

Bolivia: Fourth Review Under the Stand-By Arrangement and Request for Waiver of Nonobservance of Performance Criteria—Staff Report; Press Release; and Statement by the Executive Director for Bolivia

In the context of the fourth review under the Stand-By Arrangement and request for waiver of nonobservance of performance criteria with Bolivia, the following documents have been released and are included in this package:

- the staff report for the fourth review under the Stand-By Arrangement and request for waiver of nonobservance of performance criteria, prepared by a staff team of the IMF, following discussions that ended on September 9, 2004, 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 September 27, 2004. 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 Press Release summarizing the views of the Executive Board as expressed during its September 27, 2004 discussion of the staff report that completed the review.
- a statement by the Executive Director for Bolivia.

The documents 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

*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
Washington, D.C.**

INTERNATIONAL MONETARY FUND

BOLIVIA

**Fourth Review Under the Stand-By Arrangement and Request for Waiver of
Nonobservance of Performance Criteria**

Prepared by the Western Hemisphere Department

(In consultation with other Departments)

Approved by Caroline Atkinson and Michael T. Hadjimichael

September 21, 2004

- **Stand-By Arrangement.** The current arrangement was approved on April 2, 2003 for a 12-month period in an amount equivalent to SDR 85.75 million (50 percent of quota). It was extended on April 1, 2004, until June 15, 2004. On June 10, 2004, the arrangement was augmented by SDR 42.88 million (25 percent of quota) and extended through end-2004. This would be the penultimate review under the current SBA.
- **Discussions.** The review discussions were held in La Paz during August 10–25 and at headquarters during September 8–9. The mission met with President Mesa, Mr. José Antonio Galindo, Minister of the Presidency; Mr. Horst Grebe, Minister of Economic Development; Mr. Javier Cuevas, Minister of Finance; Mr. Juan Antonio Morales, Central Bank President; Mr. Fernando Calvo, Superintendent of Banks and Financial Institutions; and other senior officials. The team comprised M. Piñón (Head), A. Aisen, R. Balakrishnan, O. Williams (all WHD); A. Giustiniani (MFD); P. Medas (FAD); and K. Kostial (PDR), and was assisted by S. Cueva (Resident Representative). C. Mollinedo (IBRD) joined the mission. A. Segura (OED) also participated in discussions. The mission overlapped with FAD and MFD technical assistance missions.
- **Program.** In the attached Letter of Intent and Memorandum of Economic and Financial Policies, the authorities describe their policies for the remainder of the program period through 2004 and broad parameters of the 2005 budget and macroframework.
- **Economic and policy developments.** Real GDP growth is picking up, buoyed by strong export performance. Inflation has increased but remains in low single digits. The performance criteria (PCs) on NIR and NDA were not met owing to financial sector deposit withdrawals and delays in external disbursements. The PCs on the fiscal deficit, domestic financing, and BCB net credit to the NFPS were observed. The gas referendum resulted in a positive vote on all five questions, giving the authorities some breathing room to develop their hydrocarbons' policy.

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EXECUTIVE SUMMARY

Background

Social and political conditions were less difficult than feared in the build-up to the July 18 gas referendum although pressures are reappearing. The referendum was held without major incident, President Mesa won a yes vote on all five questions and a draft hydrocarbons law is being discussed with Congress.

Economic activity is picking up, led by exports. Real GDP growth is projected to reach 3.8 percent in 2004. Inflation has increased but remains in low single digits. The current account surplus increased, although recent capital outflows more than offset the improvement.

The 2004 program is broadly on track. Fiscal quantitative performance criteria (PCs) at end-June were observed, while PCs for NIR and NDA were not met because of financial deposit withdrawal and delays in external disbursements. NIR and NDA are now on track.

Policy discussions

Discussions focused on: (i) the 2004 macroeconomic objectives and program targets; (ii) understandings on broad parameters for the 2005 budget; (iii) steps to protect and strengthen the financial system; and (iv) implications of hydrocarbons' policy for medium term sustainability.

Understandings were reached on a 2004 fiscal deficit of 6.0 percent of GDP (after grants), and a 2005 deficit target of 5¼–5½ percent of GDP. With higher than expected revenues (partly one-off), the authorities expect to achieve the 2004 target, despite increased infrastructure spending. Additional planned spending on roads and some earmarking of gas revenues in 2005 mean new measures of about 1¼ percent of GDP will be needed.

Measures are being taken to protect and strengthen the still-fragile financial system. These include strengthening supervision and liquidity monitoring, while improving prudential norms and moving towards a risk-based supervisory framework. The authorities also agreed to elevate to law a decree strengthening the independence of the superintendency of banks.

In face of difficult congressional discussions, the government has submitted a compromise hydrocarbons bill with a greater role for the state. The bill would allow exports but there are concerns regarding the larger role of the state oil company in hydrocarbon related decisions. A "commission of notables" and the World Bank are working with the government to strike a balance between popular demands and the legal conditions essential for development of the sector and medium-term sustainability.

Risks to the program remain substantial. The social and political situation remains fragile, and domestic consensus weak. Fiscal and financial risks remain high, with potential for capital spending overruns ahead of end-year municipal elections, a need for politically difficult adjustment measures to be taken for 2005, and the highly dollarized financial system vulnerable to deposit runs. Considerable uncertainty also surrounds hydrocarbons' policy.

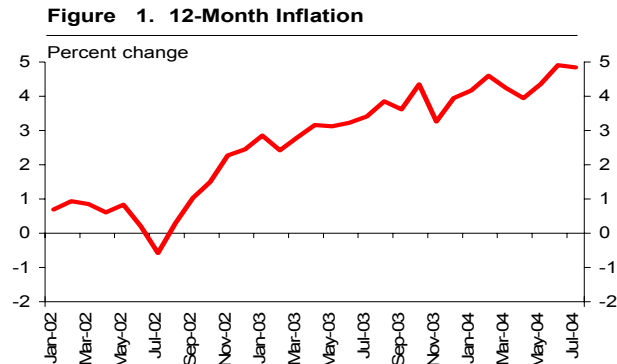
I. POLITICAL CONTEXT

1. **Social and political conditions were less difficult than feared in the build-up to the July 18 gas referendum, although pressures are reappearing.** The referendum was held without incident, road blockades were peacefully removed, and agreements were reached with teachers and pensioners that avoided social disruptions. More recently, tensions flared up with a large transportation strike demanding fuel price freezes, and blocking of some gas fields arising from demands for the construction of roads. Renewed social unrest could be triggered by the contentious Congressional debate over hydrocarbons' policy.
2. **Seeking to capitalize on the positive response in the referendum, the government submitted an initial hydrocarbons bill to Congress in early-August.** A yes vote on all five questions in the referendum strengthened President Mesa's political position (Box 1). However, the ambiguity of the questions and the overwhelming support of the questions that proposed an enhanced state role, mean that approving a business-friendly hydrocarbons law remains a challenge. The government this month submitted a revised bill in the face of fierce congressional pressure to toughen its initial post-referendum stance.
3. **Political parties are repositioning themselves ahead of the end-December municipal elections.** A number of political parties are adopting populist positions to improve their electoral prospects, including calls to nationalize hydrocarbon resources. Until recently, the main opposition leader had taken conciliatory positions, but he is now taking a tougher stance against the government (Box 2).

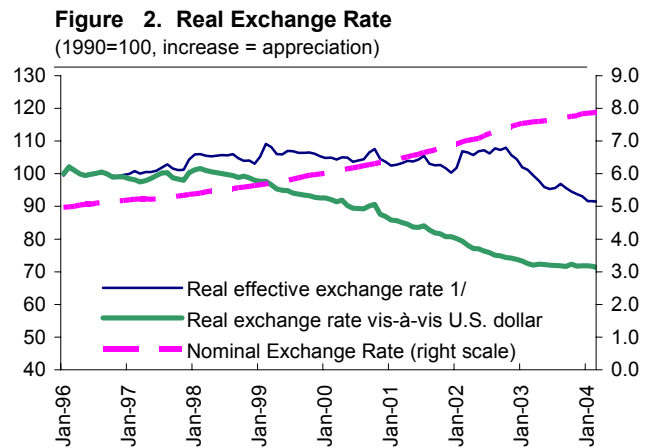
II. RECENT ECONOMIC DEVELOPMENTS AND PROGRAM PERFORMANCE

4. **Strong exports have buoyed the economy and helped boost fiscal revenues this year, but the fiscal position and the highly dollarized financial system remain fragile.** Key developments include:
 - **A pick up in economic activity, led by exports.** 12-month growth of 3.8 percent in the first quarter was $\frac{1}{4}$ percent higher than anticipated, owing to strong transportation and construction activities, and hydrocarbons and mineral exports. Preliminary indicators suggest this trend continued in the second quarter.

- **An upturn in inflation, although it remains below 5 percent** (Figure 1). The 12-month rate, which declined in the spring, increased to 4.8 percent in July as bad weather pushed up food prices.

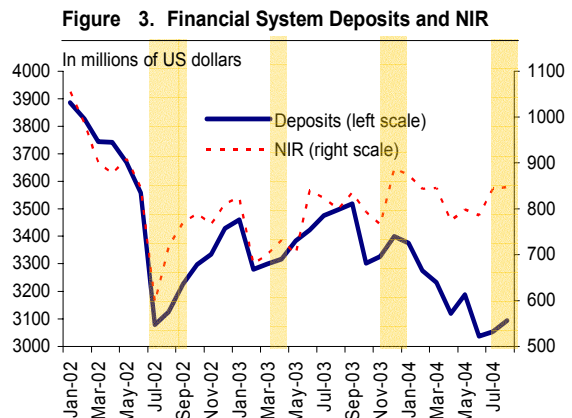


- **A significant strengthening of the external current account surplus, more than offset by a deterioration in the capital account.** The current account registered a surplus of 2 percent of GDP in the first semester (compared with a deficit of 0.7 percent of GDP projected in the program). Exports—particularly soy, minerals, and hydrocarbons—were boosted by higher soybean and nontraditional export prices, faster growth in neighboring economies, and the more



competitive level of the Boliviano (now at its most depreciated real effective level of the last decade, Figure 2). The 2004 current account surplus is now expected to be around 2½ percent of GDP compared with ½ percent of GDP under the program. However, the overall balance of payments has deteriorated because of large capital outflows associated with economic and political uncertainties and the introduction of the financial transactions tax (FTT).

- **A significant drop in financial sector deposits around the time of the introduction of the FTT, followed by a partial recovery.** Deposits stand at US\$3,094 million (end-August), more than 9 percent below the end-December 2003 level (Figure 3). As the July 1 implementation date for the FTT neared, deposit outflows accelerated, bringing the level of deposits to a low of US\$3,011 million on July 1. Domestic banks experienced the heaviest losses, concentrated in demand and savings



BOX 1. THE QUESTIONS OF THE REFERENDUM ON GAS EXPORTS

1. Revoke the current hydrocarbons law? (87 percent yes).

The current law (1996), aimed at attracting foreign investment, led to the discovery of large gas reserves. However, it is perceived by large segments of the population as too favorable to investors.

2. Recover state ownership of hydrocarbons at well head? (92 percent yes).

Some view this as a question on nationalization. The government does not support nationalization, but a greater role for the state in hydrocarbon-related decisions.

3. Give the state oil company a larger role in oil and gas exploration? (87 percent yes).

The government needs to clarify the extent and financing of the larger role envisaged for state oil company. The new hydrocarbons bill proposes to share some 1/6 of gas royalties with state oil company.

4. Support President Mesa's policy of using natural gas as a strategic tool to achieve sovereign access to the Pacific Ocean? (55 percent yes).

This question is related to Bolivia's long-term grievances with Chile. Beyond a recent announcement by the President that gas is to be exported via Peru, the implications are unclear.

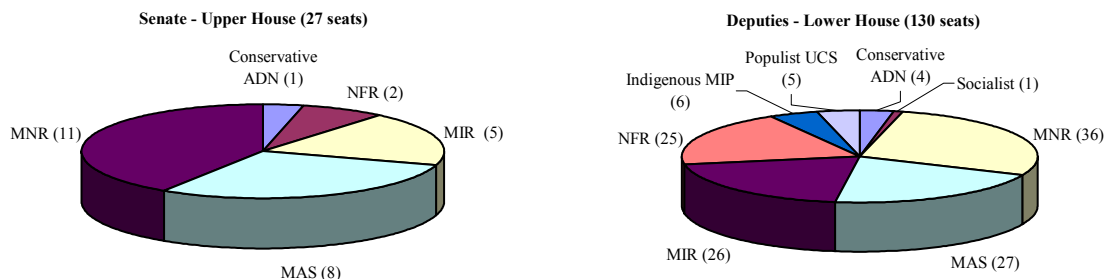
5. Support the export of natural gas subject to the following conditions: gas industrialization; meeting domestic demand; setting tax rates at up to 50 percent; and earmarking revenues for health, education and infrastructure? (62 percent yes).

The hydrocarbons bill submitted to Congress aims at reaching a 50 percent tax take on average, with significantly higher rates for larger fields, and lower rates for smaller fields. Some revenues are earmarked for special purposes subject to fiscal constraints.

BOX 2. POLITICAL BACKGROUND

Despite President Mesa's high approval ratings, and success in the recent gas referendum, the implementation of his economic and political agenda is proving difficult. His independence from traditional parties has allowed him to maintain high levels of popularity. However, passing legislation is proving to be challenging because of his lack of a political base in Congress, which has a close to even split among parties and regions. Against this background, he has had to compromise on his agenda and canvass support from different political parties at different times.

- **Congress is split among four main parties.** In the June 2002 elections, four parties obtained between 16–23 percent of the vote: Movimiento Nacionalista Revolucionario (MNR), Movimiento al Socialismo (MAS), Movimiento de Izquierda Revolucionaria (MIR), and Nueva Fuerza Republicana (NFR), in declining order (see charts below).

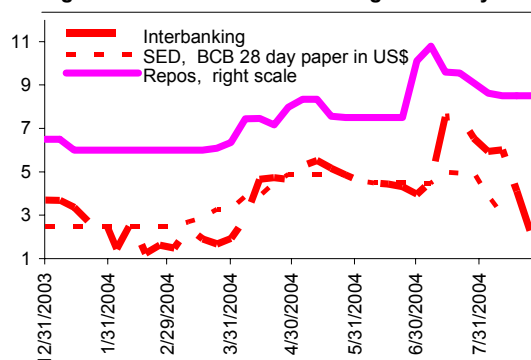


- **The main political parties are regionally defined.** MNR is a pro-market party of former President Sánchez de Lozada. The party has a stronghold in rich gas-producing lowlands. MIR is a center-left party and former coalition partner under the previous president. Its constituency is among the middle class in the highlands. NFR, a previous coalition partner, has its base in Cochabamba, the third largest city. MAS, the main opposition party, has its political base among the poor in the highlands.
- **Given his lack of a political base in Congress, President Mesa has relied on the support of different parties to pass legislation.** MAS's conditional support to the government has weakened radical groups' ability to mobilize support for national strikes. MNR and MIR have also supported President Mesa to pass selective legislation. A splinter group of deputies from several parties has vowed to support some of the President's initiatives, but so far has not played a major role. Approving laws on more divisive issues—such as the new hydrocarbons law or revenue and expenditure reforms—could prove challenging.
- **The gas referendum boosted President Mesa's national standing, but demonstrations continue.** After a lull following the yes vote in the referendum, radical leaders have gradually resumed demonstrations calling for abandoning market-oriented reforms and hydrocarbons' nationalization. Moreover, as municipal elections scheduled for late 2004 approach, parties are adopting a more populist stance.

deposits in foreign currency, on which the FTT is levied.¹ Term or “time” deposits and investment funds, which were exempted from the FTT, increased. From July 1 to end-August deposits have recovered by US\$83 million, about a third of the losses since early-June.

- **A rise in interest rates as liquidity conditions tightened, with a decline in recent weeks as liquidity has started to return (Figure 4).** As banks facing deposit withdrawals requested liquidity credits of some US\$42 million during the week of June 30, the central bank (BCB) increased interest rates by 250 basis points. Toward the end of July, liquidity started to return to the system and interest rates declined, with BCB repo and 28-day paper rates falling by 230 and 200 basis points respectively from their July peaks. With the recent stabilization in deposits and the high cost of central bank credits, financial institutions reduced their liquidity credits from the BCB to less than US\$1 million.

