November 2005
IMF Country Report No. 05/393

Bolivia: Sixth Review Under the Stand-By Arrangement and Requests for Modification and Waiver of Nonobservance and Applicability of Performance Criteria, Rephasing, and Reduction of Access—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Bolivia

In the context of the sixth review under the Stand-By Arrangement and request for modification and waiver of nonobservance and applicability of performance criteria, rephasing, and reduction of access, the following documents have been released and are included in this package:

- the staff report for the Sixth Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on September 16, 2005, 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 October 14, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of October 28, 2005 updating information on recent developments.
- a Press Release summarizing the views of the Executive Board as expressed during its October 31, 2005 discussion of the staff report that completed the review.
- a statement by the Executive Director for Bolivia.

The documents listed below have been separately released.

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

*May also be included in Staff Report

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

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

BOLIVIA

Sixth Review Under the Stand-By Arrangement and Requests for Modification and Waiver of Nonobservance and Applicability of Performance Criteria, Rephasing, and Reduction of Access

Prepared by Western Hemisphere Department
(In Consultation with Other Departments)

Approved by Caroline Atkinson and Michael T. Hadjimichael

October 14, 2005

- **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 has subsequently been extended and/or augmented on April 1, 2004; June 10, 2004; December 27, 2004; March 30, 2005; and April 8, 2005, when total access was augmented by SDR 42.86 million (25 percent of quota), to SDR 171.5 (100 percent of quota) and the arrangement was extended through March 31, 2006.

- **Discussions**. The discussions were held in La Paz during September 5–16. The staff team consisted of Messrs. Furtado (Head), Balakrishnan, López-Murphy, and Vesperoni (all WHD); Mr. Dodzin (PDR); Ms. Heysen (MFD); and Mr. Medas (FAD). It met with Finance Minister Gutiérrez; Central Bank President Morales; other senior officials; multilaterals and donors; and the teams of the leading presidential candidates. The mission was assisted by Mr. Cueva (resident representative). Mr. Cuevas (OED) participated in the discussions.

- **Political setting and economic developments**. Following heightened social unrest, President Mesa resigned, the two congressional leaders in the line of succession stepped aside, and the President of the Supreme Court, Eduardo Rodríguez, took over as interim President on June 9. The constitution has been amended to allow early general elections in December. Despite the major political changes, and still a vulnerable financial system, macroeconomic stability has been maintained and overall performance in 2005 has been positive.

- **Program**. The fiscal deficit target for 2005 has been reduced to 3.5 percent of GDP, and the target for 2006 to 3.0 percent of GDP. The end-December 2005 monetary targets have been adjusted accordingly. The government will proceed with additional structural reform actions as feasible during the political transition.

- **Fund Relations**. GRA credit outstanding as of August 31, 2005 amounted to SDR 106.1 million and PRGF credit outstanding amounted to SDR 82.93 million. Bolivia has accepted the obligations of Article VIII, sections 2, 3 and 4. The last Article IV consultation was concluded on July 7, 2003. Relations with the Fund are detailed in Appendix I.

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EXECUTIVE SUMMARY

- **Since the completion of the fifth review and approval of the extension of the Stand-By Arrangement in April 2005, several major political developments have taken place**. Following heightened social unrest, President Mesa resigned, and the President of the Supreme Court, Eduardo Rodríguez, took over as interim President on June 9. The constitution was also amended to allow early general elections in December and, for the first time, elections of regional governors.

- **Despite the political changeover, and aided by a favorable external environment, macroeconomic performance in 2005 has been positive**. While the blockades of May/June had a negative impact on economic activity, real GDP growth is still expected to be around 4 percent in 2005. Inflation remains in single digits and the external current account continues to register a substantial surplus. However, structural policy implementation has suffered setbacks: while progress has been made with financial sector and fiscal reforms, the new hydrocarbons law is likely to discourage investment.

- **In light of the developments so far, the macroeconomic program for 2005 is being strengthened, the structural reform program reprofiled, and access reduced**. The limit on the fiscal deficit has been set at 3.5 percent of GDP, compared with the original target of 5.2 percent of GDP. The revised program targets a substantially higher NIR accumulation of US$135 million and liquid foreign asset coverage of financial system deposits of 54 percent. At the same time, given their interim mandate, the authorities are proposing a scaling down of the structural reform agenda for 2005, particularly in the tax policy area. Accordingly, and in view of the stronger than envisaged balance of payments outcome, they are requesting a rephasing and reduction of access under the SBA, which would be made precautionary.

- **The fiscal deficit is expected to decline further to 3 percent in 2006.** This will be achieved by saving part of the large increase in hydrocarbons revenue, related to the new law and strong gas export prices, while prudently managing current spending. Submission to congress of a 2006 budget proposal in line with the agreed target is a prior action for the sixth review. Additional prior actions comprise submission to congress of the budget framework and deposit insurance laws.

- **The economy is characterized by a number of vulnerabilities that require policy vigilance**. These include a highly dollarized financial system subject to deposit runs; uncertainty surrounding the investment climate after passage of the new hydrocarbons law; and a fiscal position sensitive to revenue/expenditure-sharing arrangements between the central and subnational governments. At the same time, political uncertainties abound.

- **The program provides a critical anchor for economic policy during the political transition**. Policies to ensure continued macroeconomic stability and prepare for further essential structural reforms will provide continuity and a framework for sound policy action by the successor government.

I. Background

1. **Shortly after the completion of the fifth review and approval of the extension of the SBA in April 2005, Bolivia experienced an acute political crisis that led to the resignation of President Mesa and to an agreement in congress on holding early general elections on December 4, 2005**. The crisis was triggered by the approval of a hydrocarbons law widely seen as detrimental to the investment climate but also sharply opposed by sectors in favor of greater state control. In the context of pent-up social and regional tensions, and deteriorating security conditions, President Mesa resigned and, after the two congressional leaders in the line of succession stepped aside, Supreme Court President Eduardo Rodríguez took over the presidency in June, on an interim basis. Shortly thereafter, the constitution was amended to allow elections for a full five-year presidential term as well as for congressional elections and, for the first time, elections for regional governors. The new president will take over on January 22, 2006. Congress also reached agreement on two other key political issues: a referendum on regional autonomy and the election of a constituent assembly, both to be held in July 2006.[1]

2. **Reflecting the political crisis and the interim nature of the current government, a reprofiling of the structural component of the SBA-supported program is necessary**. The extension of the Stand-By Arrangement (SBA) with Bolivia for one year, in April 2005, was designed as a bridge to a new PRGF arrangement. The program aimed at maintaining macroeconomic stability through continued fiscal consolidation while advancing structural reforms. In view of the importance of the hydrocarbons sector, the program also incorporated the approval of a new law that would foster investment and growth in the sector. However, given the limited mandate of the interim government, the authorities are proposing scaling down and rephasing the structural component of the program (Section II.C). Given this reprofiling, and the stronger-than-programmed balance of payments developments in 2005, the authorities are also requesting a rephasing and reduction of access under the Stand-By Arrangement, which they intend to treat as precautionary (Section II.F).

II. Report on the Discussions

3. **The major social and political developments that preceded the discussions posed a complex and delicate set of issues to be addressed in the context of the sixth review**. On the one hand, the authorities stressed that the SBA-supported program had been providing a critical umbrella of policy discipline and noted that the targets of the financial program were being met with substantial margins. On the other hand, the political crisis had contributed to deviations from the structural reform agenda, notably in the hydrocarbons sector, that were not likely to be reversible within the program period. Under these circumstances, the discussions focused on the scope for tightening the macroeconomic objectives for 2005–06 to help compensate for any deterioration in the medium term outlook resulting from the less ambitious structural reform agenda, while proceeding with the reform steps feasible within the limited mandate of the current government.

[1] The law detailing the conditions for electing the assembly still has to be approved by the new Congress.

A. Economic Developments and Outlook for 2005

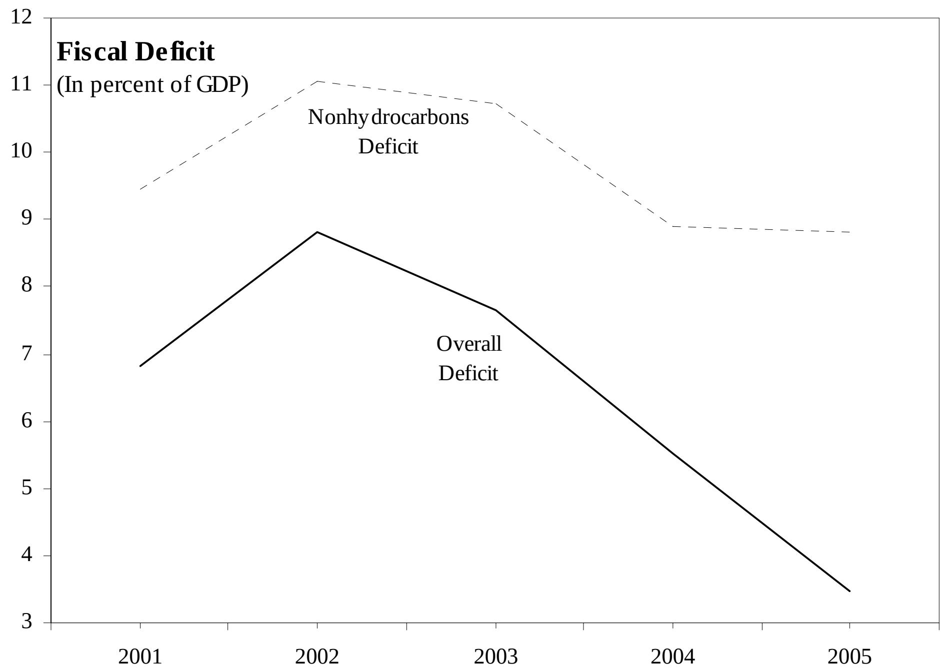
4. **Despite the major political developments, and aided by a favorable external environment, macroeconomic stability has been maintained and overall performance in 2005 has been positive**. Buoyed by the hydrocarbons sector, economic growth remained strong during the first half of the year. Temporary supply disruptions associated with road blockades led to an increase in inflation in May–June, which has since been partially reversed. The trade surplus in the first semester of 2005 was broadly in line with program projections. For the year as a whole, current projections point to somewhat lower growth and higher inflation than previously expected (Table 1). Growth is projected at 3.9 percent, compared to 3.6 percent in 2004, and twelve-month inflation is projected at 4.2 percent, down from the June peak of 6.4 percent. The overrun vis-à-vis the program inflation target of 3.8 percent is associated, in part, with the depreciation of the Boliviano vis-à-vis regional currencies. Higher taxation of the hydrocarbons sector under the new law will contribute to a low fiscal deficit, and the balance of payments is projected to be substantially stronger than programmed. Reflecting the latter, and a substantial recovery of deposits, NIR will exceed the program target by a large margin.

