net international reserves. Some increase in broad money in US dollar terms can be expected to take place as confidence returns to the economy and bank deposits recover, providing room for a gradual resumption of private credit.

As part of strengthening the **corporate and banking sectors**, the authorities intend to put in place the legal framework, mechanisms, and instruments needed to carry forward the corporate restructuring process. A flexible out-of-court workout mechanism will be introduced, coupled with modern formal bankruptcy proceedings. Plans to strengthen financial regulation over the next several months are also part of the program. This includes putting into place a framework for bank resolution and clarifying the institutional responsibility for the broad oversight over the financial sector.

Bolivia joined the IMF on December 27, 1945; its quota is SDR 171.5 million (about US$236 million). Bolivia's outstanding use of IMF credits totals SDR 142 million (about US$195 million).

Bolivia: Selected Economic Indicators

	1999	2000	2001	Prel. 2002	Prog. 2003
(Annual percentage change)					
Income and prices					
Real GDP	0.4	2.4	1.2	2.5	2.9
Real domestic demand	-2.0	-0.1	-2.0	2.7	1.9
GDP deflator	2.4	4.8	0.7	2.0	3.0
CPI (period average)	2.2	4.6	1.6	0.9	2.6
CPI (end-of-period)	3.1	3.4	0.9	2.4	2.8
(In percent of GDP)					
Investment and savings					
Gross domestic investment	18.8	17.2	13.0	14.4	14.8
Public	5.1	5.3	6.0	6.2	6.0
Private, including stockbuilding	13.7	11.9	6.9	8.2	8.8
Gross national savings	12.9	11.9	9.5	10.4	11.6
Public	2.9	2.8	1.4	0.1	1.9
Private	10.0	9.1	8.1	10.3	9.7
Combined public sector					
Nonpension balance	0.6	0.7	-2.2	-3.7	-1.6
Pension-related balance	-4.1	-4.5	-4.8	-5.0	-4.9
Overall balance	-3.5	-3.7	-7.0	-8.7	-6.5
External financing	1.9	2.0	3.1	6.2	6.4
Domestic financing	1.6	1.8	3.9	2.5	0.1
Nonfinancial public sector debt	59.1	58.9	53.9	62.3	70.2
External	49.1	47.3	36.2	42.9	50.4
Domestic	10.0	11.6	17.7	19.4	19.9
(Annual percentage change, unless otherwise stated)					
Money and credit					
Broad money (in U.S. dollars at current exchange rates)	-1.8	-3.3	-3.1	-11.7	6.3
Credit to private sector (in U.S dollars at current exchange rates)	-2.0	-9.0	-13.6	-9.5	3.4
Interest rates (percent, end-of-period)					
Commercial bank lending rate in U.S. dollars	16.3	15.3	13.5	11.9	12.2
Yield on treasury bills in local currency	13.6	14.7	12.9	17.2	13.9
Yield on treasury bills in U.S. dollars	8.9	9.1	5.6	4.9	4.8
External sector (US$ million)					
Current account	-488	-446	-276	-307	-245
(In percent of GDP)	-5.9	-5.3	-3.5	-4.0	-3.2
Capital and financial account	515	408	255	15	294
Of which: foreign direct investment	1,014	701	666	553	647
Overall balance	26	-39	-21	-293	49
Exceptional financing	16	15	9	17	16
Merchandise export volume, percent change	-1.2	13.2	6.0	7.5	4.5
Merchandise import volume, percent change	-6.8	3.1	-3.5	7.6	-0.8
Terms of trade, percent change (deterioration -)	1.4	3.6	0.5	0.5	1.3
Gross international reserves 1/					
(In months of imports of goods and services)	8.7	8.7	8.2	6.2	6.9
(In percent of broad money)	40.2	39.7	39.2	34.6	37.3
Disposable reserves in percent of dollar deposits 2/	37.7	39.5	39.4	31.6	35.1
Public sector external debt (US$ billion)	4.6	4.5	3.3	3.7	4.3
Exchange rates					
Bolivianos/U.S. dollar (end-of-period)	6.00	6.40	6.83	7.50	...
Real effective exchange rate (REER; percentage change during year)	2.2	-1.5	-3.5	4.4	...
REER, period average (percentage change)	1.4	-1.6	-2.0	3.0	...

Sources: Central Bank of Bolivia; ministry of finance; and IMF staff estimates and projections.

1/ Equal to central bank's gross official reserves plus commercial banks' liquid asset requirement (RAL) held overseas;

excludes reserves from the Latin American Reserve Fund (FLAR).
2/ Central bank gross disposable reserves (excluding gold holdings) plus commercial banks' liquid asset requirement (RAL) held overseas, in percent of dollar deposits in the banking system.