Figure 4. Interest Rates in Foreign Currency



- **Increased placements of government paper since late May.** After scarce market appetite in March-April, the authorities raised interest rates and placed paper above the programmed levels through end-August (about US\$3 million per week above program). Starting in August, the authorities began to take advantage of the more liquid market by placing an increased proportion of paper in local currency and at longer maturities (up to two years).

6. **The fiscal deficit in the first six months of 2004 was ½ percent of GDP lower than programmed.** As a result, the ceilings on domestic credit to the government and BCB financing to the nonfinancial public sector were met.² The lower-than-programmed deficit mainly reflected higher tax revenues (nearly 1 percent of GDP)—owing to the economic recovery, and higher-than-expected collection under the tax regularization program. Through June, the higher revenues were partially offset by increased capital spending (0.2 percent of GDP higher-than-programmed), mainly by the municipalities, and lower external grants

¹ The FTT is applied at a rate of 0.3 percent on both credits and debits. In the weeks leading up to its implementation, demand and savings deposits declined by US\$111 million and US\$118 million respectively.

² Wide margins on BCB financing for the NFPS reflected a swap of assets and liabilities between the BCB and the treasury that resulted in an increase in deposits at the BCB. Adjusting for this, both program targets would have still been met.

7. (0.2 percent of GDP). In addition, starting in July, road projects have begun to be implemented at a faster than expected pace. Despite a bonus payment to teachers (with a large component already programmed) and pension payments to the so-called “*sandwich generation*” (contributors to the old pension system but not eligible under the new), overall current expenditures were contained in line with the program, reflecting tighter treasury control over other outlays.

8. **NIR fell short of the end-June PC reflecting delays in external disbursements and the drop in financial sector deposits in the first half of 2004.** World Bank disbursements of US\$25 million, initially expected for late June, were received in July following procedural delays. There were also shortfalls in project financing of about US\$50 million, owing to slow execution rates. Reserve margins that had been built up through mid-June were lost, as banks facing deposit withdrawals requested dollar liquidity or withdrew excess deposits from the BCB. With a cumulative loss in NIR from end-December of US\$151 million through end-June, the end-June PC was missed by US\$30 million, leaving reserve coverage of banking system dollar deposits at 35 percent. Since then, NIR have recovered by US\$91 million (through end-August) with some margins relative to the program.

9. **Some progress has been made on structural reforms under the program:** (i) the expenditure commission that is to make recommendations on the prioritization of spending for the 2005 budget has met regularly and the final report is expected by end-September (appointment of its members was an end-June benchmark); (ii) the Upper House of Congress has approved a law regulating the administrative procedures (*recurso de alzada y jerárquico*) introduced with the new tax code, and the Lower House is expected to approve it before end-September (structural PC); (iii) in line with the findings of the due diligence process, shareholders’ capital in Banco Union was written down conferring an overall majority to the state-owned bank NAFIBO (fulfilling part of an end-September benchmark); and (iv) the operational and budgetary independence of the Superintendency of Banks and Financial Institutions (SBEF) and the BCB were strengthened through a decree issued in June.

III. POLICY DISCUSSIONS

10. **Discussions for the completion of the fourth review under the SBA centered on:** (i) assessing performance through end-June and discussing measures to ensure that the end-September and end-December targets would be met; (ii) reaching understandings on broad parameters for the 2005 budget, including possible revenue and expenditure measures; (iii) identifying next steps to protect and strengthen the financial system in light of recent capital outflows; (iv) assessing the implications of the gas referendum for hydrocarbons’ policy and the status of discussions on a new hydrocarbons law; and (v) examining progress on the preparation of a new PRSP, including the national dialogue. Based on these understandings, the next review would focus on assessing the consistency of the budget with the deficit target after grants of below 5½ percent of GDP, progress toward securing Congressional approval of the 2005 budget, and the likely impact on medium-term prospects from the Hydrocarbons Law.

A. Fiscal Policy

11. **The authorities intend to contain the fiscal deficit target to 6.0 percent of GDP for 2004, slightly better than programmed.** Given the results for the first semester, and an FTT yield close to program during its first two months of implementation, revenues are now expected to be 0.7 percent of GDP higher for the year. However, spending is also expected to be higher. The authorities have accelerated the implementation of infrastructure projects, particularly roads deemed important to integrate the country. In response to staff concern that this would lead to a higher spending base for 2005 that Bolivia could not easily afford, the authorities stressed the importance of the infrastructure projects for growth and stated that this spending would be contained within program ceilings. With respect to fuel prices, staff argued that the recent fuel price freeze was a backward step, noting that fuel prices in Bolivia were well below those in neighboring countries. The authorities assured staff that the freeze was temporary and that they intended gradually to resume price increases later in the year.³

12. **The authorities reaffirmed their intention to speed up the implementation of projects financed with concessional resources during the remainder of the year.** A slow implementation rate of externally financed projects led to lower than expected multilateral disbursements in the first half of 2004. The authorities agreed to make a concerted effort during the second half of the year to accelerate the implementation of concessionally financed projects, including from the World Bank and IDB. This would also help them limit nonconcessional financing, while meeting their investment objectives.

13. **Understandings were reached to contain the 2005 budget deficit before grants to 8½ percent of GDP, or 5¼–5½ percent of GDP after grants.** The authorities will submit a budget bill to Congress in October consistent with this deficit target, and include funds and expenditures that have previously been outside the budget. Budgetary discussions with line ministries have started, including through efforts to strengthen intra-government coordination for budget preparation and implementation. This contrasts with the previous practice of discussions only after the approval of the budget, often resulting in its modification.

14. **Both revenues and expenditures are expected to rise in 2005.** Higher gas exports, the full-year implementation of the FTT, and expected outcome of the hydrocarbons bill (being considered by Congress) will tend to raise tax revenues next year. However, this would be partially offset by the loss of the 2004 revenues associated with the tax amnesty. On the expenditure front, while total spending is now expected to rise, the authorities plan to

³ The authorities also committed to isolate the impact of accounting transactions on the measurement of program performance. A supplementary technical memorandum of understanding includes new adjusters for September and December targets, including for transactions between the BCB and any public sector financial institution.

reduce current spending as a percent of GDP, excluding pensions, through restraint, particularly on salary increases. The staff highlighted the danger that in order to accommodate increased capital spending—especially on roads—expenditure on goods and services could be compressed to unsustainable levels, jeopardizing the provision of public services. The authorities said that they plan to maintain spending on goods and services at levels consistent with the efficient provision of public services.

15. **The authorities committed to identifying additional measures—estimated at 1¼ percent of GDP—to ensure the 2005 budget meets the deficit target and is consistent with available financing.** Fiscal policy in 2005 will be a focus of the next review. The authorities agreed with the staff that implementing additional measures to meet the fiscal targets, while accommodating higher capital spending, would be challenging. On revenues, there are several alternative measures that could be considered for 2005–06 (Box 3). In light of the social sensitivity of some of these measures, staff pressed the authorities to ensure that measures are implemented only after appropriate safeguards to protect the poor are in place, and the potential for social unrest is minimized. On spending, the authorities are conducting a thorough review of existing projects aimed at identifying cuts for those of lower priority. They also agreed to study and, if necessary, take action to limit the scope of the proposed transfers to state oil company and the implementation of the new road projects.

16. **The authorities reiterated their commitment to completing pension reform, while improving transparency and auditing procedures.** While acknowledging delays, they indicated that: (i) recently issued decrees mandating pension payments to the so called “*sandwich generation*” and early payments to the remaining eligible pensioners would lead to savings in NPV terms; and (ii) there is an action plan to implement previously envisaged measures, including the strengthening of the independent institution managing the pension system (SENASIR), and the digitalization of records. The staff indicated that a broader reform package aimed at reducing pension costs may be needed. The authorities responded that they have a pension commission studying ways to defray pension costs and were awaiting the recommendations of the commission before making new decisions.

17. **The staff urged the authorities to improve the reporting from local governments.** Recognizing increased delays in reporting by municipalities, the Ministry of Finance recently issued a circular reminding municipalities of their reporting obligations. Accounts of municipalities that are not complying have been subject to temporary freezes until appropriate reporting has been restored. The authorities also agreed to strengthen efforts to maintain and improve the financial management information system (SIGMA) at the local government level, in order to improve the coverage of pro-poor spending.

18. **The expenditure commission has made some progress in reviewing the structure and composition of expenditures.** The commission is drawing on the inputs from the World Bank-IDB public expenditure review (PER), Country Financial Accountability Assessment

BOX 3. TAX POLICY AND ADMINISTRATION REFORMS

This box presents possible measures to generate additional revenue in light of Bolivia's needed fiscal consolidation over the medium term, including improving coordination between the semi-autonomous revenue agencies and the Ministry of Finance and other areas of government.

Tax Policy reforms^{1/}

The tax framework has become complex and its efficiency and equity are being undermined by the special regimes to sectors and regions, as well as a system of crediting between unrelated taxes. Possible measures include:

- **Elimination of the transactions tax (IT—a cascading sales tax) by integrating it into the VAT.** The VAT rate would have to be raised at least to offset the revenue loss—with one percentage point rate additional increase yielding about 0.3–0.4 percent of GDP.
- **Introduction of a personal income tax (PIT) to replace the RC-IVA** (withholding tax on wages and interest income). The RC-IVA base has been eroded by abuse and fraud, as VAT on consumer goods can be credited against it. A PIT with rates of 5–25 percent and a threshold exempting 80–85 percent of the population, in tandem with a system of final withholding taxes for capital and wage income, could generate around one percent of GDP.
- **Replacement of the special regimes with presumptive tax on small taxpayers and review of the system of tax incentives, including free zones, to reduce tax privileges and simplify the regime.** Special sectoral regimes facilitate tax evasion and treat similar taxpayers differently. For instance, the agriculture sector provides only a negligible contribution to tax revenue, despite its large share in GDP. The creation of a presumptive tax, independent of sector, would prevent large taxpayers from benefiting from sectoral exemptions and increase the level of equity.
- **Strengthening the corporate tax (IUE).** Eliminating loopholes and expanding the tax base would protect the efficiency of the IUE, and could raise revenue by 0.2–0.3 of GDP. Moreover, the introduction of a minimum profit tax (based on sales) could be considered, in particular if the IT (which has served, in practice, as a minimum tax) were to be eliminated.

Tax Administration reforms

The political and fiscal crisis in recent years has put in jeopardy the customs reform of 1999 and the ongoing reform of the tax administration agency as the appointment of the board of directors requires a qualified majority vote in Congress, which has been difficult to secure. Efforts are necessary to prevent deterioration and a negative impact on revenue. FAD technical assistance is currently helping develop action plans.

- The **customs agency requires** a medium-term strategy. Customs also suffers from a lack of support by other institutions in combating smuggling and other related problems. The transitory character of the customs leadership has made it difficult to implement sustainable action plans.
- The ongoing reform of the **tax administration agency (SIN)**, together with the introduction of the new tax code and the creation of the Tax Superintendence, could improve tax collection and support future tax policy reforms. However, the authorities will need to give priority to further improve SIN's institutional capacity and the coordination between agencies to combat smuggling.

1/ This section is largely based on the findings of a FAD technical assistance mission (August 2004).

(CFAA), and HIPC assessment. It is expected to have a final report ready by late September (structural PC for end-September).

B. Monetary and Exchange Rate Policies

19. **The authorities reaffirmed their commitment to strengthening international reserves, in the context of low inflation.** NIR are currently back on track and inflation, although currently higher than programmed, is expected to be in line with the program by end-2004. To ensure that these objectives are met, the authorities agreed to: (i) pursue a proactive interest rate policy in response to changes in liquidity conditions; and (ii) given the improved domestic bond market, increase placements at longer maturities, including at two to four years.

20. **The authorities noted that the crawling peg exchange rate arrangement has served Bolivia well in maintaining low inflation, while allowing some flexibility to absorb shocks.** They explained that, while exchange rate policy was highly constrained by the virtual dollarization of the financial system, the rate of crawl has been adjusted periodically to changes in conditions. The nominal exchange rate has depreciated by 30 percent since 2000. Reflecting this, and recent moves in the exchange rates of trading partners against the dollar, the real effective exchange rate is at its most depreciated level since 1996. A large current account surplus is expected in 2004. The staff noted these achievements, but emphasized that the weak fiscal situation makes it more difficult to adapt to shocks and that Bolivia's neighbor countries have moved toward more flexible exchange rate regimes. Moreover, despite the 2004 current account surplus, international reserves are expected to decline owing to capital outflows, partly related to deposit withdrawals from the banking system. Against this background, and given Bolivia's extreme vulnerability to confidence shocks, staff advised the authorities to make further efforts to strengthen the reserve position, while gradually creating the conditions for increased exchange rate flexibility over the medium term.

21. **The authorities agreed to explore options to protect further the reserves position of the BCB and to consider gradual steps over time toward a more flexible regime that could help reduce medium-term vulnerabilities.** The authorities recognized that greater flexibility over the medium term would be helpful to reduce vulnerabilities to shocks. They also agreed that it would be helpful within the existing crawling peg exchange rate arrangement to seek ways to build up the BCB reserves. The current auction system only provides for the BCB to supply foreign exchange to the market; on the basis of the findings of a BCB study, the authorities are gathering comprehensive interbank data on foreign exchange transactions to help design an appropriate mechanism for central bank purchases of foreign exchange. Options include expanding the current auction mechanism to include purchases as well as sales. In the interim, the BCB is making direct purchases of foreign exchange from commercial banks, facilitated by the positive developments in the external current account. The authorities also plan to press ahead with measures to promote the use of domestic currency, including by implementing the recommendations of Fund TA planned for October.

C. Financial Sector Policies

22. **The authorities recognized the need to strengthen prudential regulation and supervision although the environment in which they operate remains difficult.** Given a high

level of nonperforming loans (NPLs) and the need for banks to enhance loan provisions, the authorities plan to strengthen supervision to place the banking system on a firmer footing. The authorities noted that inspection activity has intensified and affirmed their commitment to move toward an enhanced risk-based supervision. The staff stressed the importance of reinforcing prudential supervision, and pointed to the need over time to remove current elements of forbearance in prudential norms and to strengthen banks' capitalization.

23. **The authorities plan to strengthen the independence of the superintendency of banks and financial institutions (SBEF).** In response to concerns expressed by commercial banks, a commission comprising monetary and regulatory authorities and representatives of the banking industry was recently established to provide advice on measures to strengthen the banking system. However, in order not to undermine the authority of the SBEF, the authorities agreed with the staff that the commission would be headed by the superintendent and be limited to an advisory role. They also plan to elevate its independence from a presidential decree approved in June 2004 to a law.

24. **Progress is being made in developing a business plan for a bank where public sector loans were converted to equity.** A new Board of Directors and management have been appointed and shareholders' equity written down based on the findings of a due diligence process. The authorities are formulating a business plan and intend to privatize the institution no later than end-2005. In the case of another financial institution, recapitalization options are being considered, including the possibility of extending the maturity of outstanding subordinated debt held by foreign institutions.

25. **Following delays earlier in the year, corporate restructuring reforms have recently regained momentum with the appointment of a new Superintendent of Enterprises.** So far, six enterprises have entered the administrative process of debt restructuring envisaged by the informal workout law, and one has recently reached an agreement with its creditors. The Superintendency is currently reviewing the documentation for another fifty enterprises. This would allow the authorities to identify shortcomings and to propose changes to the bankruptcy legal framework by end-November.

D. Hydrocarbons Sector

26. **Facing strong pressures by Congress for a comprehensive hydrocarbons bill, the authorities have recently submitted a compromise bill to build on popular support from the referendum.** The authorities initially planned to push for a short "framework" bill that would respond to the call for a higher tax take and a larger role for the state oil company, while maintaining a business-friendly environment. Oil companies agreed that the August bill represented an improvement over earlier drafts but remained concerned about the effects of increased taxation on investment levels. However, discussion in Congress proved difficult, as congressional leaders considered the draft as too friendly to oil companies.