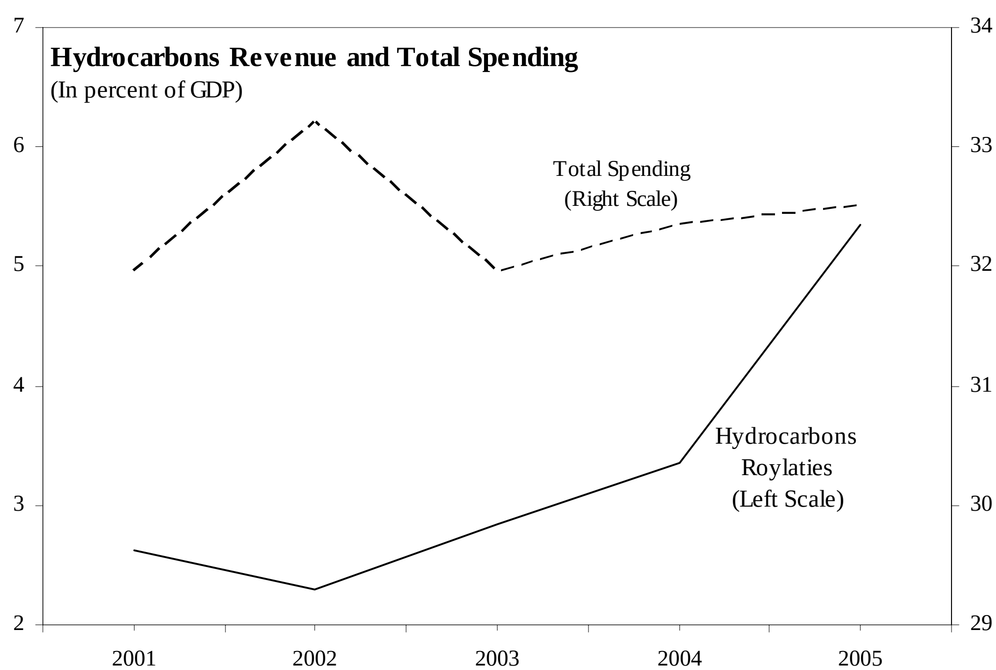
Fiscal policy

5. **The fiscal deficit is expected to continue its sharp decline from a peak of nearly 9 percent of GDP in 2002 to 3.5 percent of GDP in 2005 (Table 2 and Figure 1)**. In the first seven months, the combined public sector recorded an overall surplus of 0.4 percent of GDP. There was a large increase in revenue, related to strong gas export prices and the changed tax regime for the hydrocarbons sector, including the introduction of a new tax—the *Impuesto Directo a los Hidrocarburos* (IDH). Spending was significantly constrained, reflecting, in large measure, slow execution of capital projects associated with the events leading up to the changeover to the present government. The authorities hope to accelerate project execution and spending on some social programs (subsidies to low-income housing), and a seasonal pickup in current spending is expected in the last quarter. Nonetheless, the 2005 fiscal deficit is now projected at no more than Bs 2,728 million (3.5 percent of GDP), compared with the original program target of Bs 3,763 million (4.8 percent of GDP).[2]

[2] These ratios are based on an upward revision to GDP. In relation to the programmed GDP, the corresponding ratios are 3.7 and 5.2 percent, respectively. The program approved at the time of the fifth review provided for the authorities to save at least one-third of the excess of actual over programmed tax revenue. The current revised target is lower than the adjusted target would have been.

Figure 1. Bolivia: Fiscal Deficit, Spending, and Hydrocarbons Revenue





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

Monetary policy and debt management

6. **The authorities tightened monetary policy in response to pressures during the political crisis, and are set to achieve the program's NDA and NIR targets with substantial margins**. In May/June, the Central Bank of Bolivia (BCB) raised repo rates by over 100 basis points in response to large deposit withdrawals. Since then, and in the context of a shift in sentiment following the assumption of the interim government and the agreement on early general elections to be held in December, financial system deposits have recovered, the related liquidity assistance provided to banks has been fully repaid, and repo rates have been correspondingly reduced. The net liquid foreign assets of the financial system have increased significantly, including a substantial strengthening of central bank reserves, which are now much higher than what had been originally programmed (Figure 2). In view of the potential monetary impact from the reserves increase, the BCB has stepped up open market operations and is targeting a substantial reduction in the 12-month growth in currency issue in coming months.[3] For the year as a whole, NIR is projected to increase by US$230 million, compared with the programmed increase of US$40 million. This would be consistent with an increase in financial system liquid foreign asset coverage of deposits to around 54 percent (Tables 3–5).

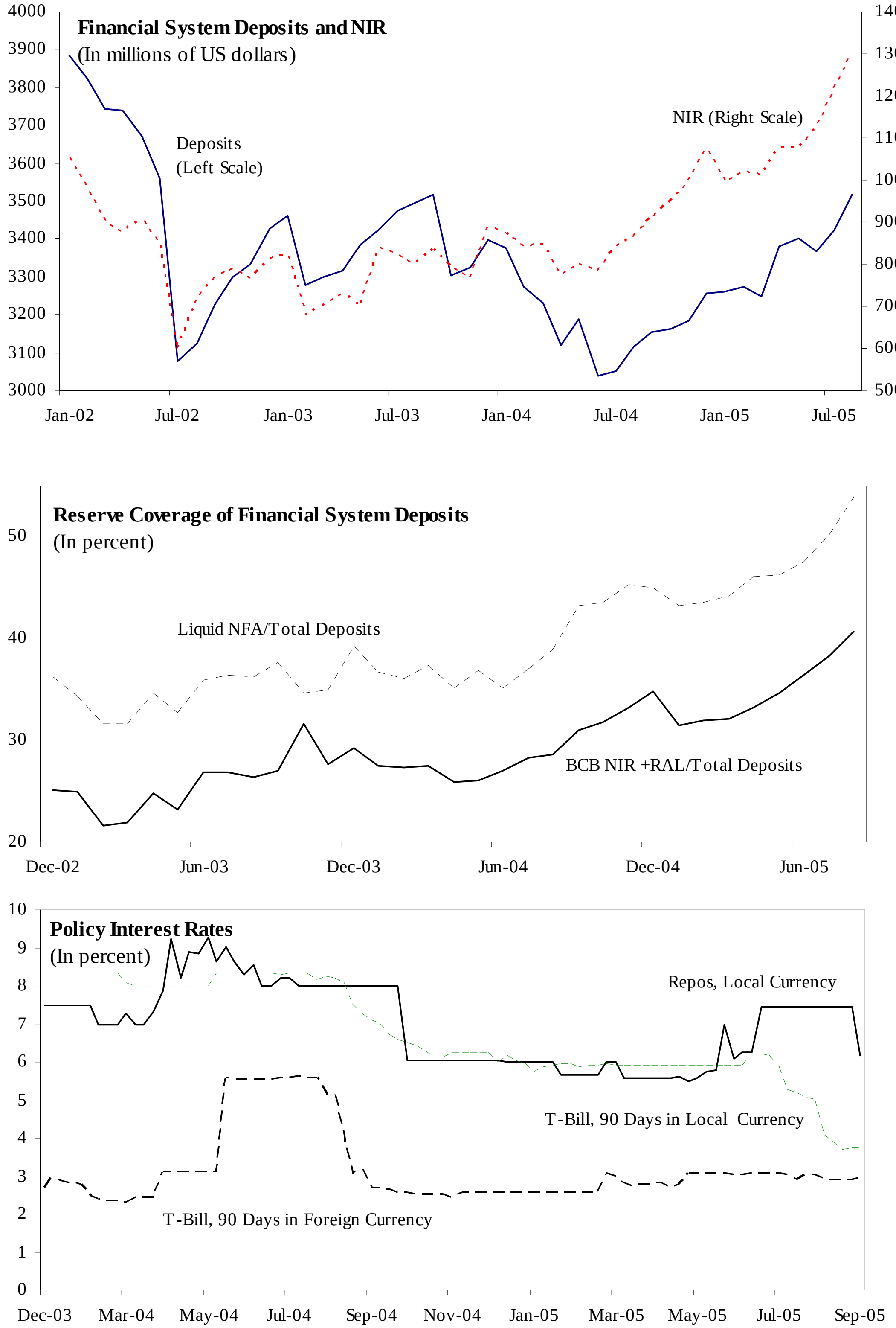
7. **The issue of continued financial sector vulnerabilities figured prominently in the discussions.** While the authorities agreed to propose a modification to the NIR floor, they cautioned that—given the experience with deposit withdrawals around the time of previous elections—there was a need for a significant margin in setting the program floor on NIR accumulation. The mission reached understanding on a floor below the revised projection. Specifically, the end-December 2005 floor on NIR accumulation would be raised to the mid-point between the original target and the current projection (i.e., to US$135 million).

8. **The authorities have taken advantage of the favorable market conditions to continue their de-dollarization efforts and improve the maturity structure of domestic debt**. Through the BCB's open market operations, the authorities have increased the share of local currency treasury paper by over 20 percentage points since end-2004, and tripled the average maturity of newly issued treasury paper to over three years (Figure 3).[4] The authorities noted that the infrastructure for debt management has been enhanced by the introduction of a new electronic auction system that has improved market transparency and information sharing. On the financial system front, increases in average and marginal reserve requirements on dollar deposits, which started in April 2005, have helped to continue the process of gradual de-dollarization of banking system deposits and loans.

[3] The substantial increase in currency issue so far this year (above 30 percent on a 12-month basis as of end-August) reflects large external inflows, in part associated with increased demand for local currency (as evidenced by significant sales of foreign currency to the central bank). To the extent that the external inflows have not been fully matched by the increased demand for local currency, the central bank is sterilizing these flows to mitigate any potential inflationary impact.

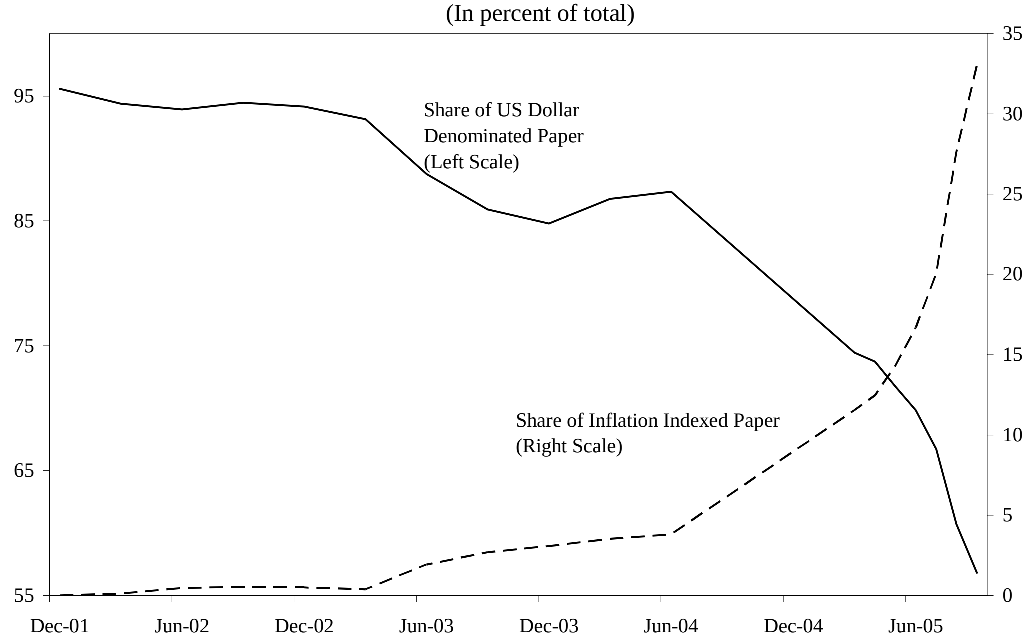
[4] A small share of new treasury paper has been placed at fixed interest rates, while most of the paper has been indexed to inflation.