Statement by Guillermo Le Fort, Executive Director for Bolivia and Alonso Segura, Assistant to Executive Director April 2, 2003

Overview and Recent Developments

We thank the staff for a highly informative report that opens the way for the Board discussion on a program to allow Bolivia to consolidate macroeconomic stability and overcome the pressures on the financial system resulting from the recent episode of political unrest. The Stand-By program should help to establish the conditions for moving towards a medium-term oriented arrangement supported under the PRGF and aimed at confronting low growth and a high poverty level.

The Bolivian economy grew in the 1990s at an average rate above 4 percent, while inflation was sharply reduced. Macroeconomic stabilization was accompanied by a decisive drive in the implementation of structural reforms, including but not limited to, redefining the role of the state in the economy; one of the most ambitious privatization plans in Latin America; a far-reaching pension system reform; the closure of public banks and the elimination of financial repression; and the liberalization of international trade. However, over the past four years, growth has been significantly slower, averaging only 1.5 percent, in a context of continuous adverse shocks. Exogenous shocks included contagion from financial crises in countries of the region; the deterioration in terms of trade; and a significant loss of income, originated by the eradication of coca crops since 1999, which have only been partially replaced by alternative legal crops.

The confluence of several factors stemming from the weakening in economic activity has considerably deteriorated the fiscal position. The weak domestic demand depressed public sector revenues; pension costs derived from the 1997 reform rose further; and the expansion in public expenditures to confront the effects of the stagnant economy increased social expenses from 10.6 percent of GDP in 1999 to 12.4 percent in 2002. Additionally, strong political pressures made it impossible to advance a tax reform directed at partly compensating the loss of revenue and to unfreeze domestic fuel prices. Given this, the third-year PRGF arrangement went off track in the second half of 2001. As a result of an unexpected social uprising last February, the economic program had to be redefined in order to put in place a program that, while recognizing the political constraint, is still consistently aimed at stabilizing the economy and reducing the existing macroeconomic imbalances.

The economic program for 2003 includes a new attempt at fiscal consolidation based on an effort to garner a wider consensus represented in a new budget, recently submitted to Congress. The program aims at restoring stability and investor confidence as well as advancing structural reforms in the banking and corporate sectors as the basis for sustained growth. Growth under the program is projected at around 3 percent in 2003 and expected to increase to 4-5 percent in the medium term.

Fiscal Policy, Financing, and Debt Dynamics

The Bolivian authorities consider the correction of the fiscal slippages of the past two years as a priority. In that sense, the program is targeted to reduce the fiscal deficit from 8.7 percent in 2002 —and a passive projection by the staff of 9.4 percent for 2003— to 6.5 percent in 2003. This adjustment would be sustained over the following two years to drive down the gap towards 3-3.5 percent by 2005, and further over the next years. This reduction, more gradual than originally considered prior to social uprising, is defined so as to protect social spending, which is targeted to rise from 12.4 percent of GDP in 2002 to 12.9 percent in 2003. Moreover, emphasis is given to poverty-related programs aimed to strengthen the safety net, as well as to public investments financed by grants or concessional loans.

The reduction in the fiscal gap is derived both from revenue and expenditure measures, as well as from increased grants. On the revenue side, the original payroll taxes and the elimination of VAT deductions are no longer considered. Instead, revenue increases rely mainly on excise taxes on fuels, aimed at a better alignment of international prices with ex-refinery prices and extending the taxable base of fuel products. Other important revenue-enhancing measures are tax regularization and strengthening of the tax administration agencies, comprising broadening or increasing some taxes (on travel and services provided by nonresidents, among others), the elimination of loopholes and tax exemptions, and the implementation of a new tax procedure code.

On the expenditure side, along with holding real wages constant and trimming down the size of the government, the main instrument is the reduction of pension costs through tighter administrative controls directed at eliminating fraudulent claims and strictly enforcing eligibility criteria (0.5 percent of GDP). It is worth noting that the pension reform enacted in 1997 implies an annual fiscal burden of around 5 percent of GDP, and that the authorities are discussing with the World Bank and the IDB possible technical assistance on the matter. Finally, additional grants totaling 0.4 percent of GDP will be secured. Nevertheless, the authorities are aware of the problems involved in attaining the targeted fiscal adjustment, and they are ready to take any necessary measures to achieve it. In this respect, the fiscal program already considers a contingency plan, which would include raising domestic fuel prices in line with the evolution of international prices, and eventually delay or reduce some low-priority investment projects to cover any arising fiscal gaps.