27. **The new bill preserves many of the key elements of the short "framework" bill, but proposes a greater state role.** Key elements remaining include: (i) a complementary tax based on production (varying with oil prices and field size), with payments credited towards corporate tax obligations; (ii) elimination of the existing surtax; (iii) revenue sharing arrangements with all

regions and earmarking of resources for social spending, security, and state oil company; and (iv) transparency requirements for the use of funds. However, the new draft proposes a more predominant role for the state, including by requiring firms to channel exports through the state oil company and mandating changes on existing contracts. World Bank staff is concerned that these changes could make major new investments less likely. Ongoing discussions between World Bank staff and the authorities aim at addressing some of these concerns and reducing risks. In addition, the government has agreed that it will contract several international experts to review the proposed changes and to make recommendations that are expected to facilitate discussions of the bill in Congress. The staff will, in collaboration with the World Bank, continue its discussions with the authorities on the contents of the Hydrocarbons Law before its expected approval by Congress by end-October, and assess its implications for the medium-term macroframework at the time of the next review.

28. **In response to staff concerns, the authorities agreed to limit the use of earmarked revenues and include safeguards to ensure transparency and protect the fiscal position.** The government views some earmarking of hydrocarbon revenues for local governments and state oil company as essential to obtain political consensus for a new hydrocarbons' policy that would permit exports. The staff noted the problems associated with earmarking revenues in many countries and stressed that Bolivia's difficult fiscal situation would be further complicated by undue inflexibility in the budget. In this connection, the authorities agreed to introduce provisions to the hydrocarbons bill to allow for cuts in earmarking in the event of budgetary difficulties or failure of accountability by the funds or agencies using the earmarked revenue. They intend to specify fiscal deficit and debt ceilings through regulations, above which no earmarking could take place.

29. **The authorities stressed that the state-oil company would be funded and operated transparently and following principles of efficiency.** The overwhelming "yes" vote to the third question of the referendum meant that strengthening the state oil company is a key priority of the administration. However, the authorities emphasized that any transfer of resources or borrowing would be included explicitly in the budget and that the state oil company would be operated transparently, and guided by principles of efficiency and cost minimization. The authorities will use the shares from previous capitalizations of oil companies to capitalize the state oil company, while continuing to pay the pension-like "Bonosol" payments from dividends. Following concerns expressed by the staff, the authorities explained that there would be no additional use of public funds to meet "Bonosol" payments.

E. Program Financing

30. **The authorities committed to continue limiting nonconcessional financing to well-targeted projects, and avoiding payment guarantees.** They indicated that any new borrowing would be concessional or fully within the ceilings for nonconcessional borrowing. They expected nonconcessional borrowing in 2005 to be lower than programmed for 2004. In the case of roads to link the country with Paraguay and Brazil, the authorities are pursuing concessional loans without guarantees. They also indicated that, if they are not successful in securing concessional

loans, they would resort to nonconcessional credits⁴ within a framework of fiscal discipline and a transparent bidding process, and noted the importance that the country attached to these roads for medium-term growth.

F. PRSP Issues and Medium-Term Framework

31. **The ongoing national dialogue and discussions with Congress, including on hydrocarbons' policy, are expected to lead to a better defined medium-term agenda.** The first phase of the national dialogue focused on training participants and prioritizing key issues to be carried through to subsequent stages. Initial discussions at the local level have emphasized enhancing the capacity of the poor to generate income. The dialogue is expected to culminate in discussions at the national level in November and a new PRSP before end-2004. The authorities are hopeful that their medium-term agenda could be supported by a new three-year Fund arrangement.

32. **The authorities are hopeful that the international community will continue to play a critical role in assisting in the implementation of their medium-term agenda, including through concessional external assistance.** In this connection, they indicated that they are working with international donors to ensure close coordination and have begun preparations for a new donors' Consultative Group (CG) to be held in late 2004 or early 2005.

33. **Medium-term prospects have improved after the gas referendum, but will depend on Congressional approval of a balanced hydrocarbons bill.** The vote in favor of gas exports increases the likelihood that alternative projects that partially substitute the previous LNG project will materialize (Box 4). However, given remaining uncertainties on the future direction of hydrocarbons' policy, the current medium-term scenario (broadly unchanged from the previous one) makes conservative assumptions about increases in export volumes, that could be reached by exporting only to regional markets.

34. **In addition to a viable hydrocarbons' strategy, achieving debt and fiscal sustainability would require significant fiscal consolidation efforts over the medium term, while limiting new nonconcessional debt.** The debt to GDP ratios have increased significantly after the enhanced HIPC initiative completion point in 2001 to over 76 percent of GDP projected for 2004, or 54 percent of GDP in net present value (NPV) terms. Reducing the debt to GDP ratio in NPV terms to below 46 percent by 2015 would require significant reductions in the fiscal deficit, while financing the bulk of it with concessional resources (Box 5). The medium-term macro framework will be revisited and updated in the context of the next review.

G. Program Monitoring and IFIs Role

35. **Structural conditionality.** Structural conditionality focuses on fiscal reform, strengthening the financial and corporate sectors, and hydrocarbons' policy. For the next review,

⁴ Brazil has offered nonconcessional financing (US\$220 million or around 2½ percent of GDP to be disbursed over 3½ years).

BOX 4: HYDROCARBONS SECTOR

The hydrocarbons sector is of fundamental importance to Bolivia, which has the second largest proven and probable gas reserves in South America. In 2003, the sector represented around 30 percent of exports (US\$480 million or six percent of GDP) and generated fiscal revenues close to five percent of GDP. To reach real per capita growth rates of 1½ to 2 percent (necessary for poverty reduction), Bolivia would need to implement additional hydrocarbon projects in the medium term. However, even after assuming an optimistic scenario for the sector, further fiscal adjustment is needed to ensure medium-term debt sustainability.

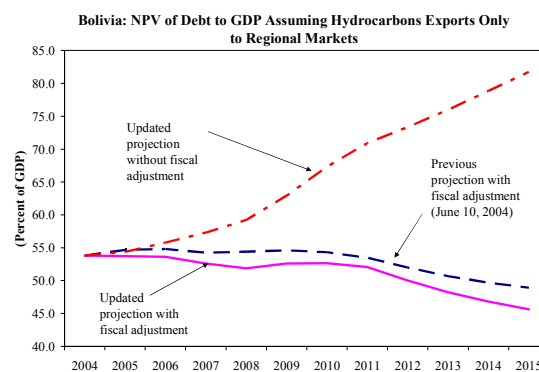
The impact of natural gas on growth in the initial phases of project implementation is small but increases over time. Contracted prices and volumes vary depending on factors including gas quality and transportation costs. Hydrocarbon projects tend to have a small immediate impact on growth since the value added from construction and business services associated with the projects is small. However, the impact in Bolivia has been substantial once production has come on stream for exports (within two to four years after the initial investment).

Bolivia is strategically located to export natural gas to several countries in Latin America:

(i) Brazil: Established contracts assure the sale of large volumes of Bolivian gas to: (i) generate electricity to help Brazil diversify its energy matrix away from hydroelectric generation, which is highly dependent on rain; and (ii) respond to calls from civil society seeking to increase the usage of more environmentally-friendly fuels (compared with coal). However, Brazil has natural gas in Santos, which could become a potential competitor for Bolivian gas.

(ii) Argentina: A contract to export gas was signed in 2004 on a temporary basis for a limited volume, likely to increase in the future. However, two potential risks remain: (i) large investments in pipelines (up to US\$1.5 billion) are needed in Argentina for volumes to reach an amount of 20 million cubic meters per day (MMm³/day), which would supply its Northwest region; and (ii) competition from domestic production, which is likely to increase as the country develops its own gas fields.

(iii) Mexico: Liquefied Natural Gas (LNG) exports could cover the potential demand from the Pacific coasts of Mexico and California. However, economic viability of the project is uncertain given that, for political considerations, exports would have to be shipped from a Peruvian port (instead of closer Chilean ports) increasing costs substantially. Moreover, Peru has its own gas reserves and it is still unclear if both countries would cooperate in selling LNG or are competing for the same markets.



Two scenarios for the hydrocarbons sector were considered that included, in addition to already contracted gas exports to Brazil: (i) exports of around 14 MMm³/day starting in 2009 from one or more of the following projects: Argentina, Mexico, petrochemicals or gas-to-liquids (previous projection); and (ii) exports to Argentina starting in 2005 with 6.5 MMm³/day and increasing to 20 MMm³/day by 2012 (updated projection). In both scenarios, fiscal adjustment is necessary to attain medium-term debt sustainability.

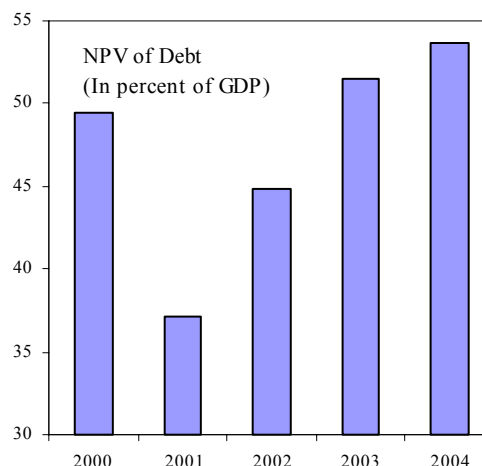
Bolivia: Fiscal Deficit from Alternative DSA Scenarios (In Percent of GDP)

	2004	2005	2006	2007	2010	2011	2013	2015
Previous projection with fiscal adjustment (June 10, 2004)	-6.1	-5.4	-4.1	-3.4	-1.8	-1.5	-1.3	-1.2
Updated projection with fiscal adjustment	-6.1	-4.9	-3.5	-2.7	-1.6	-1.5	-0.8	-0.7
Updated projection without fiscal adjustment	-6.1	-6.1	-6.1	-6.1	-6.1	-6.1	-6.1	-6.1

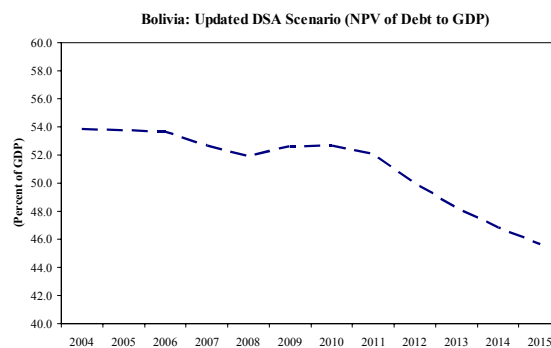
Source: Fund staff estimates and projections.

Box 5: Total Public Debt Dynamics

- With still-high fiscal deficits in recent years, public debt has risen back to its pre-enhanced HIPC initiative levels. A combination of low growth and high fiscal deficits—reaching around 9 percent (after grants) in 2002—contributed to an increase in public debt of over 20 percentage points of GDP since 2001, with a projected level of over 76 percent of GDP at end-2004. In net present value (NPV) terms, the debt ratio climbed from 37 percent of GDP after enhanced HIPC initiative completion point in 2001 to 51.5 percent in 2003, and is projected to rise further in 2004, to 54 percent. In relation to exports of goods and services, the NPV of public external debt is projected at 142 percent in 2004 (compared with 100.2 percent at enhanced HIPC initiative completion point), and nominal external debt at 203 percent. Despite substantial grants and concessional financing from the international community, Bolivia has also financed a part of the fiscal deficit with nonconcessional domestic and external resources, exacerbating the deterioration in debt dynamics. The ratio of debt service to government revenues has increased from 26.2 percent to 41 percent from 2001 to 2003.**



- Achieving debt sustainability would require both significant fiscal adjustment and continued access to concessional financing.** In the updated medium-term scenario, sustainability would be achieved through an appropriate mix of macroeconomic and structural policies. This scenario hinges critically on three assumptions: (i) a viable hydrocarbons' strategy (see Box 4); (ii) a steady reduction of the fiscal deficit to below 3 percent of GDP by 2007 (in part through the implementation of further tax and expenditure reform), and to below 2 percent in the outer years of the projection (by exporting gas that generates additional fiscal revenues of about 1 percent of GDP by 2010); and (iii) financing the bulk of the fiscal deficit with concessional resources. On this basis, Bolivia's public debt would decrease over the medium term to below 46 percent of GDP by 2015.



the benchmark on the approval of the hydrocarbons law would be expanded to include the issuance of the implementing regulations of the hydrocarbons law.

36. **Next review.** The next review of the SBA will focus on assessing progress toward securing Congressional approval of a 2005 budget consistent with: (i) a deficit target after grants below 5½ percent of GDP, taking into account the expenditure limits and revenue projections in the budget bill, as well as the likely revenue yield from specific revenue measures to be agreed with the staff and incorporated into the MEFP for the fifth review; and (ii) the prospective availability of external concessional financing and grants, while limiting nonconcessional financing. If necessary, the budget and macro frameworks for 2005 would be revisited to ensure consistency with available external financing. The review will also assess the likely impact on prospects for gas exports from the Hydrocarbons Law that would be expected to have been approved by Congress.

37. **World Bank and IDB role.** These institutions are actively engaged in Bolivia, focusing on poverty reduction, strengthening institutions in the fiscal, financial and corporate sectors, and advising on an appropriate hydrocarbons strategy. World Bank and IDB have various projects on roads, health, education, and the environment. The World Bank approved a Social Sector Programmatic Adjustment Credit in June 2004 and the IDB Board approved a reorientation of its portfolio toward the poverty reduction fund *Propais* in August 2004. On institutional strengthening, the World Bank and IDB have structural conditionality on: (i) supporting the independent institutions managing pensions and tax administration (IDB); (ii) establishing principles governing the use of funds for financial and corporate restructuring (World Bank); and (iii) improving prudential norms for the financial system (World Bank). The World Bank has also been helping the government with expertise to evaluate the hydrocarbons' framework.

H. Program Risks

38. **The program remains subject to considerable risks, notably:**

- **Despite the strong results of the referendum, social and political conditions remain difficult and the domestic consensus weak.** In particular, given President Mesa's lack of a political base, the adoption by Congress of his agenda is subject to considerable risk. There is also a possibility of renewed social unrest in the weeks ahead, with radical leaders calling for the adoption of populist policies and organizing demonstrations. Recent road blockades by the transportation sector, which led to a 100-day freeze in fuel prices, illustrate the pressures facing the government.
- **Fiscal risks remain high, including from the authorities' plan to increase spending on priority sectors.** Bolivia's precarious fiscal position, with a large fiscal deficit and high debt, means that slippage in planned fiscal consolidation or excessive nonconcessional borrowing could jeopardize sustainability. While the deficit ceiling has been observed so far, higher spending is based on revenues that could prove to be temporary. Moreover, with municipal elections scheduled for December, spending pressures could arise.
- **The highly-dollarized financial system remains weak and vulnerable to further deposit runs.** Deposit runs are closely linked to lingering political and economic uncertainties.

In this context, the introduction of the FTT further weakened the financial system with sizable losses experienced in the run-up to the introduction of the new tax.

- **Financing of the program depends importantly on securing concessional resources as well as on the smooth functioning of the domestic bond market.** Bolivia continues to rely on a broad international efforts to obtain financing on affordable terms. It is also dependent on access to domestic financing. As recently as May, political and social uncertainties led to a significant decline in domestic bond placements, which together with external assistance, are necessary for the financing of the fiscal deficit. Renewed episodes of this nature would entail considerable risks to the program.
- **In addition to fiscal adjustment and securing concessional financing, medium-term sustainability depends on developing a viable hydrocarbons' policy.** With the growing calls for populist measures in Congress, including nationalization, there is a risk that the eventual hydrocarbons law could deter investment.

IV. STAFF APPRAISAL

39. **The results of the gas referendum have improved prospects for the implementation of the authorities' policy agenda, but significant challenges remain.** President Mesa's national standing was boosted by the yes vote in the referendum. However, the mandate received from the referendum is somewhat unclear given the ambiguity of its questions. Continuing opposition to the government agenda illustrates the need for the authorities to capitalize on these results and broaden domestic consensus.