Figure 2. Bolivia: Monetary and Financial System Indicators



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

Figure 3. Bolivia: Composition of Outstanding Treasury Open Market Paper
(In percent of total)

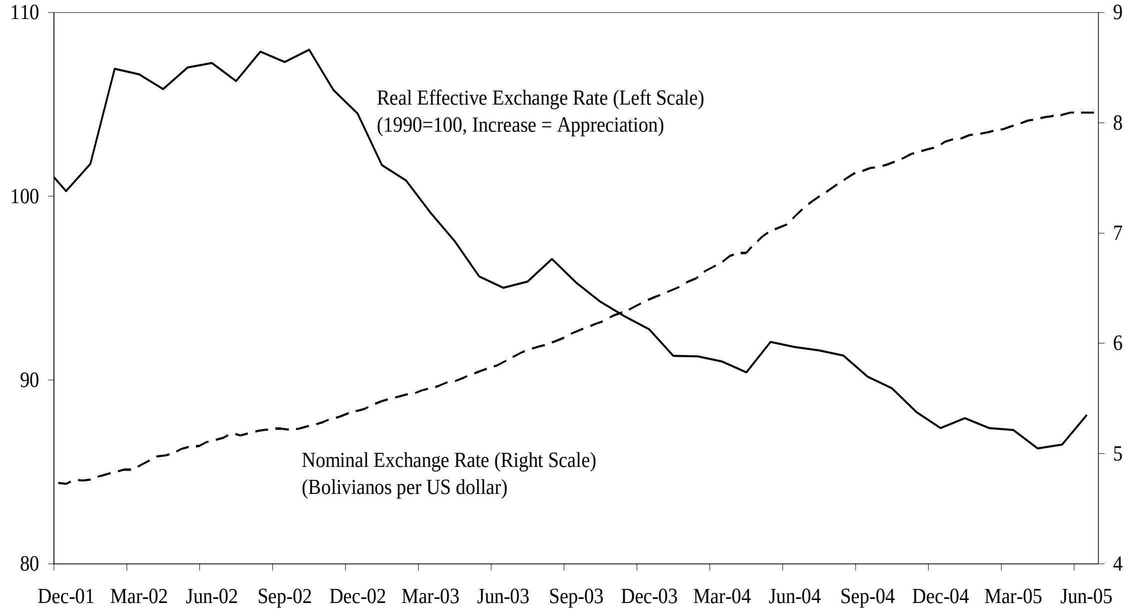


Exchange rate policy and the balance of payments

9. **The BCB has maintained the bilateral exchange rate of the Boliviano virtually unchanged against the U.S. dollar since end-2004**. This has implied a highly competitive real effective exchange rate, given the appreciation of major regional currencies (Figure 4). In July, and again in mid-September, the BCB marginally appreciated the Boliviano against the U.S. dollar under the crawling peg. With the July step, the BCB also widened slightly the buy-sell spread, which has been reflected in increased activity in the interbank foreign exchange market. The mission explored with the authorities the scope for moving, over the medium term, to a more flexible exchange rate regime than the present crawling peg, in which the exchange rate is adjusted through discrete small steps. While the authorities did not dispute that greater flexibility would allow a more agile response to shocks, they are not considering changes in the exchange rate regime at this stage.

10. **The balance of payments has been substantially stronger than programmed**. With exports benefiting from high energy and metals prices, the current account surplus has been broadly in line with the program, despite supply disruptions in the first half of the year. The capital and financial account has recorded a higher-than-projected surplus, despite a shortfall in disbursements of external loans for public investment projects. This was associated in part with the increasing demand for Bolivianos and direct foreign investments in the mining sector. Overall, as noted above, these trends have resulted in a higher-than-programmed level of international reserves (Table 6).

Figure 4. Bolivia: Exchange Rates



B. Preliminary Macroeconomic Framework for 2006

11. **The authorities envisage for 2006 real GDP growth in the range of 4–4½ percent, lower inflation, and a further reduction of financial sector vulnerabilities**. Achievement of the growth objective is predicated on an acceleration of growth in the mining and construction sectors, reflecting large ongoing mining investments, and higher capacity utilization in the hydrocarbons sector.[5] Lower inflation would be facilitated by prudent management of the revenue windfall from the hydrocarbons sector, a significant portion of which will again be saved to reduce the fiscal deficit and avoid creating expenditure rigidities. The proposed fiscal stance and competitive exchange rate, together with strong prices for hydrocarbons products and mining exports, would help maintain sizable external current account and overall balance of payments surpluses. This would imply a further increase in the reserve coverage of financial sector deposits.

12. **The government intends to submit to congress, prior to the Executive Board meeting, a 2006 budget consistent with a further reduction in the fiscal deficit to 3.0 percent of GDP**. This is predicated on an increase in tax revenue by about 0.5 percent of GDP, as an increase in hydrocarbon royalties and IDH (production) taxes would compensate for a decline in corporate income tax (from the hydrocarbon sector, as profits after production taxes will fall). The revenue projection includes the elimination of the financial transactions tax (FTT) on local currency sight deposits; the FTT on foreign currency sight

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[5] Following a decline in capacity utilization in the first half of 2005, which has since been reversed, a recovery in annual output is expected in 2006.

and savings deposits will be maintained at the current rate both to cushion the impact on revenues and as part of efforts to promote de-dollarization. On the expenditure side, the authorities stressed that the new hydrocarbon revenues should be partially used to address the many needs on infrastructure and social capital, with total public investment (including by subnational governments) expected to increase in relation to GDP. Meanwhile, the government will continue to contain current spending in relation to GDP, including the wage bill, and expects a further reduction in pension costs. Nonetheless, fuel subsidies could surpass one percent of GDP in 2006 (from 0.8 percent of GDP in 2005), as domestic prices have remained constant after the increase in late 2004 (Box 1). While the limit on the deficit of the combined public sector authorized in the government's proposal will be equivalent to 3.7 percent of GDP, this is consistent—based on the Fund staff's revenue projection and assuming an implementation rate of 93 percent[6] of the investment budget—with a fiscal deficit outturn of 3.0 percent of GDP.

C. Structural Reforms

13. **The authorities have made progress with fiscal and financial sector reforms, and are planning further reform steps**. In the fiscal area, congress elevated to law the new tax code procedures. In the financial sector, provisioning and reserve requirements were tightened and congress approved a law establishing the Financial Restructuring Fund (FRF) as a legal entity and enhancing the autonomy of the banking superintendency and the central bank.

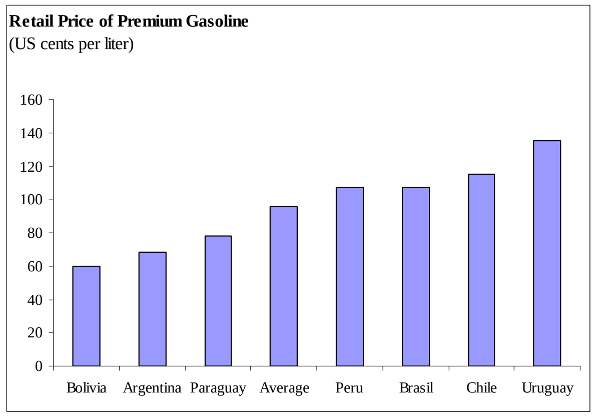
14. **The mission expressed concern about the hydrocarbons law enacted by congress in May, but the current authorities do not envisage further changes to the legal framework.** The mission noted that the new hydrocarbons regime risked undermining the future development of the sector, especially in light of tax rate rigidities and legal uncertainties (Box 2). The authorities emphasized that—given the far-reaching changes introduced, the altered energy price outlook, and the ongoing contacts with oil companies on the implementing regulations—the impact of the new law still needed to be fully assessed. Hence, the current administration has moved on to implement and regulate the law as mandated, no further legislative adjustments are contemplated at this stage, and any potential review of hydrocarbons policy would be conducted by the next government.

15. **Looking ahead, and taking into account their limited mandate, the authorities are committed to further structural reform actions in the fiscal and financial sector areas** (MEFP ¶ 15 and Table 2), including:

[6] The average of the last six years, excluding the highest and lowest observations.

Box 1. Bolivia: Petroleum Product Pricing

- **Domestic petroleum product prices, which are set administratively, have mostly not reflected changes in international prices in recent years**. During 2000-04, the authorities maintained domestic retail prices broadly constant, which implied changes in excise taxes (as these are determined residually by the difference between retail prices and production/distribution costs). In December 2004, domestic petroleum product prices were raised by an average of 10 percent for major products, since when they have remained unchanged.



- **During 2000-04, the pricing policy led to a substantial erosion of tax revenue, which was partially reversed in 2005**. Specifically, excise taxes on petroleum products declined from 2.6 percent of GDP in 2000 to 1.6 percent of GDP in 2004. The increase implemented in December 2004 is reflected in an increase in the yield of excise taxes to an estimated 2.4 percent of GDP in 2005. However, these ratios are overstated given that the cost structure of petroleum products in Bolivia is kept artificially low by a freeze on the price of domestically produced crude oil, at US$27 per barrel. If crude oil were sold domestically at the export price, excise tax revenue on the sales of the derived products would be sharply reduced. Alternatively, if the additional cost were fully passed on to consumers, excise tax collection would be protected and the government could receive additional revenue of up to 2-3 percent of GDP from production and corporate income taxes on upstream producers.

- **The domestic prices of diesel and liquefied petroleum gas (LPG) are set substantially below their import and production costs, which gives rise to an explicit subsidy in the budget**. With diesel imports accounting for about one-third of domestic consumption, and international prices rising, diesel subsidies are projected to reach close to 1 percent of GDP in 2006. Despite efforts to control the borders, the very low domestic prices have also led to the smuggling of LPG and diesel to neighboring countries.

- **While the current pricing policy is regressive, a reform is politically and socially challenging, in view of the major rigidities and distortions accumulated over time.** A Poverty and Social Impact Analysis (PSIA) conducted by FAD in 2004 showed that the benefits of the low domestic fuel prices are not well targeted as they are captured predominantly by the higher income groups. Accordingly, the PSIA recommended more flexibility in fuel prices, but that a substantial increase in fuel prices, particularly for LPG, should be accompanied by measures to alleviate the impact on the more vulnerable groups.

Box 2. Bolivia: The New Hydrocarbons Regime

- **Until May 2005, Bolivia's hydrocarbons sector had been governed by a law introduced in 1996 (Law 1698) to attract foreign investment given the limited domestic capacity to develop the country's large natural gas reserves**. While that regime increased profit-based and excise taxes, it also set lower production taxes for new fields and created additional incentives for production and new investment. Concurrently, the role of the state-oil company (YPFB) was significantly reduced as it was split up and mostly privatized. The 1996 regime was successful in attracting new investment and in substantially increasing Bolivia's proven reserves of natural gas. However, tax collection, in particular of profit-based taxes, fell below expectations.

- **In May 2005, a new hydrocarbons law introduced sharp changes to the legal framework, largely consistent with the results of a national referendum conducted in mid-2004**. The new law introduced a production-based tax, the Impuesto Directo a los Hidrocarburos (IDH), which—together with the existing royalties—implies a flat production-based tax rate of 50 percent for all fields. Moreover, the role of YPFB has been expanded into that of a more active market participant as well as a regulator. Specifically, following the required implementing regulations, the law provides that YPFB will intermediate all contracts to export natural gas and would become the only importer and wholesale distributor of fuel products. Finally, a particularly important and controversial feature of the new law is the mandatory migration to new contracts imposed on the energy companies operating in Bolivia.

- **The reaction of the private sector has been sharply negative, indicating a serious risk to continued foreign investment**. Energy companies are considering international arbitration over the new law, in particular over the migration provision. Companies have also argued that the new tax system, and the expanded role of YPFB, are likely to undermine the prospects for the additional investment in the hydrocarbons sector.

- **The new hydrocarbons law also contains revenue sharing provisions that will tend to create challenges to fiscal management over the medium-term**. The central government will see its share of revenues reduced while maintaining most of the spending responsibilities. At the same time, regional spending rigidities are likely to emerge—a major vulnerability given the possibility of future declines in hydrocarbons-based revenue.

Fiscal reforms

- Submitting to congress a draft **budget framework law** aimed at enhancing the budget process at all levels of government (prior action, previously an end-June 2005 benchmark). The main objectives include: (i) strengthening the budget preparation; (ii) enhancing fiscal reporting; and (iii) setting clear and enforceable rules and sanctions.

- Preparing a **draft tax reform bill, including a personal income tax**, for consideration by the new government (December 2005 benchmark; previously, submission was an end-September 2005 benchmark).

- Advancing with the **program to register all public sector employees and pensioners**, as well as with the implementation of a **registry system on subnational debt** (December 2005 benchmark, previously end-September 2005).