Likewise, it is worth pointing out that fiscal financing for the 2003 program has already been secured from a combination of net external financing from multilateral sources (World Bank, Inter-American Development Bank, and Andean Development Corporation, totaling US$ 248 million), bilateral sources (US$ 131 million), and external grants (US$ 146 million, including an additional US$ 30 million obtained after the events in February). Taking into consideration sustainability issues, the program would limit the increase in net non-concessional external debt to US$ 150 million in 2003.

The envisaged fiscal path over the medium term would render a sustainable public debt path. Even though external debt indicators are higher than anticipated when the decision point under the Enhanced HIPC Initiative was reached, due to the higher than expected fiscal gap over the past years and lower growth, still it is worth noting that the ratio of the NPV of debt to exports remains below the threshold level of 150 percent. We regard the inclusion of Annex IV on Debt Sustainability Analysis as extremely useful, and, as the staff points out, the Bolivian authorities are aware of the risks that are pinpointed in the stress tests. My authorities remain confident, however, that the assumptions regarding GDP and export growth —which include projected liquid natural gas (LNG) exports to the U.S.— and the evolution of the currency are reasonable.

Monetary and Exchange Rate Policy

As noted by the staff, the monetary program in 2003 includes targeting a buildup of US$ 65 million in net international reserves. The authorities emphasize the high liquidity of the Central Bank (gross international reserves exceed 6 months of imports) which, if needed, could resort to the back-up lines from the Latin American Reserve Fund (FLAR) for an additional US$ 190 million. The Central Bank has proved its commitment and effectiveness in tackling adverse developments, notably the political transition period in June 2002 and in the February events.

The Bolivian authorities are aware of the risks associated with the crawling peg exchange rate system in effect, and agree on the benefits of gradually moving towards a more flexible exchange regime. However, given the high dollarization of assets and liabilities of economic agents, a steep depreciation of the currency is to be avoided, as it would result in large adverse effects on the balance sheets of corporations and banks. In this regard, they intend to gradually induce a de-dollarization process, with the promotion of the new inflation-indexed unit of account (UFV) as an initial step. Most importantly, measures will be implemented, aiming at strengthening the position of corporations and banks, as will be stressed below, as a pre-condition to consider a change in the exchange rate regime. Nonetheless, as noted by the staff, the Central Bank will undertake a study in the near future, with their assistance, in order to lay the foundation for a guideline in this respect.

Medium-Term Policy Framework and Structural Reforms

The authorities are aware of the importance of strengthening the corporate and banking sectors, severely weakened by the last four years of low growth. They are committed to the implementation of measures in line with the findings of the FSAP mission, several of which, in fact, constitute performance criteria and benchmarks under the requested program. In the banking sector, the provisioning requirements have already been met (as of March 2003), under a previously issued decree. Moreover, further regulations to strengthen and clarify competences for supervisory institutions will be enacted in the next few weeks. On the corporate front, as part of a comprehensive strategy, draft laws for bankruptcy and a corporate debt workout mechanism involving out-of-court settlements are on their way to Congress. These are centerpieces of the corporate restructuring process that will allow corporations and financial institutions to restore profitability and jumpstart the growth and credit cycle.

The economic program for 2003 is the first piece of a medium-term strategy designed by the Bolivian authorities to lay the foundation for sustainable growth and poverty reduction. As part of this strategy, a PRSP progress report has been drafted for broad-based discussion. A gradual but continuous reduction of the fiscal gap is a central element of this strategy, which considers shifting resources towards poverty-reducing programs. The feasibility of the projected fiscal path relies on further fiscal, expenditure and tax reforms, beyond one-off measures. An important element in the development strategy will be a timely and efficient implementation of the project to exploit vast reserves of gas and oil. In this sense, it is necessary that the LNG project for the U.S. market reaches a satisfactory solution on the basis of efficiency criteria. Finally, regarding the pension system, work remains to be done in order to limit the fiscal burden incurred by the reform. The authorities, together with a mission from the World Bank, are devoting efforts to this task.

The Bolivian authorities recognize the importance of correcting the fiscal slippages to guarantee a sustainable path of public debt and foster high growth and reduction of poverty. They also recognize the crucial importance to press ahead with pending structural reforms, both in the fiscal, banking and corporate sectors and are aware of the risks and severe challenges they face, along with the stiff opposition to market-oriented programs coming from certain political and social fronts. However, despite the risks they remain committed to an ambitious reform program that holds the key out of the current conditions. We believe that Bolivia's sound track record on economic reform and the authorities' commitment to their program are strong reasons to deserve Fund support under a Stand-By Arrangement.