40. **While the 2004 fiscal program remains on track, the authorities should stand ready to adopt additional measures if deviations arise.** There is a risk that spending pressures could emerge as municipal elections near, and vocal sectors lobby for their inclusion in the old pension system and for the construction of large infrastructure projects. The recent decision to freeze fuel prices temporarily could also entail higher than programmed fiscal costs. The authorities should move ahead as soon as possible to implement an automatic price adjustment mechanism, supported by social safety nets, and stand ready to take contingency measures to meet the deficit target if needed. In addition, yields from the FTT, while so far in line with the program, are subject to uncertainties given the vulnerabilities in the highly dollarized financial system.

41. **It is essential that the authorities move promptly to identify the substantial fiscal measures needed for the 2005 budget, and develop the necessary domestic consensus.** The staff welcomes the authorities' intention to make further progress towards fiscal sustainability in 2005. The authorities will need to intensify their discussions with Congress to secure the timely approval of the 2005 budget and the associated new revenue measures, consistent with the budget deficit target and available external financing. Given Bolivia's high deficit and debt levels, further consolidation is urgently needed to reduce vulnerabilities. Strong commitment and perseverance by the authorities will be necessary to achieve this goal. Political and social constraints are severe and the authorities' plans to increase infrastructure spending and recapitalize the state oil company will require additional adjustment measures in other areas.

42. **Debt sustainability depends to a large extent on financing the deficit with grants and concessional credits.** In this connection, it is important to contain nonconcessional financing,

including for the state oil company, and other priority projects, such as roads, within the program ceilings, while avoiding collateralization of future tax revenues.

43. **Initiatives to improve data reporting at the local government level are crucial for effective program monitoring and implementation.** The staff commended the authorities for issuing directives to local governments reminding them of their legal obligations to submit data on their operations in a timely manner, including freezing some accounts to enforce compliance. The staff also welcomed steps to expand the implementation of the financial management information system (SIGMA) in local governments.

44. **Continuing to protect the reserve position of the BCB, after the losses that arose earlier in the year, will be important.** The staff welcomes the authorities' commitment to be proactive in accumulating reserves by allowing interest rates to respond to liquidity conditions and by purchasing foreign exchange from commercial banks. The authorities intention to allow the exchange rate to be more flexible later in the year, including possibly by introducing weekly foreign exchange purchase auctions, is a positive step.

45. **Reestablishing credit flows to sustain private sector growth will depend to a large extent on strengthening prudential regulation and supervision.** Increased political and economic uncertainties have adversely affected the performance of financial institutions. It will be important to address weaknesses in individual institutions and take steps to strengthen liquidity and solvency overall, in order to reduce vulnerability and reactivate the banking system. The introduction of risk-based supervision and the elimination of forbearance in the application of prudential norms will have to be implemented gradually, so as not to further weaken the institutions in the short term.

46. **The authorities have made some progress on the structural front, and need to press ahead with implementing further reforms.** The staff welcomed the appointment of the expenditure commission and efforts to privatize a bank where public sector loans were converted into equity. While the corporate restructuring agenda has been delayed, the appointment of a new superintendent of enterprises should add much needed impetus to these reforms. Lower House approval of the law regulating the administrative procedures (*recurso de alzada y jerárquico*) introduced with the new tax code remains a critical part of the program conditionality.

47. **While the draft hydrocarbons bill contains improvements over earlier versions, there are remaining concerns that should be addressed to ensure the development of the sector over the medium term.** In particular, it is important that the bill to be approved by Congress, and the implementing regulations, maintain an environment consistent with increased investment and exports. The role of the government and the state-oil company in the sector should not be allowed to hinder the development of potential markets and the effective operation of private companies, which are essential to attract needed foreign investment.

48. **While recognizing the importance of earmarking hydrocarbons' revenues in galvanizing political support, it is critical to limit such earmarking in light of the fiscal situation and to promote transparency and accountability.** Earmarking tends to create rigidities and complicate fiscal management. Staff was nevertheless encouraged by the improvements incorporated in the current draft hydrocarbons bill, including: (i) channeling

resources through the budget; (ii) reducing transfers to the state oil company to about 1/6 of royalties from 1/3 of royalties that had been previously proposed; (iii) limiting earmarking to a maximum (instead of a fixed) of 16 percent of revenues; and (iv) allowing for cuts in the event of budgetary difficulties or failure of accountability by the funds/agencies using earmarked revenue. It will be important that further specific safeguards are incorporated in the implementing regulations to the law. In order to further improve fiscal transparency, all extra budgetary funds should be included in the 2005 budget.

49. **Notwithstanding the significant risks, the staff believes that the program can achieve its objectives.** The authorities are taking important steps to mitigate risks to the program. In particular, the authorities have: (i) made progress in broadening domestic consensus, as evidenced by the results of the referendum; (ii) maintained current spending and the budget deficit within the program limits; (iii) taken a number of initiatives to protect the financial sector, including by strengthening banking supervision and increasing interest rates, as necessary. The authorities can further reduce risks by broadening support for their economic agenda through the ongoing national dialogue and by pressing ahead with the planned fiscal consolidation and the implementation of other key reforms. Staff therefore recommends the completion of the review and—based on the temporary nature of the deviations—the granting of waivers for the nonobservance of performance criteria.

Table 1. Bolivia: Selected Economic and Financial Indicators

	2000	2001	2002	2003	2004	2004	2005
				Prel.	No.04/193	Proj.	Proj.
(Annual percentage change)							
Income and prices							
Real GDP	2.3	1.5	2.8	2.5	3.6	3.8	4.5
Real domestic demand	1.2	-2.5	1.6	-1.3	4.1	3.5	3.2
GDP deflator	5.3	0.7	2.7	5.1	5.4	6.9	1.2
CPI inflation (period average)	4.6	1.6	0.9	3.3	3.6	3.9	3.5
CPI inflation (end-of-period)	3.4	0.9	2.4	3.9	3.5	3.5	3.5
(In percent of GDP)							
Investment and savings							
Gross domestic investment	18.3	14.2	14.7	11.1	13.1	13.6	16.8
Public	5.2	5.8	5.4	4.7	4.6	5.0	5.2
Private, including stockbuilding	13.1	8.5	9.4	6.4	8.4	8.6	11.6
Gross national savings	13.0	10.8	10.6	11.6	13.6	16.3	17.9
Public	2.8	1.4	-0.4	0.2	2.0	2.8	4.0
Private	10.2	9.4	11.0	11.4	11.5	13.5	13.9
Combined public sector							
Overall balance	-3.7	-6.9	-8.9	-8.1	-6.1	-6.0	-5.2
External financing	2.0	3.1	6.1	5.4	4.3	4.7	3.9
Domestic financing	1.8	3.9	2.8	2.7	1.9	1.3	1.3
Nonpension balance	0.7	-2.1	-3.9	-3.2	-1.1	-1.1	-0.1
Pension-related balance	-4.5	-4.8	-5.0	-4.9	-5.0	-4.9	-5.1
Nonfinancial public sector debt	58.6	53.6	61.5	73.0	76.8	76.3	73.0
External 2/	47.1	36.0	42.2	50.3	53.1	53.5	50.3
Domestic 2/	11.5	17.6	19.3	22.7	23.7	22.8	22.7
(Annual percentage change, unless otherwise stated)							
Money and credit							
Broad money (in U.S. dollars at current exchange rates)	-3.3	-3.1	-11.7	-3.3	-5.3	-6.6	2.8
Credit to private sector (in U.S. dollars at current exchange rates)	-9.0	-14.3	-9.4	-1.4	-0.8	-4.3	1.5
Interest rates (percent, end-of-period)							
Commercial banks lending rate in U.S. dollars	15.3	13.5	11.9	11.5	...	...	...
Yield on treasury bills in local currency	14.7	12.9	17.2	10.9	...	...	...
Yield on treasury bills in U.S. dollars	9.1	5.6	4.9	6.2	...	...	...
External sector (US\$ million)							
Current account	-446	-276	-324	36	41	223	95
(Percent of GDP)	-5.3	-3.4	-4.2	0.5	0.5	2.7	1.1
Excluding exceptional imports (in percent of GDP)	-3.4	-1.6	-1.1	1.6	2.2	4.9	4.6
Capital and financial account	408	238	32	42	-110	-291	12
Of which: net foreign direct investment	701	666	674	195	240	267	496
Overall balance	-39	-38	-293	77	-69	-68	107
Exceptional financing	15	9	17	16	14	13	3
Merchandise export volume, percent change	13.2	6.0	7.9	7.5	8.0	10.8	11.8
Merchandise import volume, percent change	3.1	-3.5	9.1	-11.3	7.3	8.3	9.4
Terms of trade, percent change (deterioration -)	3.6	0.5	-1.4	10.0	6.0	10.6	-7.4
Gross international reserves 3/							
(Months of imports of goods and services)	8.7	8.0	6.5	6.9	5.9	6.0	6.0
(In percent of broad money)	39.7	39.2	34.6	42.3	43.4	44.0	44.4
Disposable reserves in percent of dollar deposits 4/	39.5	39.4	31.6	39.1	39.2	40.8	40.8
Public sector external debt (US\$ billion) 5/	4.5	3.3	3.7	4.5	4.8	4.8	5.1
Exchange rates							
Bolivianos/U.S. dollar (end-of-period) 6/	6.40	6.83	7.50	7.84	7.92	...	...
REER (percentage change during year)	-1.6	-3.2	4.4	-8.5	...	...	...
REER, period average (percentage change)	-1.6	-1.8	3.0	-8.6	...	...	...

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

1/ Country Report No. 04/5.

2/ External debt indicators reflect assistance under the original and enhanced HIPC Initiatives, and beyond HIPC relief.

Domestic debt is the nonfinancial public sector debt, excluding bonds issued for the recapitalization of the central bank.

End-2003 external debt reflects valuation changes.

3/ 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).

4/ 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.

5/ External debt indicators reflect assistance under the original and enhanced HIPC Initiatives, and beyond HIPC relief; includes obligations to the Fund and debt with public guarantee. End-2003 external debt reflects valuation changes.

6/ Official (sell) exchange rate.; August 30, 2004.

Table 2. Bolivia: Operations of the Combined Public Sector

(In percent of GDP)

	2000	2001 Prog.	2001	2002	Prel. 2003	No.04/193 2004	Proj. 2004
Balance excluding pensions (deficit -)	0.7	0.6	-2.1	-3.9	-3.2	-1.1	-1.1
Current revenue	22.8	23.1	22.9	22.5	21.7	23.0	23.6
General government	22.3	22.7	22.1	21.9	21.7	22.8	23.2
Taxes	18.7	19.3	18.1	18.0	18.3	19.8	20.3
Hydrocarbons	5.1	5.5	5.1	4.7	4.7	4.7	4.7
Other 1/	13.6	13.9	13.0	13.4	13.6	15.0	15.6
Direct taxes	3.8	...	3.4	3.4	3.2	3.3	3.6
Corporate income tax	2.1	...	2.0	1.9	1.8	1.9	2.1
Indirect taxes	9.7	...	9.6	10.0	10.4	11.7	12.0
<i>Of which:</i>							
VAT	5.6	...	5.7	6.1	6.3	6.7	6.6
Financial transactions tax	...	...	...	...	...	0.6	0.5
Customs duties	1.3	...	1.1	1.1	0.9	0.9	0.9
Nontax revenue	3.6	3.4	3.9	3.8	3.4	3.0	3.0
Public enterprise operating balance	0.0	0.1	0.3	0.1	-0.1	0.0	0.1
Central bank operating balance	0.5	0.3	0.5	0.5	0.2	0.2	0.2
Current expenditure of general government	17.8	18.0	19.2	20.2	19.7	19.5	19.2
Wages	8.3	8.3	8.8	9.0	9.3	9.1	8.9
Interest	2.3	2.6	2.6	2.6	2.9	3.2	3.0
Other	7.2	7.1	7.7	8.6	7.5	7.3	7.3
Official grants	2.2	2.4	2.5	2.3	3.0	3.5	3.3
<i>Of which: HIPC assistance from grants</i>	0.9	0.8	1.1	0.9	0.9	1.1	1.0
Capital revenue	0.6	0.3	0.1	0.0	0.1	0.0	0.0
Capital expenditure	7.1	7.1	8.5	8.5	8.3	8.2	8.8
General government	6.9	7.0	8.3	8.4	8.2	8.2	8.8
Public enterprises	0.2	0.1	0.2	0.2	0.1	0.0	0.0
Pension-related balance (deficit -)	-4.5	-4.3	-4.8	-5.0	-4.9	-5.0	-4.9
Revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	4.5	4.3	4.8	5.0	4.9	5.0	4.9
Pensions	4.1	4.0	4.4	4.6	4.5	4.6	4.6
General government employer contributions	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Unidentified measures (deficit-)	0.0		0.0	0.0	0.0	0.0	0.0
Overall balance	-3.7	-3.7	-6.9	-8.9	-8.1	-6.1	-6.0
without grants	-6.0	-6.1	-9.4	-11.2	-11.1	-9.7	-9.3
Financing	3.7	3.7	6.9	8.9	8.1	6.1	6.0
External	2.0	2.5	3.1	6.1	5.4	4.3	4.7
<i>Of which: HIPC assistance from refinancing</i>	0.2	0.2	0.1	0.2	0.2	0.7	0.2
Domestic	1.8	1.2	3.9	2.8	2.7	1.9	1.3
Central bank	0.4	0.1	-0.5	1.7	-0.2	-0.1	-0.5
Commercial banks	0.4	0.0	0.9	0.2	-0.1	0.0	0.0
Pension funds	1.7	1.4	1.7	1.7	1.6	1.7	1.6
Other	-0.7	-0.2	1.8	-0.7	1.4	0.2	0.2
Memorandum items:							
Overall balance before grants (deficit -)	-6.0	-6.1	-9.4	-11.2	-11.1	-9.7	-9.3
Overall balance excluding grants and hydrocarbons (deficit -)	-11.1	-11.6	-14.5	-15.9	-15.8	-14.4	-14.0
Primary deficit (-)	-1.5	-1.5	-4.3	-6.3	-5.2	-2.9	-3.0
Poverty reducing expenditure	10.8	12.1	12.1	12.6	12.1	12.8	12.8
Total assistance under the HIPC Initiative	1.0	1.2	1.1	1.6	1.5	1.5	1.4
Original HIPC	0.9	0.8	0.7	0.5	0.5	0.4	0.4
Enhanced HIPC	0.0	0.4	0.3	1.1	1.0	1.1	1.0
HIPC assistance from stock-of-debt reduction	0.1	0.2	0.2	0.4	0.5	0.4	0.4
On interest	0.1	0.1	0.1	0.2	0.2	0.2	0.2
On amortization	0.0	0.1	0.1	0.2	0.3	0.2	0.2
GDP (in billions of bolivianos)	51.9	57.0	53.0	55.9	60.3	65.8	66.8

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

1/ The increase in the taxes include the impact from the measures introduced at end-2003 and early 2004, the tax code, the tax law 843, and the tax amnesty. The first two measures are expected to yield around 0.3 percent of GDP, and the last about 1.0 percent of GDP in 2004.