Financial sector reforms[7]

- Submitting to congress a draft law introducing a **partial coverage deposit insurance scheme** (prior action, previously an end-September 2005 benchmark).

- Submitting to congress draft legislation to improve the **corporate restructuring and bankruptcy framework** (December 2005 benchmark, previously end-September 2005).

- Divesting the remainder of the **state's assets in banks** where the public sector holds a majority ownership (December performance criterion to be maintained).

D. Medium-Term Outlook

16. **The staff has updated the medium term outlook and the debt sustainability analysis taking into account, inter alia, the impact of the new hydrocarbons law**. The law has increased the tax burden on the sector and requires changes in the current contracts with foreign investors. Discussions with the private sector suggest that these provisions will likely discourage new large investment in the hydrocarbons sector over the medium term. Accordingly, the updated medium-term outlook incorporates a broadly flat path for natural gas production and export volumes and correspondingly conservative real GDP growth assumptions (Table 7).

17. **Nonetheless, the fiscal prospects for the next five years have improved since the discussions for the fifth program review in early 2005**. The combination of higher hydrocarbons taxation, stronger international commodity prices, and the envisaged tax

[7] Financial sector reforms are detailed in Box 3.

Box 3. Bolivia: Financial Sector Reforms in 2005

- **Provisioning and reserve requirements have been tightened.** The tightened loan classification and provisioning rules imply US$ 57 million additional provisions (a 21 percent increase on average), of which US$ 45 million are to be constituted over three years. Some banks have indicated their intention to constitute these provisions immediately, not using the three year allowance. The authorities will have to monitor those banks for whom the tightened provisioning requirements will require the three-year period and may demand a capital injection. The increase in average reserve requirements of 2 percentage points on dollar deposits in April 2005, and subsequent increases on marginal reserve requirements, have helped increase reserve coverage of deposits and encouraged de-dollarization.

- **The capacity of the Superintendencia de Bancos y Entidades Financieras (SBEF) to enforce corrective actions and resolve weak banking institutions has been strengthened**. In June 2005, congress approved a law that fully restores the SBEF's regulatory, operational and budgetary autonomy. At the same time, the first of a two step process to strengthen the bank resolution framework was approved. This step included two key amendments to the bank resolution framework: (i) the *Fondo de Restructuración Financiera* (FRF), the Bolivian version of a deposit insurance scheme, was established as a legal entity, thereby correcting legal risks entailed in earlier legislation, which made it almost impossible for the FRF to operate; and (ii) the liquidity contribution of the Central Bank on behalf of the Treasury to facilitate the bank resolution processes was extended through end-2005, allowing the FRF to further build resources. These changes empower the SBEF to enforce corrective actions.

- **Implementation of an explicit deposit insurance scheme with partial coverage is the second step toward strengthening Bolivia's bank resolution framework**. Under the current law, the FRF can only contribute up to 30 percent of covered deposits to facilitate a purchase and assumption (P&A) of assets and liabilities. If a P&A is not feasible, the financial institution is liquidated and the FRF does not cover depositors, thus putting pressure on the Central Bank to provide a blanket guarantee to avoid a costly liquidation. Under the proposed bill, the FRF would cover deposits up to a pre-established ceiling such that over 90 percent of depositors would be protected.

- **The authorities are working on a draft bill to address the weakness of the corporate restructuring and bankruptcy legal framework.** The corporate restructuring framework is inconsistent with best practices and deprives creditors of important rights, as (i) a restructuring can be unilaterally imposed on creditors by any debtor; (ii) a mandatory 90-day stay on all actions by creditors against debtors can be imposed; and (iii) creditor voting provisions affect the interests of secured minority and public sector creditors. The bankruptcy framework is outdated and includes a presumption of fraud—disqualifying the shareholders, for life, from doing business in Bolivia. These weaknesses discourage orderly and swift bankruptcies and make it almost impossible to close ailing firms. The authorities are stepping up the work to finalize the related draft legislation to be submitted to congress by year end.

reform is expected to boost fiscal revenue over the medium term. Over the period 2006–10, higher tax rates and the upward revision of gas export prices would be reflected in higher annual hydrocarbons-based fiscal revenue by about 1 percentage point of GDP in relation the medium term scenario presented in March for the fifth review. The enlarged revenue envelope will allow a more upfront reduction in the fiscal deficit than previously envisaged, with a correspondingly more rapid reduction in the debt ratio, without undermining Bolivia's poverty-reduction and growth-enhancing efforts.

18. **The main risks to the medium-term scenario are related to a larger-than-projected fall in energy prices and to potential expenditure pressures.** Regarding the latter, the regions and municipalities stand to benefit from higher hydrocarbons-based revenue, reflecting both the introduction of the IDH and the recently agreed increase in their share (from 45 percent to 65 percent), but without receiving spending responsibilities from the central government. Accordingly, there is a risk that spending rigidities could develop at the subnational level in the context of exceptionally high hydrocarbons-based receipts. The staff emphasized that, to mitigate these risks, it would be important to develop a more balanced distribution of expenditure responsibilities among all levels of government.[8]

Bolivia: Comparison of Medium-Term Scenarios

	Fifth Review Baseline 2/						Sixth Review Baseline					
	2005	2006	2007	2008	2009	2010	2005	2006	2007	2008	2009	2010
Market conditions												
Gas exports volumes (MM3 per day)	31	33	40	46	52	56	28	31	31	31	31	31
Gas prices (10^12 BTU)	1.6	1.5	1.4	1.4	1.4	1.4	1.8	1.9	1.9	2.0	1.9	1.9
WEO oil price ($ per barrel)	41	38	36	35	35	34	54	62	60	58	57	57
Fiscal situation												
Average production-based tax rate on hydrocarbons	25	36	37	37	36	36	38	50	50	50	50	50
Hydrocarbons revenue (% of GDP) 1/	3.9	5.0	4.7	5.1	5.1	5.4	5.4	6.7	6.3	5.9	5.5	5.2
Overall balance (% of GDP)	-5.2	-4.0	-3.3	-2.4	-2.2	-1.9	-3.5	-3.0	-2.6	-2.3	-2.2	-1.9
of which:												
Overall nonhydrocarbons balance	-9.1	-9.0	-8.0	-7.5	-7.3	-7.2	-8.8	-9.7	-8.9	-8.2	-7.7	-7.0
Debt Ratio												
Nominal debt (% of GDP)	76.6	76.4	74.8	72.9	71.2	68.5	72.1	71.4	68.7	67.3	65.8	64.2
Net Present Value (% of GDP)	57.6	58.0	57.4	56.4	56.0	54.5	53.7	53.8	52.9	52.1	51.2	50.2
Memorandum Items:												
Real GDP growth	4.5	3.7	5.0	4.9	4.1	4.5	3.9	4.1	3.9	3.0	3.0	3.0

Source: Fund staff estimates.

1/ Does not include excise taxes
2/ As in Country Report No. 05/146.

[8] The 2006 constituent assembly and referendum on regional autonomy will play a key role in fiscal decentralization issues.

E. Debt Sustainability Analysis

19. **The debt sustainability analysis is anchored on a long-term scenario consistent with a continuation of broadly unchanged natural gas production and export volumes through 2015**.[9] On this basis, the debt sustainability framework suggests that the public debt would be on a sustainable path, with the ratio of the NPV of the nonfinancial public sector debt to GDP declining from about 55 percent in 2004 to 44 percent by 2015 (Table 10, Figure 5). The declining trend would appear quite robust, as suggested by the following stress tests (Table 11):

- A **permanent decline in hydrocarbons-based revenue** (of about 20 percent on average for 2006–10) results in an NPV/GDP ratio about 7 percent points higher (51 percent in 2015), but the declining trend of the ratio would be maintained.[10]
- Bolivia would withstand relatively well **an increase in interest rates**, or an increase in the share of nonconcessional financing.
- A **30 percent devaluation** in 2006 would lead to an initial sharp increase in the NPV/GDP ratio (to 76 percent), but the effects of the shock would diminish over time.
- However, if the **primary balance remains unchanged** at the projected 2005 level (a deficit of 0.5 percent of GDP), the NPV/GDP ratio would remain virtually unchanged, declining only marginally to 53 percent by 2015. This underscores the need for fiscal adjustment over the medium term, as assumed in the baseline scenario.

F. Program Issues

20. **In the attached Letter of Intent (LOI) and Memorandum on Economic and Financial Policies (MEFP), the authorities request completion of the sixth review and describe the supporting policies**. The request involves one waiver of nonobservance of a structural performance criterion for June 2005; waivers of applicability in respect of two end-September performance criteria; a modification of one end-December 2005 structural performance criterion, to be converted into a structural benchmark; and modification of several structural benchmarks. The authorities' documents cover the following program-related points:

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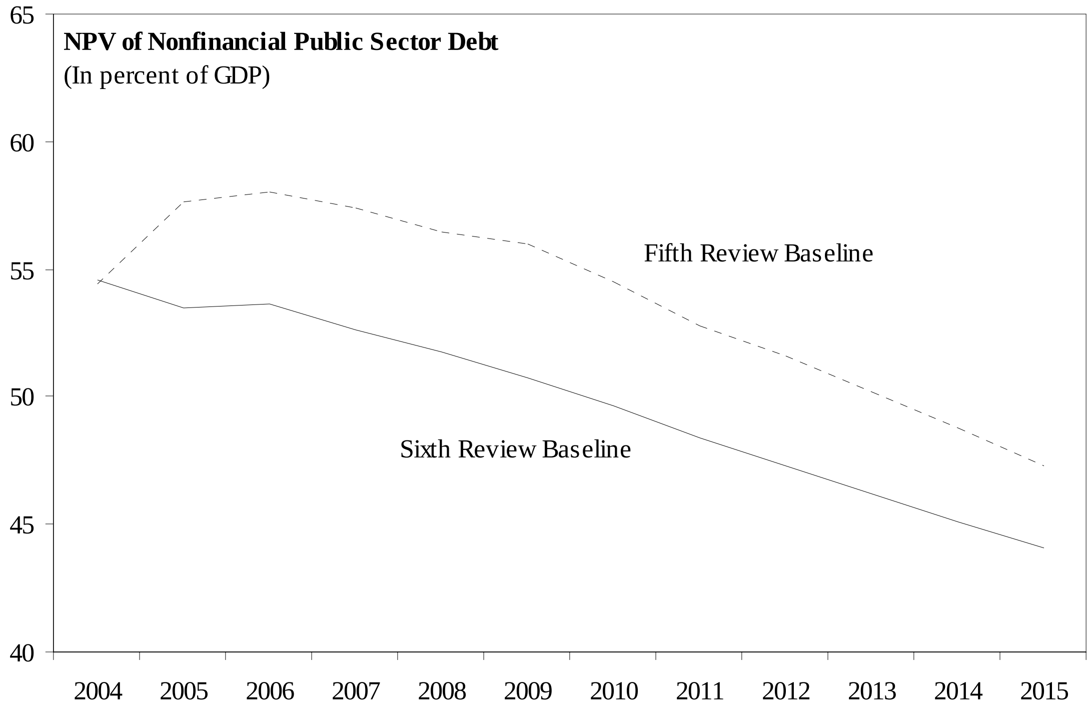
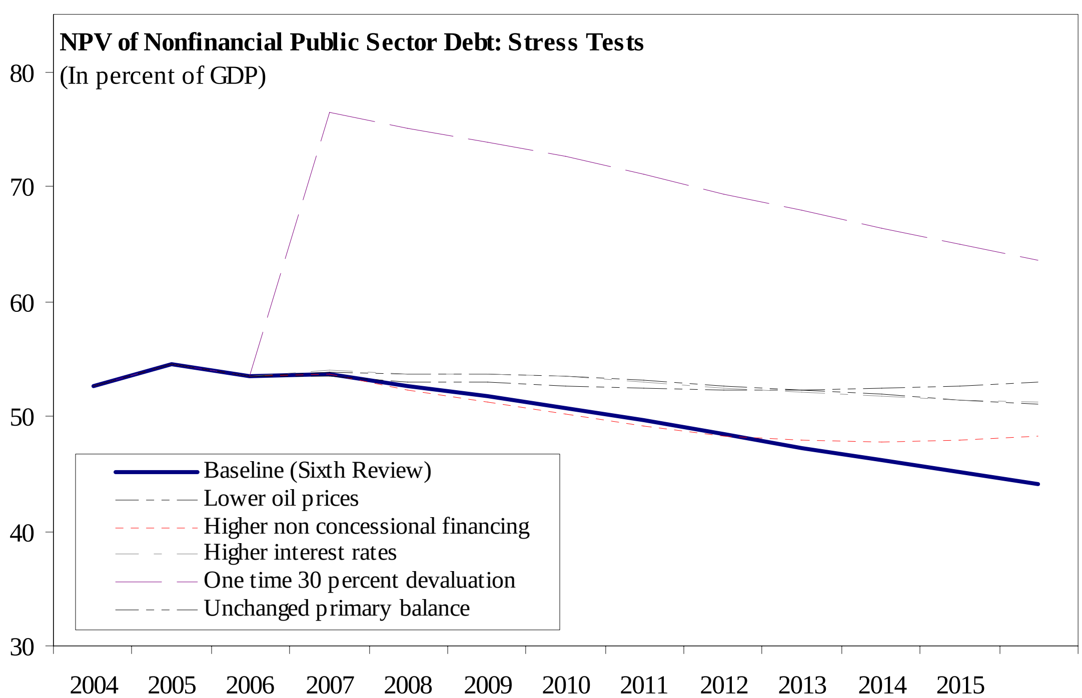
[9] This may require adjustments to the current hydrocarbons regime, which would be consistent with discussions held by the mission with the leading presidential candidates or their representatives, all of whom highlighted the importance of pursuing policy adjustments that may be needed with a view to ensuring continued natural gas output and exports.