Table 3. Bolivia: Summary Balance of Payments
(In millions of U.S. dollars, unless otherwise noted)

	2000	2001	2002	2003	No.04/193 2004	Proj. 2004
Current account	-446	-276	-324	36	41	223
Trade balance	-584	-423	-471	-36	71	190
Exports, f.o.b.	1,246	1,285	1,299	1,573	1,835	1,989
<i>Of which:</i> gas	122	237	266	381	575	611
Imports, c.i.f.	-1,830	-1,708	-1,770	-1,609	-1,764	-1,799
<i>Of which:</i> exceptional imports	-161	-153	-235	-92	-140	-184
Services (net)	-24	-36	-18	-68	-108	-76
Income (net)	-226	-210	-205	-301	-360	-343
<i>Of which:</i> interest due on external public sector debt 1/	-130	-115	-98	-106	-114	-107
<i>Of which:</i> investment income (net)	-146	-165	-180	-231	-266	-279
Transfers (net)	387	393	369	441	437	452
<i>Of which:</i> HIPC assistance from grants	57	65	80	67	75	74
Capital and financial account	408	255	32	42	-110	-291
Capital transfers	0	3	0	7	0	8
Direct investment (net)	701	666	674	195	240	267
Gross investment	...	...	999	511	593	660
Disinvestment and investment abroad	...	...	-325	-351	-353	-393
Portfolio investment (net)	55	-23	-19	-68	-148	-160
Public sector loans	112	189	321	373	396	331
Disbursements	292	364	577	697	721	644
Amortization	-180	-175	-256	-370	-324	-313
Banks' net foreign assets, excl. liquid asset requirement	-369	-401	16	17	29	7
Nonbank private sector loans	-16	-50	-34	40	-65	-61
Other, including errors and omissions	161	-74	-826	166	267	-428
Errors and omissions	-237	-54	-100	-690	-830	-253
Overall balance	-39	-21	-293	77	-69	-68
Exceptional financing	15	9	17	16	14	13
<i>Of which:</i> HIPC assistance from rescheduling	15	9	17	16	14	13
GAP					0	0
Net international reserves (increase -)	23	29	275	-93	55	55
Memorandum items:						
Gross official reserves (end-of-period)	1,162	1,116	854	1,057	1,021	1,019
(In months of imports of goods and services) 1/	7.0	6.5	5.2	5.8	4.9	5.0
Gross international reserves (end-of-period) 2/	1,436	1,375	1,073	1,268	1,232	1,231
(In months of imports of goods and services) 1/	8.7	8.0	6.5	6.9	5.9	6.0
Gross Fund Financing	14.6	24.2	0.0	0.0	94.8	0.0
Total HIPC assistance and beyond HIPC relief	80	99	159	160	184	183
Original HIPC framework	79	59	43	39	34	31
<i>Of which:</i> assistance from debt reduction	7	8	7	10	11	10
Enhanced HIPC framework	1	28	84	80	86	87
<i>Of which:</i> assistance from debt reduction	1	5	22	26	20	21
Beyond HIPC and other debt relief	0	12	32	41	64	66
	(In percent)					
Export volume growth	13.2	6.0	7.9	7.5	8.0	10.8
Import volume growth	3.1	-3.5	9.1	-11.3	7.3	8.3
Nonexceptional import volume growth	22.7	-3.6	4.0	-3.6	3.2	3.2
Terms of trade change	3.6	0.5	-1.4	10.0	6.0	10.6
	(In percent of GDP)					
Current account	-5.3	-3.4	-4.2	0.5	0.5	2.7
Current account, excluding exceptional imports	-3.4	-1.6	-1.1	1.6	2.2	4.9
Current account before HIPC assistance 3/	-6.0	-4.4	-5.5	-0.7	-0.7	1.4
Merchandise exports	14.8	16.0	16.6	20.0	22.4	23.9
Merchandise imports	21.8	21.3	22.7	20.4	21.5	21.6
<i>Of which:</i> capitalization and pipeline	1.9	1.7	3.0	1.2	0.3	0.6
Direct investment (net)	8.3	8.3	8.6	2.5	2.9	3.2
Grants and loans 4/	5.7	6.8	9.7	13.0	12.0	11.0
NPV of debt to GNFS exports (3-year backward moving avg.)	199.3	100.2	118.9	139.9	141.3	137.9
External debt service to GNFS exports	20.4	18.1	12.4	15.4	14.6	14.6

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

1/ In months of imports of goods and services in the following year.

2/ Commercial banks' liquid asset requirement (RAL) held overseas added to central bank gross official reserves.

3/ Before any assistance under the HIPC Initiative.

4/ Official transfers and loans to the public sector, excluding HIPC debt relief.

Table 4. Bolivia: Monetary Survey 1/

	2000	2001	2002	2003	No. 04/193 2004	Proj. 2004
I. Central Bank						
(In percent of currency issue at beginning of period)						
Net international reserves	-6.0	-7.7	-71.7	23.7	-12.5	-12.6
(Flow in millions of U.S. dollars)	-23.4	-28.5	-275.4	93.0	-55.0	-55.1
Net domestic assets	6.2	19.1	84.2	-7.6	19.5	19.5
Net credit to nonfinancial public sector	8.5	-11.1	34.6	-15.2	-1.2	-9.4
Net credit to financial intermediaries	-20.6	4.1	4.0	7.6	16.9	5.9
<i>Of which: open market operations</i>	16.0	6.7	5.8	3.3	-4.3	3.7
Medium- and long-term net foreign liabilities	8.7	16.6	39.1	1.1	-2.4	23.7
(Flow in millions of U.S. dollars, increase -)	33.9	61.0	150.1	4.4	-10.4	104.1
Other	9.6	9.6	6.4	-1.1	6.2	-0.6
Currency issue	0.2	11.4	12.5	16.0	7.0	7.0
II. Banking System						
(In percent of broad money at beginning of period)						
Net short-term foreign assets	6.6	9.1	-10.8	2.9	-3.4	-1.9
(Flow in millions of U.S. dollars)	244.4	329.3	-379.2	88.8	-102.4	-58.1
Net domestic assets	-8.6	-11.1	0.7	-5.3	-0.9	-3.6
Net credit to the public sector	1.7	0.8	4.2	-2.2	-0.1	-1.5
Credit to the private sector	-10.7	-15.2	-9.3	-1.4	-0.7	-4.4
Medium- and long-term net foreign liabilities	3.3	1.5	4.7	-0.6	1.4	2.6
(Flow in millions of U.S. dollars, increase -)	122.7	54.2	164.7	-19.4	43.2	77.2
Other	-2.9	1.8	1.1	-1.1	-1.5	-0.3
Broad money	-2.0	-2.0	-10.1	-2.4	-4.3	-5.6
(12-month percentage change)						
Broad money 2/	-2.0	-2.0	-10.1	-2.4	-4.3	-5.6
Liabilities in bolivianos (M2)	3.8	13.7	2.6	17.0	0.1	11.6
Foreign currency deposits 3/	-2.6	-4.6	-12.3	-6.8	-5.5	-10.2
Credit to private sector	-8.8	-13.4	-9.2	-1.3	-0.7	-4.2
Credit in bolivianos	-2.3	-14.8	-15.4	-1.3	-0.7	-4.2
Foreign currency credit 3/	-9.0	-13.4	-9.1	-1.3	-0.7	-4.2
Memorandum items:						
(Average stock in percent of GDP)						
Currency issue	3.8	4.0	4.1	4.4	4.4	4.3
Broad money 2/	43.3	43.6	38.8	35.1	30.8	29.9
Credit to private sector	52.3	46.9	42.0	38.5	35.0	33.3
(In percent of total deposits or credit at current exchange rates)						
Dollarization (end-period stocks)						
Foreign currency deposits 3/	92.6	91.5	91.9	91.0	92.2	89.0
Foreign currency credit 3/	96.3	97.1	97.5	97.6	97.7	97.7
(12-month percentage change at current exchange rates)						
Broad money 2/	3.4	3.4	-3.0	1.1	-0.6	-2.0
Credit to private sector	-2.6	-8.5	-0.5	3.1	4.2	0.5
(12-month percentage change in U.S. dollars at current exchange rates)						
Broad money 2/	-3.3	-3.1	-11.7	-3.3	-5.3	-6.6
Credit to private sector	-9.0	-14.3	-9.4	-1.4	-0.8	-4.3

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 certificates 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 Banks Performance Indicators
(In percent)

	2004											
	1999	2000	2001	2002	2003	Jan	Feb	Mar	Apr	May	Jun 1/	
Profitability												
<i>Ratios to total average assets (period average) 2/</i>												
Operating Income	4.9	3.5	3.7	4.1	4.4	5.8	5.5	5.5	5.6	5.7	5.5	
Profits after taxes	0.8	-0.8	-0.4	0.1	0.3	0.0	0.2	-0.2	-0.5	-0.4	0.2	
<i>Ratios to average equity</i>												
Profits before taxes	13.2	-4.3	-0.5	3.5	5.1	2.6	3.6	0.5	-1.6	-0.5	3.9	
Profits after taxes	8.7	-8.6	-4.1	0.6	2.7	0.2	1.3	-1.8	-3.9	-2.9	1.6	
Assets quality												
<i>Ratios to total loans (end-of-period)</i>												
Nonperforming loans	6.6	11.6	16.2	17.6	16.7	17.6	18.2	18.2	18.0	18.2	17.6	
Nonperforming loans (net of provisions)	2.9	5.2	7.0	6.4	4.4	4.9	5.5	5.6	5.3	5.5	5.1	
Provisions (as percentage of NPL)	55.8	61.4	63.7	63.7	74.0	72.1	69.5	69.5	70.6	70.1	70.8	
Nonperforming loans 2/	9.2	15.2	21.0	24.5	26.2	26.6	26.8	26.5	26.7	26.6	26.2	
Nonperforming loans (net of provisions)	6.3	9.7	13.2	14.9	15.9	16.0	16.1	15.9	16.0	15.8	15.8	
Provisions (as percentage of NPL)	31.7	35.8	37.1	39.1	39.4	39.9	39.8	40.2	40.1	40.4	39.5	
Liquidity ratios												
<i>Ratios to total deposits (end-of-period)</i>												
Total loans	112.7	102.4	93.1	94.6	94.1	93.8	96.2	97.0	101.5	98.5	102.8	
Total liquidity assets	29.7	27.2	30.2	30.2	30.2	29.9	30.0	29.8	28.9	28.8	30.2	
of which : Government paper	4.7	3.1	4.6	5.1	6.1	5.6	5.7	6.0	4.5	4.8	4.4	
Capital Adequacy ratio												
Ratio of qualifying capital to total												
Risk-weighted assets (end-of-period)	12.2	13.5	14.3	16.1	15.3	15.5	16.0	16.1	16.1	15.9	15.3	

Source: Superintendency of Banks, and Fund staff estimates

1/ Provisional data.

2/ Nonperforming loans are defined as loans in categories 3 (3a and 3b), 4, and 5.

BOLIVIA: FUND RELATIONS
(As of July 31, 2004)

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	237.68	138.59
Reserve position in Fund	8.87	5.17

III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	26.70	100.00
Holdings	26.32	98.56

IV. Outstanding Purchases and Loans:	SDR Million	Percent Quota
Stand-by arrangements	75.04	43.76
ESAF/ PRGF arrangements	109.32	63.73

V. Latest Financial Arrangements:

Type of Arrangement	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	4/02/03	12/31/04	128.64	75.04
PRGF	9/18/98	6/07/02	100.96	63.86
PRGF	12/19/94	9/09/98	100.96	100.96

VI. Projected Payments to Fund (Expectations Basis)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	13.46	36.74	57.49	44.96	17.13
Charges/Interest	1.33	2.62	1.78	0.65	0.17
Total	14.79	39.36	59.27	45.62	17.30

Projected Payments to Fund (Obligations Basis)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	13.46	24.68	34.71	54.34	39.91
Charges/Interest	1.33	2.69	2.50	1.67	0.57
Total	14.79	27.37	37.21	56.01	40.49

VII. Implementation of HIPC Initiative:

	Original <u>Framework</u>	Enhanced <u>Framework</u>	<u>Total</u>
I. Commitment of HIPC assistance	Sep. 1997	Feb. 2000	
Decision point date			
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, the Central Bank of Bolivia (BCB) is subject to an updated safeguards assessment with respect to the existing Stand-By Arrangement, which was augmented and extended on June 10, 2004. The assessment is currently underway. The previous on-site assessment of this arrangement, which was completed in mid 2003, found no systemic risks in the safeguards of the BCB. The majority of the recommendations proposed and reported in EB/03/90 have been implemented and the few that remain outstanding continue to be monitored by staff.

IX. Exchange Rate Arrangement: The Bolivian currency is the boliviano and the exchange rate system is classified as a crawling peg. 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 August 30, 2004, the official selling rate was Bs 7.96 per U.S. dollar.

X. Article IV Consultation: The previous Article IV consultation and request for the first review under the Stand-By Arrangement July 7, 2003 (Country Report No. 03/257). Bolivia is on 24-month consultation cycle.

XI. Technical Assistance:

Dept.	Purpose	Time
FAD	Tax policy	Jan. 1999
FAD	Modernization of customs administration and follow-up missions including	June 1999 May 2001, Dec. 2001
FAD	Tax administration	June 1999, Feb. 2000, June 2001
FAD	Fiscal decentralization	Dec. 2000
MAE	Central bank operations and domestic capital markets	June 1999
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
FAD	Tax Administration	May. 2003
FAD	Pension Reform	April 2004
MFD	Banking Sector	July 2004
MFD	Banking Sector	August 2004
FAD	Tax Policy	August 2004

XII. Resident Representative: Mr. Simon Cueva, since September 2003.

BOLIVIA: RELATIONS WITH THE WORLD BANK

The World Bank has supported Bolivia extensively, and as Bolivia now faces high risks and uncertainty, the World Bank Group can provide strong support through: a combination of lending tailored to current needs, a comprehensive package of economic sector work (ESW), an IFC program of private sector support, and knowledge-sharing by the WBI to help Bolivia address its problems of exclusion, inequality, poverty, and fiscal imbalance. This support is embodied in the Bolivia CAS that was approved by the World Bank Group Board on February 10, 2004.⁵ This CAS covers a relatively short period, fiscal years 2004 and 2005.

CAS Financial Resources. The financial resources to be provided to Bolivia amount to US\$100 million a year in the base case scenario, up to US\$150 million a year in the high case scenario, both involving IDA and IBRD resources. Approximately US\$45 million a year of IDA resources will be available in the low case scenario. The proposed level of assistance in the base case would be sufficient to support an average of four projects and four pieces of Economic and Sector Work (ESW) per year during 2004–05. The composition of the lending program would be 50 percent adjustment and 50 percent investment lending.

Recent and Forthcoming Actions

Projects. In December 2003, the Emergency Economic Recovery Credit (US\$14 Million IDA) was approved by the World Bank Board. Shortly thereafter in February 2004, the First Programmatic Bank and Corporate Sector Restructuring Project (US\$15 Million IDA and US\$15 Million IBRD), was also approved. Both projects were designed to respond to the problems of maintaining macroeconomic stability. More recently, in June 2004, the World Bank Board approved the Social Sector Programmatic Adjustment Credit (US\$25 Million IDA) aimed at helping maintain progress in health, education and water and sanitation and would accelerate progress towards MDGs by reducing disparities in outcomes across different regions, ethnic groups and income classes.

Projects in the FY05 pipeline include the following: the Land Reform Project and the Spatial Rural Development/Community-driven Development Project, that respond directly to the problems of inequality and to the problems that the poor have in generating income; and the Second Institutional Reform Project, would help the government re-launch its institutional reform and anti-corruption programs. In this regard, the World Bank is stationing the task manager of this project in La Paz, given the high priority of the project. Another project is the Second Social Sector Programmatic Adjustment Credit that, like the First, will address issues in the basic social protection areas.

To catalyze the implementation of projects, the World Bank (i) has reviewed the Bolivia portfolio and reallocated funds from slow disbursement projects to other more promising; and (ii) has offered the authorities to cover some of the project-driven expenditures, according to a new Bank approach (i.e., expenditure flexibility) aimed at facilitating project disbursements.

⁵ Bolivia-Country Assistance Strategy. Report No 26838-BO. January 8, 2004.

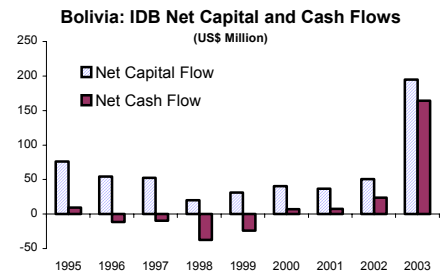
Technical Assistance and Economic Sector Work. The World Bank is presently providing technical assistance in the hydrocarbons area. This assistance include technical support in the design of Bolivia's new Hydrocarbons Law and a study on Gas Revenue Sharing. As far as economic sector work, the World Bank jointly with the IDB has recently completed a Public Expenditure Review and a Country Financial Accountability Assessment (CFAA) focused on public management and, with the support of the donor community, is planning a dissemination program of both reports in various parts of the country.