[10] Such a decline could be due to: (i) a price drop of US$15 per barrel below the baseline in 2006, and US$10 below the baseline thereafter; (ii) a 30 percent drop in the average annual volume of natural gas output (by nine-thousand cubic meters per day) in 2006-2015, as might occur in the absence of improvements in the investment climate; or (iii) a linear combination of these shocks.

Figure 5. Bolivia: Debt Sustainability Analysis





- **All end-June 2005 quantitative performance criteria were observed**. In particular, the fiscal deficit was smaller than programmed and the NIR target was met with a large margin (LOI ¶ 2, MEFP ¶ 2, and MEFP Table 1). The authorities have met, or expect to have met, all quantitative performance criteria for end-September 2005 with margins. However, as no final information is available on the combined public sector deficit and domestic financing outturns relative to their end-September 2005 performance criteria, the authorities are accordingly requesting waivers of applicability for those performance criteria.

- **The authorities are requesting a waiver** for nonobservance of the end-June 2005 structural performance criterion on passage of a revised 2005 budget law (LOI ¶ 3 and MEFP Table 2). The staff indicated that it would recommend in favor of granting this waiver, given that the original fiscal program objectives are expected to be observed with a margin and that the current fiscal program incorporates a correspondingly tighter budget deficit target.

- **The Executive Board discussion of the request for completion of the sixth review is contingent on prior actions**. These comprise submitting to congress: (i) the 2006 budget; (ii) the budget framework law; and (iii) the law creating a partial deposit insurance scheme (LOI ¶ 5, MEFP ¶ 12 and ¶ 15, and MEFP Table 2).

- **Completion of the seventh review is** contingent on the observance of end-December 2005 performance criteria (LOI ¶ 5 and MEFP Tables 1 and 2). Completion of the seventh review will also be based on an assessment of the direction of policies of the new government.

- **The authorities are proposing modifications to the end-December 2005 quantitative performance criteria**. This includes tighter targets for the fiscal deficit, net credit from the BCB to the nonfinancial public sector, and the net international reserves and net domestic assets of the BCB (LOI ¶ 3, MEFP ¶ 9 and ¶ 10, and MEFP Table 1).

- **The authorities are proposing modifications to the structural conditionality for the seventh review**. The proposed changes to the structural component of the program are discussed in the LOI (¶ 4) and MEFP (¶ 15), and summarized in Table 2 of the MEFP. They include conversion of the end-December 2005 performance criterion on the approval of the 2006 budget to a benchmark, which is associated with higher uncertainty—in view of the pressing political items on congress's agenda, including possibly the choice of president in case none of the candidates achieves a majority in the December 4 election—regarding congress's ability to complete consideration of the budget proposal before the end of the year.[11]

[11] However, the authorities expect to submit the budget to congress in time to benefit from the constitutional provision that allows lapse-of-time approval of the budget proposal.

- **The authorities are requesting a reduction and rephasing of access, and treatment of the SBA from now on as precautionary**. They propose that: (i) total access under the SBA be reduced by SDR 25.72 million (15 percent of quota), corresponding to the last currently scheduled purchase; (ii) the remaining amount of SDR 17.14 million (10 percent of quota), available under the SBA after the purchase associated with this sixth review, be rephased and linked to the next and final review; and (iii) the arrangement be treated as precautionary (Table 8 and LOI ¶ 5).

- **The discussions for the seventh review** would provide an opportunity for the next government to outline its medium-term economic policies and poverty reduction strategy, including its intentions regarding relations with the Fund, as well as the potential implications for Bolivia of the G-8 debt cancellation initiative (LOI ¶ 5).

III. STAFF APPRAISAL

21. **Since the completion last April of the fifth review of the program supported by the Stand-By Arrangement, Bolivia has experienced far-reaching political developments**. It is a sign of political development and institutional maturity that, despite the complex social and regional factors involved, these developments unfolded strictly within the constitutional framework, tensions have been diffused, and economic stability has been maintained. However, the institutions of Bolivia will again be tested, in the period ahead, by the general elections and the two major events scheduled for mid-2006—the elections for the constituent assembly and the referendum on regional autonomy. Continued adherence to an orderly resolution of political issues is a key pre-condition for a positive economic outlook.

22. **The authorities are to be commended for their financial management during the political transition and adherence to the quantitative targets of the program, which have been met with substantial margins**. The central bank implemented a timely and measured monetary policy response that struck a balance between tightening of monetary conditions and providing needed liquidity to banks facing deposit withdrawals. Once sentiment improved, the authorities rebuilt international reserves while partially sterilizing the monetary impact through stepped up open market operations. Reflecting the favorable market conditions, these results were achieved in the context of a decline in policy interest rates and a significant improvement in the maturity structure and currency composition of the domestic debt. Further progress in strengthening the debt structure will be important in reducing vulnerability.

23. **Favorable developments on the monetary front have been greatly helped by the much better-than-programmed fiscal position, which it will be central to sustain**. While the strength of the fiscal outcome is in large measure related to a hydrocarbons revenue windfall and a low implementation of investment projects, the proposed tightening of the fiscal deficit target for 2005 constitutes welcome evidence of the authorities' commitment to prudent fiscal management. Continued firm control of the deficit is crucial for maintaining macroeconomic stability.

24. **The budget proposal for 2006 would consolidate the sharp decline in the fiscal deficit since the very high recent peak of nearly 9 percent of GDP in 2002**. The proposal

to be submitted to congress is consistent with a reduction in the fiscal deficit to 3 percent of GDP, based on staff revenue projections and assumptions on the rate of execution of the capital budget. Achievement of this target will require, in particular, continued strict control over current expenditure. The budget proposal is underpinned by specific agreements between the central and subnational governments on revenue sharing and spending responsibilities during 2006. While this enhances the credibility of next year's budget, over the medium term Bolivia will face the challenging task of reconciling the widespread domestic calls for increased fiscal decentralization and regional autonomy with the need to ensure that future revenue sharing and expenditure assignment agreements are consistent with continued fiscal consolidation and efficient public spending at all levels of government. The authorities are therefore encouraged to build on international best practices in designing their own fiscal decentralization policies in the period ahead, and the staff stands ready to provide related technical assistance.

25. **While budgetary revenue is likely to benefit from the new hydrocarbons law for several years, the design of that law raises serious concerns in terms of its potential adverse impact on the development of this key sector of the Bolivian economy**. These concerns are mostly associated with the rigidities and uncertainties created by the law. Specifically, there is a need for more flexibility in effective tax rates to take account of diverse profitability conditions and changes in international oil and gas prices, and, equally important, a need to overcome the legal issues surrounding the mandatory "migration" to new contracts. The authorities are urged to correct these distortions as soon as possible—including, as appropriate, through mutually acceptable interim arrangements with the concerned companies within the current legal framework. Failure to address these issues may jeopardize investment and growth prospects in the sector in coming years, and undermine fiscal sustainability over the longer term.

26. **In other areas of structural reform, the authorities have made important progress, particularly in light of the challenging political and social environment**. In the fiscal area, tax enforcement has been strengthened by the enactment of the revised tax code procedures. The staff urges the authorities to pursue approval of the soon to be submitted budget framework law, aimed at improving the framework for preparation and implementation of the budget. The staff attaches critical importance to the work underway on a tax reform proposal for consideration by the next government, which should be at least revenue neutral and anchored on the principles of efficiency and equity. Consistent with the latter, the personal income tax component of the reform should be designed so as to exempt low-income households, which comprise the bulk of the population. The staff urges the authorities to implement more timely adjustments to petroleum product prices with a view to reducing allocative distortions and the budgetary cost, and to make the pricing mechanism more responsive to market conditions, while directing limited and more effective subsidies to the most vulnerable groups. These reforms would provide a cushion for the expected loss of revenue from the FTT, which the authorities are encouraged to remove as soon as possible.

27. **Regarding financial sector reforms, the staff welcomes the increased reserve requirements, the new tighter norms on provisioning, and the enhanced autonomy of the central bank and the superintendency of financial institutions**. Moreover, approval of

the new deposit insurance law to be submitted to congress would help further reduce the still serious vulnerabilities of the financial system. In the same vein, the authorities are encouraged to submit to congress as committed, by the end of the year, a legislative proposal to reform the corporate restructuring and bankruptcy framework.

28. **The crawling peg exchange rate regime has continued to serve Bolivia well and has contributed to the stronger-than-programmed balance of payments performance in 2005**. It has allowed Bolivia to maintain over the years a competitive exchange rate through small discrete nominal adjustments, while keeping balance sheet effects manageable in a highly dollarized environment. At the same time, the system is not flexible enough to allow an agile response to shocks and its relative stability contributes to the persistent dollarization. Accordingly, the authorities are encouraged to consider a gradual move to a greater degree of exchange rate flexibility.

29. **In view of its transitional character, the current government is not in a position to update Bolivia's medium-term poverty reduction strategy and to complete a revised PRSP**. However, the authorities are encouraged to advance with the background technical work for the PRSP, in coordination with civil society and the international community, and also to deepen the pro-poor orientation of public expenditure.

30. **Despite the improved macroeconomic performance, the economy remains subject to a host of vulnerabilities that policy must continue to guard against**. First, the financial system remains highly dollarized and subject to rapid shifts in market sentiment. Second, the environment for private investment has been injected with uncertainties in the wake of the hydrocarbons law, which, if not diffused, could be highly detrimental to growth prospects. Third, the fiscal position is highly sensitive to the revenue/expenditure-sharing arrangements between the central government and the regions and municipalities. The staff therefore advises the authorities to remain vigilant over the financial system, address the impediments to further development of the hydrocarbons sector, and maintain over the medium term an adequate balance between revenue allocations and spending responsibilities at all levels of government.

31. **The staff believes that the program constitutes a critical counterweight to the economy's vulnerabilities**. The program seeks both to ensure macroeconomic stability and to support a continuation of structural reforms during the political transition, with a view to providing continuity and a framework for sound policy action by the successor government. Accordingly, the staff supports the authorities' request for completion of the sixth review, and their requests for waivers of nonobservance and applicability, and modification of performance criteria. In view of the reduced balance of payments need, and consistent with the proposed changes to the structural component of the program, the staff also supports the authorities' request for rephasing and reduction of access under the Stand-By Arrangement, and its treatment from now on as precautionary.

Table 1. Bolivia: Selected Economic and Financial Indicators, 2001-06

	2001	2002	2003	Prel. 2004	2005 Prog. 1/	2005 Proj.	Proj. 2006
				(Annual percentage change)			
Income and prices							
Real GDP	1.7	2.4	2.8	3.6	4.5	3.9	4.1
GDP deflator	0.7	2.7	5.1	11.1	4.0	8.5	4.1
CPI inflation (period average)	1.6	0.9	3.3	4.4	4.7	5.3	3.4
CPI inflation (end-of-period)	0.9	2.4	3.9	4.6	3.8	4.2	3.5
				(In percent of GDP)			
Combined public sector							
Revenues and grants	25.1	24.4	24.1	26.8	28.1	29.0	29.6
of which:							
Royalties on hydrocarbons	*2.6*	*2.3*	*2.8*	*3.4*	*3.7*	*5.4*	*6.7*
Expenditure	32.0	33.2	32.0	32.3	33.2	32.5	32.7
of which:							
Pension related	*4.7*	*4.9*	*4.7*	*4.3*	*4.9*	*4.1*	*3.9*
Interest payments	*2.6*	*2.6*	*2.8*	*2.9*	*3.0*	*2.9*	*2.6*
Overall balance	-6.8	-8.8	-7.9	-5.5	-5.2	-3.5	-3.0
Non-hydrocarbons balance	-9.4	-11.1	-10.7	-8.9	-9.1	-8.8	-9.7
Non-pension balance	-2.1	-3.9	-3.1	-1.3	-0.3	0.7	0.9
Total nominal debt	60.1	69.2	73.8	76.4	74.6	72.1	71.1
Total debt in NPV terms	43.8	44.8	53.0	54.6	57.6	53.7	53.8
	(In percent of broad money at the beginning of the period, unless otherwise stated)						
Money and credit							
NFA of the banking system	9.1	-10.8	3.2	3.6	3.0	14.0	6.2
NDA of the banking system	-11.1	0.7	-4.4	-5.3	6.1	-0.7	2.5
Credit to private sector	-15.2	-9.3	-4.9	-6.8	7.7	3.8	3.6
Broad money	-2.0	-10.1	-1.1	-1.6	9.1	13.3	8.7
Interest rates (percent, end-of-period)							
Yield on treasury bills in local currency	12.9	17.2	10.9	10.6	...	...	...
Yield on treasury bills in U.S. dollars	5.6	4.9	6.2	4.3	...	...	...
				(In millions of US dollars, unless otherwise stated)			
External sector							
Current cccount (percent of GDP)	-3.4	-4.1	0.6	3.2	1.7	2.1	1.5
Merchandise export (percent of GDP)	15.8	16.4	19.4	24.4	26.5	25.7	26.0
Merchandise import (percent of GDP)	20.9	22.3	19.9	21.0	23.8	23.4	24.3
Overall balance	-37	-293	77	160	37	230	60
Exceptional financing	9	17	16	13	3	0	0
Gross international reserves 2/	1,375	1,073	1,268	1,424	1,426	1,614	1,636
(In percent of broad money)	39.1	34.5	41.7	47.8	45.1	47.9	...
Exchange rates							
Bolivianos/U.S. dollar (end-of-period) 3/	6.81	7.48	7.82	8.04	...	...	...
REER, period average (percentage change)	0.0	-1.9	-12.4	-7.3	...	...	...
Memorandum item:							
Nominal GDP (in millions of Bs.)	53,790	56,818	61,959	69,626	73,003	78,497	85,027

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

1/ As in Country Report No. 05/146.
2/ Excludes reserves from the Latin American Reserve Fund (FLAR).
3/ Official (sell) exchange rate.

Table 2. Bolivia: Operations of the Combined Public Sector, 2001-06

	2001	2002	2003	Prel. 2004	2005 Prog. 1/	2005 Proj.	Proj. 2006
	(In millions of bolivianos)						
Revenue and grants	**13,520**	**13,890**	**14,928**	**18,661**	**20,510**	**22,785**	**25,188**
Current revenue	12,142	12,592	13,100	16,764	18,253	20,982	22,895
General government	11,706	12,229	13,059	16,493	18,109	20,578	22,660
Taxes	9,619	10,079	11,005	14,319	15,879	18,244	20,204
Hydrocarbons	2,719	2,610	2,831	3,480	4,870	6,082	7,608
Of which: Royalties and IDH	1,414	1,300	1,763	2,333	2,881	4,200	5,692
Other	6,901	7,469	8,174	10,839	11,010	12,162	12,596
Direct taxes	1,824	1,887	1,922	2,475	2,674	3,248	2,943
Indirect taxes	5,076	5,582	6,252	8,364	8,339	8,915	9,652
Of which: Financial transactions tax	...	...	...	318	621	630	592
Nontax revenue	2,087	2,149	2,054	2,175	2,229	2,334	2,456
Public enterprise operating balance	173	81	-80	70	7	230	30
Central bank operating balance	262	282	121	201	137	173	205
Capital revenue	78	19	31	152	0	28	0
Official grants	1,301	1,279	1,797	1,744	2,256	1,775	2,293
Of which: HIPC assistance from grants	524	495	544	550	574	653	448
Total spending	**17,189**	**18,871**	**19,803**	**22,520**	**24,272**	**25,513**	**27,772**
Current expenditure	10,157	11,318	11,854	13,190	14,097	15,284	16,055
Wages	4,672	5,058	5,615	6,264	6,610	6,645	7,125
Interest	1,399	1,471	1,743	2,038	2,198	2,315	2,172
Other	4,086	4,789	4,496	4,888	5,289	6,324	6,757
Pensions	2,539	2,779	2,935	2,981	3,336	3,245	3,355
Capital expenditure	4,493	4,775	5,014	6,349	6,839	6,984	8,362
Overall balance (deficit -)	**-3,668**	**-4,981**	**-4,875**	**-3,860**	**-3,763**	**-2,728**	**-2,584**
Financing	**3,668**	**4,981**	**4,875**	**3,860**	**3,763**	**2,728**	**2,584**
External	1,618	3,389	3,278	2,724	2,583	1,784	1,744
Domestic	2,050	1,592	1,597	1,136	1,180	944	841
Central bank	-270	935	-135	-561	0	-203	-231
Commercial banks	452	87	-115	216	0	-250	0
Other	1,868	570	1,847	1,481	1,180	1,397	1,072
Memorandum item:							
Overall balance before grants (deficit -)	-4,969	-6,260	-6,672	-5,604	-6,019	-4,503	-4,877
Primary deficit (-)	-2,269	-3,510	-3,132	-1,822	-1,565	-413	-412
Overall balance excluding hydrocarbons 2/	-5,082	-6,282	-6,638	-6,193	-6,644	-6,928	-8,276
Public Debt	32,346	39,297	45,718	53,223	54,460	56,585	60,464
Poverty Redcution Expenditures	6,509	7,159	7,559	8,634	9,198	...	...
GDP (In billions of bolivianos)	53.8	56.8	62.0	69.6	73.0	78.5	85.0

Table 2. Bolivia: Operations of the Combined Public Sector, 2001-06

	2001	2002	2003	Prel. 2004	2005 Prog. 3/	2005 Proj.	Proj. 2006
	(In percent of GDP)						
Revenue and Grants	**25.1**	**24.4**	**24.1**	**26.8**	**26.1**	**29.0**	**29.6**
Current revenue	22.6	22.2	21.1	24.1	23.3	26.7	26.9
General government	21.8	21.5	21.1	23.7	23.1	26.2	26.7
Taxes	17.9	17.7	17.8	20.6	20.2	23.2	23.8
Hydrocarbons	5.1	4.6	4.6	5.0	6.2	7.7	8.9
Of which: Royalties and IDH	2.6	2.3	2.8	3.4	3.7	5.4	6.7
Other	12.8	13.1	13.2	15.6	14.0	15.5	14.8
Direct taxes	3.4	3.3	3.1	3.6	3.4	4.1	3.5
Indirect taxes	9.4	9.8	10.1	12.0	10.6	11.4	11.4
Of which: Financial transactions tax	0.0	0.0	0.0	0.5	0.8	0.8	0.7
Nontax revenue	3.9	3.8	3.3	3.1	2.8	3.0	2.9
Public enterprise operating balance	0.3	0.1	-0.1	0.1	0.0	0.3	0.0
Central bank operating balance	0.5	0.5	0.2	0.3	0.2	0.2	0.2
Capital revenue	0.1	0.0	0.0	0.2	0.0	0.0	0.0
Official grants	2.4	2.3	2.9	2.5	2.9	2.3	2.7
Of which: HIPC assistance from grants	1.0	0.9	0.9	0.8	0.7	0.8	0.5
Total spending	**32.0**	**33.2**	**32.0**	**32.3**	**30.9**	**32.5**	**32.7**
Current expenditure	18.9	19.9	19.1	18.9	18.0	19.5	18.9
Wages	8.7	8.9	9.1	9.0	8.4	8.5	8.4
Interest	2.6	2.6	2.8	2.9	2.8	2.9	2.6
Other	7.6	8.4	7.3	7.0	6.7	8.1	7.9
Pensions	4.7	4.9	4.7	4.3	4.3	4.1	3.9
Capital expenditure	8.4	8.4	8.1	9.1	8.7	8.9	9.8
Overall balance	**-6.8**	**-8.8**	**-7.9**	**-5.5**	**-4.8**	**-3.5**	**-3.0**
Ratios to program GDP 4/	...	...	...	...	-5.2	-3.7	-3.3
Financing	**6.8**	**8.8**	**7.9**	**5.5**	**5.2**	**3.5**	**3.0**
External	3.0	6.0	5.3	3.9	3.5	2.3	2.1
Domestic	3.8	2.8	2.6	1.6	1.6	1.2	1.0
Central bank	-0.5	1.6	-0.2	-0.8	0.0	-0.3	-0.3
Commercial banks	0.8	0.2	-0.2	0.3	0.0	-0.3	0.0
Other	3.5	1.0	3.0	2.1	1.6	1.8	1.3
Memorandum items:							
Overall balance before grants	-9.2	-11.0	-10.8	-8.0	-7.7	-5.7	-5.7
Primary deficit (-)	-4.2	-6.2	-5.1	-2.6	-2.1	-0.5	-0.5
Overall balance excluding hydrocarbons 2/	-9.4	-11.1	-10.7	-8.9	-8.5	-8.8	-9.7
Balance without pensions	-2.1	-3.9	-3.1	-1.3	-0.5	0.7	0.9
Poverty reducing expenditure	12.1	12.6	12.2	12.4	12.6	12.6	...
Public Debt	60.1	69.2	73.8	76.4	74.6	72.1	71.1
GDP (in billions of Bolivianos)	53.8	56.8	62.0	69.6	78.5	78.5	85.0

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

1/ As in Country Report No. 05/146.

2/ Overall balance excluding royalty payments and IDH.

3/ Programs levels as in Country Report No. 05/146, as a ratio of revised GDP (78.5 billion).

4/ Ratios as calculated with the GDP series used in Country Report No. 05/146.