The ESW program for FY05 would concentrate on issues related to growth, especially the problems faced by the poor in generating income. The major piece of ESW would be a Country Economic Memorandum (CEM) focusing on growth recovery and trade.

BOLIVIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

Background

As of June 30, 2004, the Inter-American Development Bank (IDB) had approved loans to Bolivia amounting to US\$3.4 billion, with disbursements totaling US\$2.7 billion. Bolivia's outstanding debt to the IDB was US\$1.7 billion. Since 2000, net cash flows to the country have remain positive owing to debt relief provided by the IDB under the HIPC initiative and extraordinary financing offered in 2003. In the coming years the sign of these flows will highly depend upon disbursements, which have been negatively affected by the institutional and economic crises.



Country Strategy and Lending Program

Sustainable poverty reduction is the overarching objective of the Bank's country strategy with Bolivia. In pursuit of this the Bank will support government-led efforts to overcome the country's economic and social development challenges on three areas: (a) improve the managerial capacity and transparency of the State, (b) support competitiveness and sustainable development of the private sector; (c) enhance efficiency and equity in basic services delivery. The backdrop for the strategy's implementation is a complex one, characterized by a widespread rejection of the reform process, fiscal crisis, the need to develop of a shared vision for the future and a far-reaching political agenda that includes a national consultation on the use of gas reserves and a Constitutional Assembly. In this context, the strategy has been conceived as a process in which the Bank, in concert with the Government and other partners, identify near-term high priority interventions that could attenuate economic risks and preserve the social gains of the last decade. As political and economic uncertainty diminish, Bank's actions will increasingly move towards tackling impediments to more equitable and sustainable social and economic progress. From the operational standpoint, the Bank's portfolio in Bolivia represents a valuable resource with which to implement the strategy. As of June 30, undisbursed balances amounted to US\$525.2 million, exceeding the expected flow of fresh IDB concessional resource allocation to Bolivia for the period 2004-2007, estimated at US\$350.0 million.

IDB's lending program will continue to provide concessional resources to support fiscal sustainability, while protecting investments that are in the critical path to achieve the Millennium Development Goals. The proposed IDB lending program for Bolivia for 2004-2005 consists of 10 loans for a total of US\$145.5 million, of which US\$92.0 million will support policies to promote competitiveness and private sector development.

IDB non-reimbursable technical cooperation and small projects

The IDB portfolio also includes active projects for US\$26.4 million in nonreimbursable technical cooperation, and US\$2.3 million in non-reimbursable 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 June 30, 2004)					
Loans Totally disbursed (less cancellations)			2,067.1		
Sectors		35	1,123.6	598.5	525.2
Roads		4	222.0	120.7	101.3
698/OC	Beni-La Paz Peruvian Border Corridor		55.0	54.6	0.4
893/SF	Cotapata - Santa Barbara		40.0	39.9	0.1
1039/SF	Ventilla-Tarapaya Highway/Sector Support		52.0	25.7	26.3
1101/SF	Trade Corridor Sta. Cruz - Puerto Suarez		75.0	0.4	74.6
Tourism		1	10.0	0.7	9.3
1098/SF	Sustainable Tourism Development Program		10.0	0.7	9.3
Agriculture and Environment		7	135.8	47.1	88.7
929/SF	Protection of environment		17.2	16.8	0.4
964/SF	Irrigation and drainage		25.6	20.3	5.3
1099/SF	Env-Soc. Protection Santa Cruz - Pto. Suarez		21.0	0.7	20.3
1057/SF	Agricultural Services Program		34.0	9.1	24.9
1116/SF	Emergency Attention Plan: Fire Cordillera Sama-Tarij		2.5	0.2	2.4
1512/SF	Land Regularization and Legal Cadastre		22.0	-	22.0
1515/SF	Rural Productive Development Support Program		13.5	-	13.5
Sanitation		2	110.0	52.4	57.6
987/SF	Urban Sanitation PRODURSA		70.0	46.8	23.2
1050/SF	Basic Sanitation for Small Municipalities		40.0	5.6	34.4
Social sectors		6	247.0	118.9	128.1
931/SF	Education Reform		80.0	66.9	13.1
995/SF	Integrated Early Childhood Development Program		20.0	9.2	10.8
1006/SF	Housing Policy Support Program		60.0	23.8	36.2
1031/SF	Epidemiological Shield and Sector Reform		45.0	16.7	28.3
1093/SF	Strengthening Technical Education		6.0	2.3	3.7
1126/SF	Education Reform II		36.0	-	36.0
Institutional strengthening		12	251.8	161.3	90.5
993/SF	Decentralization SNIPPRE		7.0	5.5	1.5
1038/SF	Loan TC Civil Society Access to Justice		2.7	2.2	0.5
1043/SF	Institutional Strengthening National Tax Agency		3.2	2.2	1.0
1046/SF	National Census Preparation Support		7.2	7.1	0.2
1056/SF	Customs reform and Modernization		5.0	3.6	1.4
1075/SF	Local Development and Fiscal Adjustment		47.0	10.0	37.0
1091/SF	Modernization Municipal Financial Administration		20.0	8.0	12.0
1118/SF	Institutional Support to Strengthen Trade		5.0	-	5.0
1121/SF	Disaster Prevention Program		2.7	-	2.7
1127/SF	Fiscal Sustainability Program		63.0	45.3	17.7
1128/SF	TC Fiscal Sustainability Support Program		2.0	0.1	2.0
1519/SF	Sector Program to Support Competitiveness		87.0	77.3	9.7
Multisectoral onlending		1	35.0	24.7	10.3
1020/SF	Support for Small and Microenterprises		35.0	24.7	10.3
Private Sector		2	112.0	72.7	39.3
1431/OC	Telecommunication Network Redibol		37.0	30.0	7.0
1444/OC	Transredes (Gas)		75.0	42.7	32.3
Technical assistance		48	26.4	16.5	9.9
Totals			3,217.1	2,682.0	535.1
Repaid				959.2	
Outstanding				1,706.4	

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 2004-2005		
Number of loans	10	
Total loan amounts	145.5	100.0
Effectiveness and Transparency of the State	25.0	17.2
Justice Sector Support	10.0	6.9
National Transparency Program	15.0	10.3
Competitiveness and Sustainable Private Development	92.0	63.2
Support to Bolivian Competitiveness System	10.0	6.9
National Plan for Property Rights	20.0	13.7
Restructuring of Private Enterprises	10.0	6.9
Northern Corridor Highway Program - 1st Stage	22.0	15.1
Rural Electrification	10.0	6.9
National Irrigation Program	10.0	6.9
Rural Infrastructure Program	10.0	6.9
Improve Delivery of Basic Services	28.5	19.6
Reactivation of the Center of La Paz (approved)	28.5	19.6

Source: Inter-American Development Bank.

La Paz, Bolivia
September 20, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

The macroeconomic policies and structural reforms pursued by our government since taking office continue to bear fruit. Several macroeconomic indicators have improved during the first half of 2004 and the social and political situation has generally remained calm. The positive outcome on the July gas referendum shows that there is growing support for our policies and is an important step in implementing our medium-term hydrocarbons strategy.

All performance criteria and indicative targets for end-June were met, with the exception of net international reserves (NIR) and net domestic assets of the central bank (NDA). The latter were affected by delays in external disbursements and significant bank deposit withdrawals in the context of the introduction of the financial transactions tax and the run up to the referendum on gas exports. With the disbursements arriving in July and the situation in the financial sector having stabilized, both indicators are now back within program limits. Thus we are requesting waivers for the nonobservance of the end-June quantitative PCs on NIR and NDA.

In support of our policies described in the attached Memorandum of Economic and Financial Policies (MEFP), the Government of Bolivia requests the completion of the fourth review under the SBA. The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Bolivia will consult with the Fund on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

Sincerely yours,

_____/s/_____
Javier Cuevas
Minister of Finance

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

Annex: Supplementary Memorandum of Economic and Financial Policies.

**Supplementary Memorandum of Economic and Financial Policies of the Government of
Bolivia
Fourth Review of the Stand-By Arrangement**

September 20, 2004

1. The positive outcome of the gas referendum was an important step forward in strengthening our democracy and broadening support for the government's political and economic agenda. We continue to implement a solid macroeconomic program, while gradually reducing social tensions. We expect to meet the quantitative targets for the remainder of 2004, which were set at the last review of the Stand-By agreement.
2. The program will continue to be guided by the macroeconomic and structural reform policies described in the Memorandum of March 21, 2003, and modified by the Supplementary Memoranda of June 20, 2003, September 24, 2003, and June 2, 2004.
3. The next review of the SBA will focus on assessing progress towards securing Congressional approval of a 2005 budget consistent with: (i) a deficit target after grants below 5½ percent of GDP, taking into account the expenditure limits and revenue projections in the budget bill, as well as the likely revenue yield from specific revenue measures to be agreed with the staff and incorporated into the MEFP for the fifth review; and (ii) the prospective availability of external concessional financing and grants, while limiting nonconcessional financing. If necessary, the budget and macro frameworks for 2005 would be revisited to ensure consistency with available external financing. The review will also assess the likely impact on prospects for gas exports from the Hydrocarbons Law that would be expected to have been approved by Congress.

A. Macroeconomic Framework

4. Solid export performance in the first half of the year owing to favorable international developments including commodity prices suggests that the real GDP growth would reach 3¾ percent in 2004, moderately higher than programmed. 12-month inflation rose to 4.8 percent by end-July, partly reflecting the impact of bad weather on agricultural production, but is expected to decline to 3½ percent by end-2004, in line with the program. The external current account surplus has widened significantly and is now expected to be almost 3 percent of GDP for 2004, reflecting strong growth in gas, minerals, and agricultural exports, partially offset by some recovery in imports.

B. Fiscal Policy

5. The fiscal deficit after grants through June 2004 was 0.7 percent of GDP below the program ceilings, reflecting mostly overperformance of tax revenues. Owing to strong hydrocarbons exports and economic activity in general, and strong results of the tax regularization program, tax revenues exceeded the program projections by almost one

percent of GDP. This positive outturn allowed us to increase domestically financed investment mainly from local governments (1/3 percent of GDP). Reflecting our austerity efforts and tight expenditure controls, current spending stayed in line with our program. As planned, we have allowed for partial payments to the so called “sandwich generation” (contributors under the old system but not eligible under the new), and begun to gradually incorporate 23,000 eligible people into the pension system that had been postponed by previous administrations. With the latter, we will fully close access to the pay-as-you-go system.

6. Given the outcome during the first half of 2004, we expect to stay slightly below the program target for the year as a whole. In particular, with the FTT yielding slightly below programmed levels during its first two months of implementation, we expect tax revenues to exceed programmed levels by 0.8 percent of GDP. To this end, we intend to maintain tax collection efforts and an efficient implementation of the new tax code. The higher revenues will allow us to accelerate the implementation of important pro-growth projects, including infrastructure, leading to an overall increase in investment of about 0.6 percent of GDP compared with the program. Pro-poor spending is expected to increase by 0.6 percent of GDP in line with the program. Despite continuing spending pressures, we intend to contain current expenditures within the program ceilings. In an effort to maintain fiscal discipline, we have reminded local governments of their reporting obligations and will strictly enforce the legal sanctions for noncompliance.

7. We will closely follow fiscal revenues and expenditures of the combined public sector, and central bank financing to the NFPS. We are committed to taking prompt corrective actions, as necessary. In particular, should deviations occur with respect to the monthly ceilings (Table 1), we intend to further curtail spending by the central government and other public sector entities, including by strengthening reporting requirements of local governments.

Table. Bolivia: Public Sector Cumulative Monthly Fiscal Targets
(in millions of Bolivianos)

	2004											
	Jan.	Feb.	March	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Total revenue and grants	1,291	2,459	4,184	5,951	7,747	8,984	10,649	11,873	13,432	14,878	16,313	18,003
Total expenditure	1,476	3,006	4,788	6,581	8,290	10,187	12,470	14,072	15,982	17,690	19,454	22,009
Deficit	-184	-547	-605	-630	-543	-1,203	-1,821	-2,199	-2,550	-2,813	-3,140	-4,005

8. Despite the shortfall in net external financing, the favorable fiscal performance allowed us to meet the end-June PCs on net domestic financing and central bank financing to the combined public sector. The outcome for both targets includes an accounting transaction consisting of a swap of assets and liabilities between the central bank and the treasury. Adjusting for this (there is no formal adjuster in the program), both the net domestic financing target and the central bank financing would have been met. The attached supplementary technical memorandum incorporates new adjusters to these program targets to ensure that the accounting impact of such operations does not affect the future measurement of performance under the program.

9. We intend to pursue efforts to prepare the stage for fiscal consolidation over the medium term. Regarding tax revenues:

- To safeguard the new tax code, the Upper House of Congress has already approved a law regulating the relevant administrative procedures (*recurso de alzada y jerárquico*), and the Lower House is expected to approve it before end-September (structural performance criterion (PC)).
- Despite a one-month interruption owing to social concerns, we resumed incremental domestic fuel prices increases in August and are committed to further adjust prices later in the year to offset the effects on revenues resulting from the high international oil prices. While our current fuel price mechanisms ensures that further increases in international prices would be absorbed by oil companies, we are committed to consider other measures, including additional price increases, if necessary, to protect tax collection. In this context, we will conduct poverty and social impact analyses (PSIAs) to evaluate the impact of some of the proposed measures on the poor and implement appropriate safety nets.
- With Fund technical assistance, we are preparing a comprehensive tax reform to both enhance revenue collection and the fairness of the taxation framework. We expect to have all relevant draft legislation ready before year-end, for Congressional consideration in 2005, and adoption in 2006 at the latest, in time to replace the FTT (expiring in mid-2006).
- A hydrocarbons framework bill has been submitted to Congress (see Section E below).

10. To support our medium-term fiscal consolidation while taking advantage of the higher-than-expected revenues, we are revising our spending priorities so as to further promote growth and poverty reduction. In particular, our strategy now includes additional projects critical for growth, and higher pro-poor spending, partially offset by cuts in other spending. To this end, we are taking the following actions:

- A commission of highly respected members of civil society appointed in June 2004 (benchmark) is preparing recommendations to improve the effectiveness and pro-poor orientation of public spending. In coordination with the ongoing national dialogue, the commission will make recommendations by end-September, in time to be incorporated into the 2005 budget (structural PC).
- The cabinet will shortly conduct a comprehensive review of public investment projects to allow a reorientation to reflect our new priorities. Taking into account the findings from the expenditure commission and the ongoing national dialogue, we will streamline investment, to allow the accommodation of projects in 2005 such as roads establishing links with Brazil and Paraguay, and YPFB funding, that would be within the program ceilings and would have noncollateralized financing. We will aim at

ensuring concessional financing for these projects. Should this prove not possible, the financing will be included within program limits for nonconcessional (domestic and external) financing of the nonfinancial public sector, consistent with debt sustainability, which we expect to be below 2004 levels.

- With IDB support, we will continue to step up efforts to control pension payments, including by strengthening an independent agency (SENASIR) to audit and control pension outlays and detect fraud. Despite some delays, SENASIR's action plan has been revamped to ensure that implementation proceeds expeditiously.
- We plan to take further steps to strengthen our debt management in order to reduce vulnerabilities, by improving the maturity and currency profile of our domestic debt through increased placements of bonds at longer maturities, including 2-4 years, and in local currency.

11. We plan to submit to Congress the 2005 budget bill before end-October (benchmark). The budget will be consistent with a deficit target of 8½ percent of GDP (before grants) for the combined public sector. Assuming the same level of grants as in 2004, this would result in a deficit below 5½ percent of GDP (after grants). The budget will include all existing extra budgetary funds, and take into account expenditure limits and revenue projections in line with the program. We expect increased revenues from the full year impact of the FTT, the hydrocarbons bill (still in Congress), and higher gas exports to Brazil and Argentina. In addition, we expect to exercise restraint on current spending including wages. We intend to identify by October specific measures of around 1¼ percent of GDP from a combination of revenue and expenditure adjustment efforts. This effort is consistent with our aim to achieve sustained fiscal consolidation by taking into account available external concessional financing and grants while limiting the use of nonconcessional financing.

12. The exceptional support from the international community both in the form of highly concessional loans and grants has been instrumental in the implementation of our program. To further enhance coordination with donors, we have set up five working groups on key areas and have agreed on a framework for multi-annual multi-donor budget support, for which six cooperation agencies have already subscribed. For our medium-term program, and in preparation for a Consultative Group (CG) meeting, we expect to conduct a donor coordination meeting by end-October, aimed at agreeing on detailed plans to strengthen public financial management, and to gather indications of potential budgetary support for 2005. We would aim to obtain appropriate financial assurances for the 2005 fiscal program, and we remain committed to implement additional fiscal measures, as necessary.

C. Monetary and Exchange Rate Policies

13. Apprehension associated with the FTT implementation and the run-up to gas referendum led to significant deposit withdrawals (about US\$200 million between mid-June to July 1). These have since been partially recovered (close to US\$70 million). During that period, the Central Bank of Bolivia (BCB) provided liquidity to the system, with adequate

collateral, and continues to stand ready to do so. Interest rates sharply increased in late June, with repo rates in U.S. dollars rising from 7½ at end-May to 10¾ percent in early July, but have since been gradually reduced to 7½ percent. However, we remain committed to allowing prompt increases in rates as necessary to reflect changes in liquidity conditions.

14. Monetary policy will continue to aim at strengthening BCB's international reserves in the context of the crawling peg, while containing inflationary pressures. Reflecting the sharp deposit withdrawals at end-June, and internal administrative procedures which delayed a US\$25 million disbursement from the World Bank, the end-June NIR and NDA targets were missed by US\$31 and US\$33 million, respectively. However, NIR have since recovered by US\$65 million and are back on track. Disposable reserve coverage of banks' dollar deposits stood at about 37½ percent on August 23 and is expected to rise to 39 percent by end-2004.

15. The currency appreciation in neighboring countries has contributed in placing our real effective exchange rate at one of its most competitive levels in the last decade. A joint BCB and Fund staff study, to be released in October, shows that concerns over exchange rate competitiveness relate more to institutional weaknesses and the limited flexibility given by the crawling peg arrangement to deal with shocks, rather than to the exchange rate level. In this connection, we have recently concluded a study on options to allow more flexibility to the exchange rate. To this end, we are also in the process of gathering additional information on the interbank foreign exchange market, and are considering to introduce weekly auctions where the BCB would buy foreign exchange to complement the existing sale auctions. Moreover, with Fund technical assistance we plan to complete a study to recommend measures to promote the use of domestic currency by October 31, 2004 (benchmark).

D. Bank and Corporate Sector

16. Although the liquidity strains in the financial system have now eased somewhat, the Superintendency of Banks (SBEF) and the BCB have intensified their joint efforts in closely monitoring banks' liquidity position and deposit taking institutions. To protect and strengthen the financial soundness of the banking and corporate sectors, we have taken the following actions:

- On-site supervision of financial institutions has been intensified. In the case of a financial institution, this has led its management to call a shareholders' meeting to consider possible recapitalization plans, including capitalization and/or maturity extension of subordinated debt.
- In a bank for which subordinated debt to the government was converted into equity, shareholders' equity was formally written down in June 2004 in line with the results of a due diligence completed by international auditors. A new Board of Directors and management have been appointed and a business plan is expected to be finalized by end-September (benchmark), including steps to return the bank to the private sector as soon as possible, and no later than December 2005. To this end, a sales plan will be

- completed by end-September that safeguards the state's financial interest without setting a minimum price.
- With World Bank support, we will issue later this year the operational manual of the public fund for bank restructuring. The manual will reflect the guidelines already set in the decree establishing the fund aimed at preventing the bail-out of shareholders of unviable institutions.
 - With CAF support, we have issued implementing regulations for the corporate restructuring fund. Although delayed, six enterprises have now been identified to undergo a pilot study and the administrative process of debt workout has been started. We remain committed to improving the provisions of the voluntary restructuring law, to encourage agreements between debtors and their creditors while we await lessons drawn from the pilot sample of firms. This will allow us to conduct an evaluation of the overall bankruptcy legislation and submit legislative changes by November 2004 (benchmark).
17. With Fund technical assistance, we intend to further strengthen the prudential framework of the financial system, including the adoption by end-October of norms and procedures to ensure the effective supervision of financial conglomerates, and strengthen early warning indicators and prompt corrective actions (benchmark). In this context, the SBEF will: (i) enhance its offsite supervision of liquidity; (ii) include in its manual specific actions for banks with extensive or protracted use of BCB liquidity; and (iii) issue norms aimed at strengthening banks' liquidity risk management by end-November. In addition, the SBEF will provide a diagnostic to increase provisions and develop a related action plan (benchmark).
18. In order to facilitate the banking resolution framework, with the aim of introducing a fully-fledged deposit insurance over the medium-term, we will amend the law on banks and financial institutions by end-November. This will ensure that the Financial Restructuring Fund (FRF) is established as a legal entity and to permit its contributions to the bank resolution process to be complemented by contributions of the central bank in this context, for 2005 only. By end-December 2004, we will also submit to Congress anti-money laundering legislation after receiving MFD TA slated for September.
19. While the operational and budgetary independence of the SBEF and the BCB was strengthened through a June decree, we intend to elevate to law the SBEF's regulatory autonomy by submitting a bill to Congress for approval by end-2004.
20. An informal working group was recently formed to provide nonbinding advice to the superintendency in its efforts to strengthen the financial system. The working group will be headed by the Superintendent of Banks, and will include representatives from the Ministries of Economic Development, Finance, the BCB, banks and other financial institutions.

E. Hydrocarbons Sector

21. The government has repeatedly emphasized that the efficient exploitation of Bolivia's large hydrocarbon resources is critical for enhancing its medium-term growth prospects. In this connection:

- We have submitted to Congress a hydrocarbons framework bill in September, reflecting the mandate we received from the gas referendum. We will shortly appoint a “commission of notables” of highly respected experts to provide impartial technical advice to: (i) facilitate and enrich the discussion; and (ii) help us to draft the regulations which will subsequently be included in an implementing bill to be submitted to Congress soon after the approval of the framework bill. Despite initial difficulties in the discussions with Congress, we expect the approval of the framework bill in October 2004. On this basis we intend to adopt a strategy on gas exports by end-October 2004 (benchmark), which will incorporate progress made in our negotiations on large gas export projects.
- The framework bill introduces a new complementary tax based on volumes and international oil prices, which would increase with the size of field. Corporate income tax can be offset against the new tax, while the existing surtax is eliminated. The idea behind these changes is to increase the tax take from the hydrocarbons sector, while maintaining an environment conducive to hydrocarbons investment.
- As mandated by the gas referendum, a portion of the additional revenues will be used to reduce poverty and social fragmentation. To this end, the framework bill includes revenue-sharing arrangements with regions and earmarking of resources for social spending and security. The earmarked revenue will be channeled through the budget. The implementing regulations of the law will: (i) set specific limits on fiscal deficit and debt levels, consistent with debt sustainability, above which no earmarking can take place; (ii) define clear standards of accountability necessary to receive earmarked transfers; and (iii) incorporate safeguards on the use of revenue sharing arrangement and earmarked revenues—avoiding the creation of extrabudgetary funds.
- The role of the state oil company (YPFB) will be strengthened. It will be split into a regulatory agency (Petrobolivia) and a company with direct participation in the sector (YPFB). YPFB's operations and financial management will be fully transparent and guided by principles of efficiency and cost minimization. Moreover, initially it will participate only in low risk downstream operations and jointly in operations with private companies. The inclusion of YPFB in transactions between private companies will not be mandatory. Any transfer of resources or borrowing to fund YPFB and Petrobolivia, including spending financed from the proposed sharing mechanism of gas royalties in the hydrocarbons law, will be incorporated in the budget and be subject to program ceilings. We intend to use minority shareholdings in privatized oil companies to capitalize YPFB. Budgetary resources will not be used to fund Bonosol payments.

F. Medium-Term Outlook and Progress Toward a PRGF Arrangement

22. Building on the current economic recovery, the government's overarching objective is to achieve sustained growth of 4½–5 percent (about 2 percent per capita), making a significant dent in poverty levels over the medium term. Our macroeconomic framework assumes a large increase in gas exports, which we consider conservative given that it could materialize through several alternatives, including through regional projects only. We will continue to make efforts to foster a stable social and economic environment, including by creating conditions for private sector-led growth. In this context, we intend to pursue further fiscal consolidation to increase the availability of financing to the private sector, while boosting and better targeting pro-poor spending. We also plan to remove structural and institutional barriers to growth, including by improving transparency and governance, and advancing negotiations on free-trade agreements with our main trading partners.

23. Through a participatory process with civil society, the national dialogue has made progress and our goal is to conclude it by November 2004, to provide input for a new PRSP. In particular, we will ensure that the PRSP encompasses a broad-based consensus on fiscal issues, by agreeing on sustainable sources of fiscal revenue, well-targeted social safety nets, and clear priorities for national spending. On this basis, we plan to request Fund support for our policies formulated in the PRSP through a new three-year Fund arrangement to succeed the current SBA expiring at end-2004. We also intend to hold a follow-up Consultative Group meeting, by January 2005. We hope that our initiatives to enhance budget transparency, pro-poor orientation of fiscal policies, governance, and donor coordination and harmonization, would be supported by concessional financing to ensure debt sustainability while increasing pro-poor spending.

Table 1. Bolivia: Quantitative Performance Criteria Under the SBA, 2004 1/

	2003		2004			
	Act.	Act.	Act.	Performance Crit.		Ind. Trgt.
	Sep.	Dec.	Mar.	Jun.	Sept.	Dec.
(Cumulative amounts from December 31, 2002 for the 2003 targets and December 31, 2003 for the 2004 targets; in millions of bolivianos)						
Deficit of the combined public sector 2/						
Unadjusted limit	2,950	4,149	...	1,590	2,557	4,033
Adjusted limit	2,960	4,125	...	1,575	...	...
Actual	2,928	4,880	605	1,203	...	...
Margin	32	-755	...	372	...	...
Net domestic financing of the combined public sector 3/						
Unadjusted limit	700	652	...	772	831	1,223
Adjusted limit	1,051	837	...	772	...	...
Actual	1,019	1,596	393	179	...	...
Margin	32	-759	...	627	...	...
Central Bank Net Credit to the NPFS						
Unadjusted limit	49	-82	...	138	-116	104
Actual	-332	-15	-288	-153	...	...
Margin	381	-67	...	290	...	...
Net domestic assets of the central bank 4/						
Unadjusted limit	-400	-245	...	500	494	688
Adjusted limit	-400	-245	...	500	...	...
Actual 4/	-594	-231	3	761	...	...
Margin	194	-14	...	-261	...	...
(Cumulative amounts from December 31, 2002 for the 2003 targets and December 31, 2003 for the 2004 targets; in millions of US dollars)						
Net international reserves of the central bank 5/						
Target	0	65	...	-121	-104	-55
Adjusted target	0	65	...	-121	...	...
Actual 4/	40	93	-93	-151	...	...
Margin	40	28	...	-31	...	...
Net nonconcessional external debt 6/						
Limit	100	150	...	-30	34	87
Adjusted limit	65	80	...	0	...	...
Actual	46	64	-17	-66	...	...
Margin	19	16	...	36	...	...
External debt with maturities up to one year						
Limit	10	0	...	0	0	0
Actual	0	0	0	0	...	...
Margin	10	0	...	0	...	...

Table 1. Bolivia: Quantitative Performance Criteria Under the SBA, 2004 1/

	2003		2004			
	Act.	Act.	Act.	Performance Crit.	Ind. Trgt.	
	Sep.	Dec.	Mar.	Jun.	Sept.	Dec.
(Cumulative amounts from December 31, 2002 for the 2003 targets and December 31, 2003 for the 2004 targets; in millions of US dollars)						
Adjuster to the net domestic financing of the NFPS						
Net external financing of the NFPS 7/						
Program baseline	245	386	...	70	172	289
Actual	200	362	10	...	...	...
Adjuster for the deficit of the SPNF						
Financing through HIPC and beyond-HIPC debt relief (program) 8/						
Program baseline	46	65	...	32	42	61
Actual	47	63	16	...	...	...
External financing for social spending						
Program baseline	70	120	...	0	0	0
Actual	70	137	0	...	...	...
Projected program grants						
Program baseline	...	...	...	2	18	45
Actual	...	...	0	...	...	...
Projected concessional program loans						
Program baseline	...	...	...	54	84	105
Actual	...	...	6	...	...	...
(Cumulative amounts from December 31, 2003 in millions of Bolivianos)						
Maximum adjustment to limit on domestic financing of combined public sector						
Program baseline	500	500	...	500	500	500
Projection	0	185	...	...	...	...
Adjuster for NIR on currency issue						
Currency issue (program)	...	...	-739	-468	-338	246
Maximum adjustment to NIR target	...	...	0	25	50	75
(Cumulative amounts from December 31, 2002 in millions of bolivianos; unless otherwise indicated)						
Memorandum items:						
Adjuster for 2003 program:						
Shortfall in currency issue 4/			0	0		
Shortfall in external financing for social spending			15	0		
Shortfall in net external disbursements			228	585		
Maximum adjustment to limit on domestic financing of combined public sector			150	500		
Excess financing through HIPC debt relief (US\$ millions, shortfall negative) 5/			4	3		

Source: Data provided by the Bolivian authorities.

1/ Definitions of the targets and adjusters as in the TMU of March 21, 2003 and the supplementary TMU of June 2, 2004. September and December targets as set in Country Report No. 04/5. For the extension of the SBA, June and September 2004 are proposed PCs and December 2004 indicative target.

2/ Limits on the deficit of the combined public sector will be adjusted downward by the difference between actual and projected program grants (i.e., earmarked for projects). They will be adjusted downward (upward) by the amount of the shortfall (excess) between actual and projected HIPC debt relief by the amount of the shortfall between actual and projected external financing for social spending, up to the designated ceilings.

3/ The limits on net domestic financing of the NFPS will be adjusted upward by the difference between projected and actual net external financing to NFPS (measured cumulatively over the same period as net domestic financing), excluding HIPC debt relief, up to the designated ceiling; it will be adjusted downward by the amount of any overdue obligations to foreign official creditors.

4/ The limits on the NDA of the BCB will be adjusted downward by the amount of any overdue obligations to foreign official creditors.

5/ The ceiling on NIR will be adjusted upwards by the amount of any overdue obligations to foreign official creditors and adjusted downward by the amount relative to the projected currency issue, up to the designated ceiling.

6/ 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.

7/ Excludes HIPC debt relief through rescheduling and the amortization component of stock of debt reduction operations under HIPC Initiative and beyond HIPC.

8/ 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 sectors.

Table 2. Bolivia: Structural Conditionality For the Extension of the Stand-By Arrangement 2004¹

Condition	Policy Measure	Date	Comments
Public Sector Reform and Financing			
Performance Criterion	Approval by Congress of the law regulating the procedural requirements of the recursos de alzada and jerárquico before the Tax Superintendency, as required by a Constitutional Tribunal ruling	Sept. 30, 2004	Approved by the Upper House and awaiting approval of the Lower House of Congress.
Benchmark	Define terms of reference and appoint high-level commission of respected members of civil society	June 30, 2004	Observed. Commission appointed.
Performance Criterion	Publish high-level commission's report with specific recommendations, including measures to (i) improve the measurement of pro-poor spending; (ii) improve the quality and efficiency of public services; (iii) prioritize spending toward growth-enhancing and pro-poor spending; and (iv) identify spending priorities to bring overall spending to a level of 32.1 percent of GDP in 2005, 31.0 percent of GDP in 2006, and 30.4 percent of GDP in 2007.	Sept.30, 2004	Commission meets regularly.
Benchmark	Submission to Congress of a budget consistent with a deficit target after grants below 5½ percent of GDP, after including currently extrabudgetary funds and taking into account: (i) expenditure limits and revenue projections in the budget bill, together with the likely revenue yields of specific additional revenue measures to be proposed by the authorities; and (ii) the recommendations of the expenditure commission.	Oct. 31, 2004	Budget preparations ongoing
Financial and Corporate Sector			
Benchmark	On banks majority-owned by NAFIBO, complete the write-offs of the shareholders capital and approve the implementation of a business plan for the next two years, which shall include re-privatization of the banks by December 2005.	Sept. 30, 2004	Due diligence completed June 15, and business plan is to be finalized.