Table 3. Bolivia: Central Bank of Bolivia, 2001-06 1/

	2001	2002	2003	2004 3/	2005 2/ Prog. 4/	2005 2/ Proj.	Proj. 2006 5/
	(Flows in millions of Bolivianos unless otherwise stated)						
Net international reserves	-188	-1,936	718	1,112	331	1,875	489
(Flow in millions of U.S. dollars)	-29	-275	93	138	40	230	60
Net domestic assets	464	2,273	-231	-354	97	-765	76
Net credit to nonfinancial public sector	-270	935	-136	-561	0	-203	-232
Net credit to financial intermediaries	100	380	-187	-355	-114	-718	65
Of which: Open market operations (increase -)	161	163	-18	-294	-570	-507	-144
Medium- and long-term net foreign liabilities (increase -)	17	1,055	-32	873	8	8	8
(Flow in millions of U.S. dollars, increase -)	61	150	-4	109	1	1	1
Other	617	-96	124	-311	204	148	234
Currency issue	276	337	487	758	428	1,110	565
	(Stocks in millions of Bolivianos unless otherwise stated)						
Net international reserves	6,886	5,428	6,866	8,940	9,271	10,815	11,304
(Stock in millions of U.S. dollars)	1,046	772	888	1,097	1,137	1,327	1,387
Net domestic assets	-4,185	-2,391	-3,341	-4,657	-4,560	-5,422	-5,346
Net credit to nonfinancial public sector	296	1,706	2,112	1,780	1,780	1,576	1,345
Net credit to financial intermediaries	1,860	1,467	1,475	1,242	1,128	524	589
Of which: Open market operations (-)	-205	-71	-95	-394	-964	-902	-1,046
Medium- and long-term net foreign liabilities (-)	-2,544	-980	-1,064	-229	-221	-220	-213
Other	-3,798	-4,584	-5,864	-7,450	-7,246	-7,301	-7,067
Currency issue	2,700	3,037	3,525	4,283	4,711	5,393	5,958
	(Change in percent of currency issue at beginning of period)						
Net international reserves	-7.7	-71.7	23.6	31.6	7.6	43.8	9.1
Net domestic assets	19.1	84.2	-7.6	-10.0	2.4	-17.9	1.4
Net credit to nonfinancial public sector	-11.1	34.6	-4.5	-15.9	0.0	-4.8	-4.3
Net credit to financial intermediaries	4.1	14.1	-6.1	-10.1	-2.7	-16.8	1.2
Of which: Open market operations (increase -)	6.7	6.0	-0.6	-8.3	-13.3	-11.8	-2.7
Medium- and long-term net foreign liabilities (increase -)	16.6	39.1	-1.1	24.8	0.2	0.2	0.1
Other	9.6	-3.6	4.1	-8.8	4.9	3.5	4.3
Currency issue	11.4	12.5	16.0	21.5	10.0	25.9	10.5
Memorandum items							
Currency issue (average stock in percent of GDP)	3.9	4.1	4.4	4.6	5.4	5.2	...
NIR coverage of broad money (percent)	29.6	24.6	29.1	37.0	35.2	39.5	38.0

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

1/ Stocks and flows in foreign currency are valued at the accounting exchange rate for the corresponding period.
2/ At the beginning of 2005 Banco Los Andes was reclassified as a bank. This has led to a step increase in the levels of broad money and credit to the private sector in 2005.
3/ 2004 stocks are measured at the accounting exchange rate for 2005.
4/ As in Country Report No. 05/146.
5/ 2006 stocks are the sum of the end-2005 stock valued using the 2005 accounting exchange and the flow in 2006.

Table 4. Bolivia: Consolidated Commercial Banks, 2001-06 1/

	2001	2002	2003	2004 3/	2005 2/ Prog. 4/	2005 2/ Proj.	Proj. 2006 5/
	(Flows in millions of Bolivianos unless otherwise stated)						
Net short-term foreign assets	2,355	-730	54	-226	408	1,518	1,218
(Flow in millions of U.S. dollars)	358	-104	7	-28	50	186	150
Net domestic assets	-2,994	-1,940	-842	-860	1,340	564	637
Net credit to the public sector	452	87	-166	122	0	-251	0
Credit to the private sector	-3,606	-2,276	-1,162	-1,659	1,853	910	999
Medium- and long-term net foreign liabilities	202	334	105	-57	-253	-122	-81
(Flow in millions of U.S. dollars, increase -)	31	48	14	-7	-31	-15	-10
Other	-41	-85	381	734	-260	26	-280
Deposits	-639	-2,669	-788	-1,086	1,747	2,082	1,855
	(Stocks in millions of Bolivianos unless otherwise stated)						
Net short-term foreign assets	4,013	3,558	3,966	3,951	4,358	5,468	6,686
(Stock in millions of U.S. dollars)	610	506	513	492	535	673	823
Net domestic assets	16,744	15,824	16,392	16,295	17,635	16,859	17,496
Net credit to the public sector	1,311	1,483	1,459	1,686	1,686	1,435	1,435
Credit to the private sector	23,289	22,559	23,583	23,147	25,000	24,058	25,056
Medium- and long-term net foreign liabilities (-)	-855	-580	-532	-618	-871	-740	-821
Other	-7,002	-7,638	-8,117	-7,920	-8,180	-7,894	-8,174
Deposits	20,757	19,381	20,358	20,246	21,993	22,327	24,182
	(Change in percent of deposits at beginning of period)						
Net short-term foreign assets	11.0	-3.3	0.3	-1.1	2.0	7.5	5.5
Net domestic assets	-14.0	-8.8	-4.0	-4.1	6.6	2.8	2.9
Net credit to the public sector	2.1	0.4	-0.8	0.6	0.0	-1.2	0.0
Credit to the private sector	-16.9	-10.3	-5.5	-7.9	9.2	4.5	4.5
Medium- and long-term net foreign liabilities (-)	0.9	1.5	0.5	-0.3	-1.2	-0.6	-0.4
Other	-0.2	-0.4	1.8	3.5	-1.3	0.1	-1.3
Deposits	-3.0	-12.1	-3.7	-5.2	8.6	10.3	8.3
Memorandum items							
Credit to private sector (average stock in percent of GDP)	46.2	41.4	38.9	33.4	33.1	30.3	...
Bank liquid NFA coverage of deposits (percent)	23.9	23.7	22.9	24.3	25.6	30.2	...
Dollarization (end-period stocks)							
Foreign currency deposits 6/	92.2	91.9	90.6	86.5	84.0	83.4	...
Foreign currency credit 6/	97.1	97.5	97.8	96.2	95.9	95.4	...

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

1/ Stocks and flows in foreign currency are valued at the accounting exchange rate for the corresponding period.
2/ At the beginning of 2005 Banco Los Andes was reclassified as a bank.
This has led to a step increase in the levels of broad money and credit to the private sector in 2005.
3/ 2004 stocks are measured at the accounting exchange rate for 2005.
4/ As in Country Report No. 05/146.
5/ 2006 stocks are the sum of the end-2005 stock valued using the 2005 accounting exchange and the flow in 2006.
6/ Includes deposits and credits in Bolivianos that are indexed to the U.S. dollar.

Table 5. Bolivia: Monetary Survey, 2001-06 1/

	2001	2002	2003	2004 3/	2005 2/ Prog. 4/	2005 2/ Proj.	Proj. 2006 5/
	(Flows in millions of Bolivianos unless otherwise stated)						
Net short-term foreign assets	2,167	-2,666	772	886	734	3,392	1,705
(Flow in millions of U.S. dollars)	329	-379	100	110	90	416	210
Net domestic assets	-2,645	177	-1,040	-1,286	1,464	-172	680
Net credit to the public sector	182	1,022	-250	-345	0	-339	-232
Credit to the private sector	-3,606	-2,276	-1,162	-1,659	1,853	910	999
Medium- and long-term net foreign liabilities	357	1,158	139	811	-653	-225	-358
(Flow in millions of U.S. dollars, increase -)	54	165	18	101	-80	-28	-44
Other	422	273	234	-92	264	-519	271
Broad money 6/	-478	-2,489	-267	-400	2,198	3,220	2,385
	(Stocks in millions of Bolivianos unless otherwise stated)						
Net short-term foreign assets	10,899	8,986	10,831	12,891	13,624	16,283	17,988
(Stock in millions of U.S. dollars)	1,656	1,278	1,401	1,582	1,672	1,998	2,208
Net domestic assets	12,381	13,106	12,758	11,273	12,737	11,100	11,780
Net credit to the public sector	1,607	3,189	3,720	3,715	3,715	3,377	3,145
Credit to the private sector	23,289	22,559	23,583	23,147	25,000	24,058	25,056
Medium- and long-term net foreign liabilities (-)	-4,143	-3,088	-3,193	-2,535	-3,188	-2,760	-3,117
Other	-8,373	-9,554	-11,353	-13,055	-12,791	-13,575	-13,304
Broad money 6/	23,280	22,092	23,590	24,163	26,361	27,383	29,769
	(Change in percent of broad money at beginning of period)						
Net short-term foreign assets	9.1	-10.8	3.2	3.6	3.0	14.0	6.2
Net domestic assets	-11.1	0.7	-4.4	-5.3	6.1	-0.7	2.5
Net credit to the public sector	0.8	4.2	-1.0	-1.4	0.0	-1.4	-0.8
Credit to the private sector	-15.2	-9.3	-4.9	-6.8	7.7	3.8	3.6
Medium- and long-term net foreign liabilities (-)	1.5	4.7	0.6	3.3	-2.7	-0.9	-1.3
Other	1.8	1.1	1.0	-0.4	1.1	-2.1	1.0
Broad money 6/	-2.0	-10.1	-1.1	-1.6	9.1	13.3	8.7
Memorandum items							
Broad money (average stock in percent of GDP) 6/	43.0	38.2	37.1	32.3	33.9	31.5	...
Credit to private sector (average stock in percent of GDP)	46.2	41.4	38.9	33.4	33.1	30.7	...
Banking system liquid NFA coverage of deposits (percent)	54.2	46.7	53.0	65.1	66.6	77.9	...
	(In percent of total deposits/credit at current exchange rates)						
Dollarization (end-period stocks)							
Foreign currency deposits 7/	92.2	91.9	90.6	86.5	84.0	83.4	...
Foreign currency credit 7/	97.1	97.5	97.8	96.2	95.9	95.4	...

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

1/ Stocks and 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/ At the beginning of 2005 Banco Los Andes was reclassified as a bank.
This has led to a step increase in the levels of broad money and credit to the private sector in 2005.

3/ 2004 stocks are measured at the accounting exchange rate for 2005.

4/ As in Country Report No. 05/146.

5/ 2006 stocks are the sum of the end-2005 stock valued using the 2005 accounting exchange and the flow in 2006.