¹ References in the table are to the relevant paragraphs of the Technical Memorandum of Understanding (TMU) of March 21, 2003, June 20, 2003, September 24, 2003, and June 2, 2004.

Condition	Policy Measure	Date	Comments
Benchmark	Superintendency of Banks and Financial Entities (SBEF) will: (i) issue a norm to ensure the effective supervision of financial conglomerates (in compliance with Basel core principle 20); and (ii) establish procedures to strengthen early warning indicators to identify individual and systemic bank vulnerabilities and apply prompt corrective actions.	Oct. 31, 2004	TA has been provided see MEFP for details.
Benchmark	Complete study with IMF technical assistance to recommend measures to promote the use of domestic currency.	Oct. 31, 2004	TA scheduled for mid-October.
Benchmark ²	The Superintendency of Banks will provide a diagnostic of banks to increase provisions and develop a related action plan.	Oct. 31, 2004	
Benchmark ²	In consultation with Fund Staff, amend the law on banks and financial institutions to ensure that the FRF is established as a legal entity and to allow that its contributions to the bank resolution process be temporarily complemented by contributions of the central bank in this context for 2005 only.	Nov. 30, 2004	
Benchmark	Drawing upon the implementation of the informal workout law to a sample of firms and submit to Congress, draft amendments to existing legislation and draft laws, including insolvency and corporate restructuring law in order to strengthen creditors' rights, and taking into account the principles stated in paragraph 15 of the March 24, 2003 TMU.	Nov. 30, 2004	Ongoing. Six firms identified.
Hydrocarbons law			
Benchmark	Adopt a strategy on gas exports based on the national referendum and the approval by Congress of a Hydrocarbons Law including issuing the implementing regulations, regulating the taxation of hydrocarbons and providing an appropriate framework for developing the large hydrocarbon reserves.	Oct. 31, 2004	A bill has been sent to Congress.

² Denotes new conditionality added since conclusion of the third review under the SBA on June 10, 2004.

² Denotes new conditionality added since conclusion of the third review under the SBA on June 10, 2004.

BOLIVIA—SUPPLEMENTARY TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This technical memorandum supplements the technical memorandum of understanding of March 21, 2003, and the supplementary technical memorandum of understanding of June 2, 2004. It defines adjusters to the existing quantitative targets (performance criteria for September and indicative targets for December) for the net domestic financing of the combined public sector and central bank net credit to the nonfinancial public sector

2. Adjusters to the net domestic financing of the combined public sector.

- *New adjuster.* The limits on the net domestic financing of the combined public sector will be adjusted downward by (1) any medium- and long-term liabilities transferred from the Banco Central de Bolivia (BCB) to the treasury in 2004; and (2) any liabilities transferred from other financial public sector institutions to the treasury in 2004. The adjustment will include the World Bank loan of US\$99.3 million, which was transferred from the BCB on June 30, 2004.
- *Existing adjuster.* For the calculation of the existing adjuster for shortfalls in external financing, actual net external financing of the nonfinancial public sector will be calculated excluding any medium- and long-term liabilities transferred from the BCB to the treasury in 2004 and any liabilities transferred from other financial public sector institutions.

3. **Adjuster to the central bank net credit to the nonfinancial public sector.** The limits on the central bank net credit to the nonfinancial public sector will be adjusted downward by any transfer of cash from the BCB to the treasury associated with the transfers of medium- and long-term liabilities in 2004 (including cash transfers used to repay outstanding central bank liquidity credits). In particular, the limits will be adjusted for the cash payment of US\$36.2 million, which was transferred on June 30, 2004.



Press Release No. 04/205
FOR IMMEDIATE RELEASE
September 27, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Fourth Review Under Bolivia's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Bolivia's performance under a 21-month, SDR128.64 million (about US\$189 million) Stand-By Arrangement that was originally approved on April 2, 2003 (see [Press Release No. 03/46](#)) and later augmented and extended (see Press Release No. 04/113). This decision enables the release of SDR 26.8 million (about US\$39 million) to Bolivia, which would bring total disbursements under the arrangement to SDR 101.84 million (about US\$149 million). In completing the review, the Executive Board approved Bolivia's request for waivers for the nonobservance of performance criteria.

Following the Executive Board discussion on Bolivia, Agustín Carstens, Deputy Managing Director and Acting Chair, said:

“Bolivia’s economic performance is improving, and implementation of the authorities’ economic program is broadly on track. Economic growth has picked up, the current account is in surplus, and inflation remains in single digits. The financial situation has stabilized in the last two months, following some deposit losses in the period leading to the introduction of the financial transactions tax. The affirmative outcome in the gas referendum should give the Bolivian authorities some breathing space to develop their hydrocarbons strategy. A national consensus on economic policies will be important to take the economic agenda forward.

“The authorities remain committed to achieving their fiscal target for 2004, and intend to continue to make progress in 2005 toward attaining fiscal sustainability while increasing infrastructure and social spending. In this regard, appropriate tax reform, including a phase-out of the financial transactions tax, and measures to improve tax administration, curtail current spending, and improve public expenditure management will be important. As Bolivia’s debt burden is sizeable, attainment of debt sustainability will depend to a large extent on financing the budget deficit with grants and concessional financing and avoiding non-concessional borrowing.

“The authorities are taking measures to protect and strengthen the financial system. These include strengthening financial supervision and liquidity monitoring, while improving prudential norms and moving towards a risk-based supervisory framework. The authorities also intend to continue their proactive interest rate policy in response to changes in liquidity conditions; and to increase placements at longer maturities given the improved domestic bond market.

“An appropriate hydrocarbons’ strategy will be necessary to attain medium-term sustainability. The authorities recently submitted a hydrocarbons bill to Congress and will continue to work toward ensuring that conditions essential for development of the sector and medium-term sustainability are developed. Furthermore, the authorities are committed to ensuring the efficient and transparent use of hydrocarbons-related revenues to benefit the Bolivian people.

“The authorities expect to complete a Poverty Reduction Strategy Paper by the end of this year, which will form the basis for the development of a medium-term economic strategy to raise Bolivian living standards. Broadening and consolidating the national consensus for policies to support growth and poverty reduction, including through the efficient development of Bolivia’s rich hydrocarbon resources, will facilitate the development of such a strategy. The IMF stands ready to continue to assist Bolivia after the current arrangement ends in December,” Mr. Carstens said.

**Statement by Hector Torres, Alternate Executive Director for Bolivia
and Alonso Segura, Assistant to Executive Director
September 27, 2004**

Key points

- *Performance under the program has been satisfactory. While two PCs, NIR and NDA, for which we request waivers, were missed in June, both are back on track.*
- *Fiscal consolidation is proceeding strongly. A fiscal adjustment of 2% of GDP is expected for 2004, with further revenue and expenditure reforms in the pipeline to guarantee the continuation of the process into the future. Continued support of the donor community is essential.*
- *The banking system has regained stability, while corporate restructuring has regained momentum.. Measures to strengthen both are being implemented.*
- *A successful National Referendum on key issues regarding the hydrocarbons sector has allowed an ongoing ample discussion on a new framework for the exploitation of hydrocarbon resources. Government efforts are geared towards consensus building with the goal of achieving an investment-promoting framework.*
- *The new PRSP based on a national dialogue is proceeding as scheduled, and a request for a PRGF arrangement should be made early next year.*

Background and Overview

1. Once again we thank the staff for a balanced assessment on the current situation in Bolivia, reflecting hard work and devotion on the part of the team, which we highly appreciate. Whereas the political and social situation has improved in the last months, aided by the high popularity of the President, the government's success in the oil referendum, and the sensible policies the government pursues, it is true that gaining and maintaining consensus within a highly fragmented political arena and social spectrum has proven to be very difficult. Nonetheless, improvements have been attained on different fronts. Despite unavoidable disagreements between the Executive and Legislative branches, the government has been reasonably successful in passing important legislation, street protests have significantly declined, fiscal consolidation is gaining decisive footing, after some turbulent weeks in the second quarter of the year the financial sector has, once again, proven resiliency, and the strategy for the development of the oil sector is being widely discussed. The situation is, nevertheless, still fragile.
2. Compliance with the program has been strong. GDP growth, which has been stronger than expected, could be above 3.8% in 2004 and is likely to reach higher rates in 2005; exports have been booming due to favorable terms of trade but also due to significant volume growth; inflation remains under control and the exchange rate has remained stable. In this context, all but two quantitative performance criteria for June, NIR and NDA, for which we request waivers, were met. These two were missed due

to a bout of instability in the financial sector that led to some withdrawal of deposits, and also due to delays in external disbursements. In both cases, these indicators have later recovered and are currently in line with the program. Ownership of the economic agenda on the part of the authorities remains strong, and despite no structural conditionality required for this review, decisive advances have been made in complying with those due for the fifth review, some of them which we will comment on later. As stated in previous BuFFs, the current Stand-By Arrangement with the Fund is a key anchor for agents' expectations, and has proven to be an effective vehicle for the Fund to provide advice to the authorities in the design and implementation of its policies, which has allowed to strike a balance between the need to ensure short-term stabilization and that of crafting the medium-term policies necessary to foster sustainable growth and poverty reduction.

Fiscal Policy

3. Strong fiscal consolidation is being attained, in line with the ambitious goals set in the program. The overall fiscal deficit for 2004 is projected at 6% of GDP, a reduction of 2% with respect to the previous year, which in the context of strong social pressures is a significant achievement. The medium-term path envisions this consolidating trend to continue in the following years, a further half to three quarters of a point in 2005 to start with, as the authorities are conscious of the risks if debt is not gradually reduced. Revenues, expenditures, and the composition of financing are all being addressed in order to promote structural changes in the fiscal accounts, that lead to a more efficient and sustainable public sector.
4. On the revenue side, the measures implemented this year and in late 2003, together with strong GDP and exports growth mainly of gas, are expected to result in higher than expected revenue collection in the order of 0.7% of GDP relative to the program, and a 2% of GDP overall increase in revenues with respect to last year. The new Tax Code (0.3% of GDP), a revised Tax Bill (0.3% of GDP), the tax regularization scheme (0.8% of GDP), the transitory two-year financial transactions tax (FTT) (0.5% of GDP), have all been instrumental in this effort. This revenue performance has allowed for an increase in pro-poor and capital expenditures, despite maintaining overall expenditures grossly constant as a share of GDP, with current expenditures falling by about half a percentage point. The wage bill is being reduced by 0.2% of GDP, with wage restraint being a key element. Poverty reduction outlays are being prioritized and would increase by a significant 0.7% of GDP. New investment projects, mainly roads to communicate Bolivia with neighbor countries have been deemed as a priority, given the landlocked nature of the country. However, the authorities have emphasized that these projects will have to be accommodated within the expenditure framework tentatively agreed with the Fund for 2005, which implies reprioritization of projects as well as subjecting to the caps on non-concessional borrowing to avoid exacerbating the debt pressures that are binding.
5. On a longer term perspective, from 2005 onwards, the authorities are aware of the need to continue the fiscal consolidation efforts. This implies, according to numbers broadly agreed between the staff and the authorities, that new measures for an equivalent to 1 1/4 percent of GDP for 2005 need to be identified, which calls for

efforts on multiple fronts. On the revenue side, a tax reform aimed at implementing a more progressive and efficient tax system is being prepared, for which an FAD mission was requested, and visited La Paz in July-August. Among the main pillars of such reform are the phase-out of the transaction tax (IT) by means of merging it to the VAT, with an increase in the later rate, as well as the introduction of a personal income tax (PIT) to replace the current RC-IVA which allows for the VAT on consumer goods to be credited against taxes on wages and interest payments, a mechanism that is widespread known as being subject to abuse and fraud. As a result of this reform, temporary and distortionary taxes would also be progressively phased-out (including the temporary FTT), and moderate gains in revenue collection would be expected. With regards to the temporary freeze on fuel prices, while this measure may have been considered technically a backward step, it was necessary in order to avoid social adverse reactions. Price increases are expected to resume by year-end, as a more flexible price mechanism is enforced again; however, it may not be prudent to move into a fully “automatic” price-adjustment mechanism.

6. On expenditures, decisive actions are being taken to improve the quality of expenditures in the medium-term, particularly those aimed at poverty reduction, as well as identifying priorities to enable the reduction in overall spending gradually through 2007. To this end, the high-level commission of members from the civil society has already finalized a report which contains specific recommendations and targets to such end. Last Monday, its preliminary results were presented to the donor community and the final report is expected by the end of the month (end-September PC). Beyond this, we have requested a new FAD mission to help us focus on public expenditure management and decentralization. We expect that such mission will arrive in La Paz next month. In sum, we aim at substantially improving Bolivia’s budget administration and expenditure management with inputs provided not only by the aforementioned high-level commission, but also by the IDB and the World Bank through the Public Expenditure Review (PER), and through the HIPC assessment and action plan.
7. Grants continue to be essential to the success of the fiscal program and the authorities are grateful to the donor community for their continuous support to Bolivia. A Consultative Group meeting is being prepared for the end of this year or early 2005, in order to gather the concessional resources and grants needed to support such fiscal program. In addition, the limits on overall non-concessional financing will be maintained and tailored to the debt situation of the country, in order to avoid exacerbating debt dynamics. Whereas a more detailed DSA analysis is envisioned for the near future, the staff’s projections show a sustainable medium-term path, supported by fiscal consolidation efforts, a continuation of concessional financing, and increased hydrocarbons production either through an LNG or alternative projects, some of them which have already implied increased production and exports.

Structural Reforms and Framework for Hydrocarbons

8. Actions to strengthen the banking and corporate sectors continue. An advisory committee, headed by the Superintendent is exploring ways to strengthen both, the independence of the Superintendence of Banks, as well as the banking system.

Regarding the bank, which is majority-owned by NAFIBO, the write-off of the shareholders capital according to the due diligence process, has already taken place, and initial actions are being taken for the re-privatization of the institution. As indicated by the staff, corporate restructuring has regained momentum with the appointment of a new Superintendent and a significant number of pilot cases being identified.

9. The conduct of monetary policy is carefully geared towards preserving adequate liquidity conditions and monitor inflation developments, as proved by the timely increases and later decreases of reference interest rates by the Central Bank (BCB). The prudent policies followed by the BCB have constituted a key anchor to expectations, successfully controlling the bouts of deposit bank runs of the last year. As a consequence, after an important loss of reserves in the first two quarters of the year, NIR are back on track, and bank deposits have partially recovered. The increased dynamism of placements of government paper is proof of the regained confidence, and the policy of extending their maturity is a sensible strategy to extend the yield curve. Increased placements in local currency mitigate debt management risks and also serve as a means to gradually reduce dollarization. As indicated by the staff, other market friendly measures are being considered, in order to bolster BCB's NIR position, while introducing flexibility into an exchange rate arrangement that has served Bolivia well so far.
10. Development of the hydrocarbons sector is key to Bolivia's future and to attain a sustainable reduction in poverty levels. Being aware of this, the authorities are doing their utmost efforts to put in place a framework for the exploitation of their vast hydrocarbons reserves, that while being market friendly, also garners the essential social consensus to allow the private sector to operate. In this delicate balancing act, pushing for a referendum proved to be an accurate decision by the authorities, since it has led to reduced social tensions and has empowered the executive branch with the popular backing to propose a new framework. A draft of the new hydrocarbons law is being discussed now, not only at the political level in Congress, but with private actors as well. The advice of multilateral institutions is being carefully considered. While there remains some contentious issues, it is important to underline the consensus building process under way. The authorities' ultimate goal is to arrive at a framework that promotes private investments, with the proper checks and balances in place to ensure a fair share of the benefits for the Bolivian people.

The Road Ahead

11. The authorities will be finalizing by year-end, a medium-term policy framework, anchored into a new Poverty Reduction Strategy Paper (PRSP) that should serve as the basis to request a new three-year PRGF program. My authorities plan to bring such a request to the Board early next year, to serve as a continuation of the expiring Stand-By arrangement.