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

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

Table 6. Bolivia: Summary Balance of Payments, 2001-06

	2001	2002	2003	Prel. 2004	2005 Prog. 1/	2005 Proj.	Proj. 2006
	(In millions of U.S. dollars, unless otherwise noted)						
Current account	**-276**	**-324**	**46**	**285**	**150**	**205**	**160**
Trade balance	-423	-471	-36	302	246	227	176
Exports, f.o.b.	1,285	1,299	1,573	2,146	2,373	2,507	2,721
Of which: gas	234	266	381	620	870	893	1,002
Imports, c.i.f.	-1,708	-1,770	-1,609	-1,844	-2,128	-2,280	-2,544
Of which: exceptional imports	-153	-235	-92	-26	-110	-151	-175
Services (net)	-36	-18	-68	-76	-92	-95	-111
Income (net)	-210	-205	-302	-385	-432	-339	-351
Of which: interest due on external public sector debt	-115	-98	-106	-103	-113	-132	-125
Of which: investment income (net)	-165	-180	-231	-303	-350	-278	-301
Transfers (net)	393	369	452	444	428	411	445
Of which: HIPC assistance from grants	65	80	67	68	59	80	55
Capital and financial account (including E&O)	**239**	**32**	**31**	**-126**	**-113**	**25**	**-100**
Capital and financial account (excluding E&O)	339	721	174	244	197	95	78
Capital transfers	3	0	7	8	9	9	9
Direct investment (net)	666	674	195	114	167	154	169
Portfolio investment (net)	-23	-19	-68	-122	-120	-120	-100
Public sector loans	189	321	374	234	321	214	218
Disbursements	364	577	744	547	631	500	512
Amortization	-175	-256	-370	-313	-310	-286	-295
Banks' net foreign assets, excl. liquid asset requirement	-401	16	-124	3	-50	-114	-120
Nonbank private sector loans	-50	-34	111	66	-50	107	50
Other	-45	-236	-320	-59	-390	-154	-148
Errors and omissions	-100	-690	-143	-370	-310	-71	-178
Overall balance	**-37**	**-293**	**77**	**160**	**37**	**230**	**60**
Financing	**37**	**293**	**-77**	**-160**	**-37**	**-230**	**-60**
Exceptional financing	9	17	16	13	3	0	0
Of which: HIPC assistance from rescheduling	9	17	16	13	3	0	0
Net international reserves (increase -)	29	275	-93	-138	-40	-230	-60
	(Annual percentage change)						
Export volume growth	6.0	7.9	8.5	17.8	11.6	2.3	6.4
Import volume growth	-5.4	3.3	-10.1	10.4	13.1	18.3	12.9
Terms of trade change	-1.4	0.5	6.1	11.9	-1.1	8.7	2.8
	(In percent of GDP)						
Current account	-3.4	-4.1	0.6	3.2	1.7	2.1	1.5
Merchandise exports	15.8	16.4	19.4	24.4	26.5	25.7	26.0
Merchandise imports	-20.9	-22.3	-19.9	-21.0	-23.8	-23.4	-24.3
Memorandum Items:							
Gross official reserves (end-of-period)	1,116	854	1,057	1,212	1,215	1,402	1,425
(In months of imports of goods and services) 2/	7	5	5	5	5	5	6
GDP	8,154	7,936	8,100	8,784	8,950	9,751	10,471

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

1/ As in Country Report No. 05/146.
2/ In months of imports of goods and services in the following year.

Table 7. Bolivia: Medium-Term Macroeconomic Framework, 2004-10

	Prel.	2005		Proj.				
	2004	Prog. 1/	Proj.	2006	2007	2008	2009	2010
	(Annual percentage changes)							
Real Sector								
Real GDP growth	3.6	4.5	3.9	4.1	3.9	3.0	3.0	3.0
Growth in hydrocarbons production	23.8	38.6	14.9	7.1	0.0	0.0	0.0	0.0
CPI (period average)	4.4	4.7	5.3	3.4	3.1	3.0	3.0	3.0
CPI (end of period)	4.6	3.8	4.2	3.5	3.0	3.0	3.0	3.0
	(In percent of GDP)							
Public sector								
Total Revenue	26.8	28.1	29.0	29.6	29.2	28.8	28.3	28.0
Of which: Hydrocarbons 2/	3.4	3.9	5.4	6.7	6.3	5.9	5.5	5.2
Primary Expenditure	29.4	30.2	29.6	30.1	29.2	28.7	28.1	27.6
Primary deficit (-)	-2.6	-2.1	-0.5	-0.5	0.0	0.2	0.2	0.4
Interest	2.9	3.0	2.9	2.6	2.6	2.5	2.4	2.3
Overall balance	-5.5	-5.2	-3.5	-3.0	-2.6	-2.3	-2.2	-1.9
Of which: Pension-related balance	-4.3	-4.9	-4.1	-3.9	-3.7	-3.7	-3.7	-3.7
Net domestic financing	1.6	1.6	1.2	1.0	0.9	0.9	0.9	0.7
Net external financing	3.9	3.5	2.3	2.1	1.7	1.4	1.3	1.2
NFPS debt (nominal)	76.4	74.6	72.1	71.1	69.4	68.0	66.5	64.8
External sector								
Trade balance	3.4	2.7	2.3	1.7	1.7	1.8	1.2	0.8
Current account balance	3.2	1.7	2.1	1.5	1.1	1.0	0.1	-0.4
Gas exports	7.1	9.7	9.2	9.6	9.2	8.7	8.1	7.6
Net foreign direct investment	1.3	1.9	1.6	1.6	0.2	0.1	0.1	0.2
Net international reserves (in US$ million, increase +)	138	40	230	60	88	83	92	104
Monetary sector								
Broad money	32.3	33.9	33.9	32.9	33.3	33.5	33.5	33.5
Credit to the private sector	33.4	33.1	33.1	28.9	28.0	27.4	26.6	25.8
Credit to the public sector	...	...	4.6	3.9	3.3	2.9	2.5	2.1
Banking system NFA coverage of deposits	63.7	...	72.9	74.4	74.9	75.6	76.6	77.8
Memorandum item:								
GDP (US$ million)	8,784	8,954	9,751	10,471	11,209	11,879	12,607	13,367

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

1/ As in Country Report No. 05/146.
2/ Excluding excise taxes on fuel products.

Table 8. Bolivia: Schedule of Purchases Under the Stand-By Arrangement, 2005-06

Date	Amount in SDR millions	In percent of quota	Conditions
			I. Approved
2005	**43.96**	**25.63**	
March 31, 2005	9.66	5.63	Fifth review; and end-September 2004 performance criteria
August 15, 2005	17.15	10.00	Sixth review; and end-June 2005 performance criteria
November 15, 2005	17.15	10.00	Seventh review; and end-September 2005 performance criteria
2006	**25.72**	**15.00**	
February 15, 2006	25.72	15.00	Eighth review; and end-December 2005 performance criteria
March 15, 2006	0.00	0.00	
2005-2006	**69.68**	**40.63**	
			II. Proposed
2005	**26.80**	**15.63**	
March 31, 2005	9.66	5.63	Fifth review; and end-September 2004 performance criteria
August 15, 2005	0.00	0.00	
October 31, 2005	17.14	10.00	Sixth review; and end-June/September 2005 performance criteria
2006	**17.14**	**10.00**	
February 15, 2006	0.00	0.00	
March 15, 2006	17.14	10.00	Seventh review; and end-December 2005 performance criteria
2005-2006	**43.94**	**25.63**	

Source: Fund staff estimates.

Table 9. Bolivia: Indicators of Fund Credit, 2001-2009
(On an obligations basis)

					Projections				
	2001	2002	2003	2004	2005	2006	2007	2008	2009
Outstanding Fund credit									
In millions of SDRs	164.9	143.7	187.5	197.7	199.8	187.6	129.9	74.2	33.9
In percent of quota	96.1	83.8	109.3	115.3	116.5	109.4	75.8	43.3	19.8
In percent of GDP	2.6	2.3	3.2	3.3	3.0	2.6	1.7	0.9	0.4
In percent of exports of goods and services	13.8	11.9	14.0	11.5	10.1	8.7	6.2	3.5	1.6
Debt service due to the Fund									
In millions of SDRs	23.8	21.9	23.0	28.6	28.8	34.9	62.6	59.0	42.1
In millions of U.S. dollars	30.3	28.4	32.2	42.3	42.7	50.8	91.2	86.0	61.4
In percent of quota	13.9	12.8	13.4	16.6	16.8	20.4	36.5	34.4	24.5
In percent of exports of goods and services	2.0	1.8	1.7	1.7	1.5	1.6	3.0	2.7	1.9
In percent of gross service due	10.5	8.2	7.0	10.6	10.9	13.0	25.8	23.6	16.3
In percent of gross official reserves	2.7	3.3	3.0	3.5	3.5	3.6	6.2	5.2	3.5
Gross Fund financing									
In millions of U.S. dollars	24.2	0.0	89.9	55.6	39.7	25.0	0.0	0.0	0.0
In percent of Bolivia's gross financing needs 1/	2.5	0.0	6.8	10.0	5.3	4.0	0.0	0.0	0.0
Memorandum item:									
Quota (in millions of SDRs)	171.5	171.5	171.5	171.5	171.5	171.5	171.5	171.5	171.5

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

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

Table 10. Bolivia: Public Debt Sustainability Framework
(In percent of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Nominal GDP (in millions of US dollars)	8,784	9,752	10,471	11,217	11,890	12,617	13,375	14,193	15,054	15,948	16,898	17,860
Real GDP growth (percent)	3.6	3.9	4.1	3.9	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Fiscal deficit	-5.5	-3.5	-3.0	-2.6	-2.3	-2.2	-1.9	-1.7	-1.6	-1.4	-1.3	-1.2
Financing	5.5	3.5	3.0	2.6	2.3	2.2	1.9	1.7	1.6	1.4	1.3	1.1
Non debt financing	-0.8	-0.3	-0.3	-0.3	0.0	-0.1	0.0	0.0	-0.2	-0.2	-0.2	-0.3
Debt Financing	6.3	3.8	3.3	2.9	2.4	2.3	1.9	1.7	1.8	1.6	1.5	1.4
concessional	4.1	2.2	2.3	1.8	1.6	1.3	1.0	0.6	0.5	0.4	0.2	0.0
nonconcessional	2.3	1.5	1.1	1.1	0.8	1.0	0.9	1.1	1.2	1.1	1.3	1.4
NPV of non-financial public sector debt	55	54	54	53	52	51	50	48	47	46	45	44
external	32	32	32	32	31	31	30	30	29	28	28	27
internal	23	22	21	21	20	20	19	19	18	18	17	17
Exports of goods and services (in millions of US dollars)	2,546	2,916	3,150	3,065	3,130	3,170	3,240	3,322	3,428	3,534	3,643	3,763

Source: Bolivian authorities, and Fund staff estimates.

Table 11. Bolivia: Debt Sustainability Analysis - Stress Tests

		Est.	Projections										
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
NPV of Debt-to-GDP Ratio													
Baseline	53	55	54	54	53	52	51	50	48	47	46	45	44
Stress test scenarios													
A1. Lower oil prices 1/	53	55	54	54	54	54	53	53	53	52	52	51	51
A2. Higher level of non concessional financing 2/	53	55	54	54	53	52	52	51	50	50	49	48	47
A3. Higher interest rates on non-concessional borrowing 3/	53	55	54	54	54	54	53	53	52	52	52	51	51
A4. One time 30 percent devaluation in 2005	53	55	54	76	75	74	73	71	69	68	66	65	64
A5. Primary balance is unchanged starting 2005	53	55	54	54	53	53	53	52	52	52	52	53	53
NPV of Debt-to-Revenue Ratio													
Baseline	241	225	200	199	196	193	192	189	186	184	181	178	175
Stress test scenarios													
A1. Lower oil prices 1/	241	225	200	203	205	206	208	208	208	209	209	208	208
A2. Higher level of non concessional financing 2/	241	225	200	199	197	206	196	195	194	193	192	190	189
A3. Higher interest rates on non-concessional borrowing 3/	241	225	200	201	200	206	202	202	202	203	203	203	203
A4. One time 30 percent devaluation in 2005	241	225	200	284	279	206	275	271	267	264	260	257	253
A5. Primary balance is unchanged starting 2004	241	225	200	199	197	197	199	200	201	204	206	208	211
NPV of External Debt-to-Exports Ratio													
Baseline	140	109	106	108	116	119	123	125	126	127	129	130	130
Stress test scenarios													
A1. Lower oil prices 1/	140	109	106	112	125	128	133	135	136	137	138	139	140
A2. Higher level of non concessional financing 2/	140	109	106	106	111	110	110	108	107	106	105	104	104
A3. Higher interest rates on non-concessional borrowing 3/	140	109	106	108	116	119	123	125	126	127	129	130	130
A4. One time 30 percent devaluation in 2005	140	109	106	108	116	119	123	125	126	127	129	130	130
A5. Primary balance is unchanged starting 2004	140	114	106	108	116	119	123	125	126	127	129	130	130

Source: Bolivian authorites and Fund staff estimates.

1/ US$ 15 below baseline in 2006 and US$10 below thereafter.
2/ Reduction in grants and higher share of non concessional borrowing result in an increase in net non-concessional financing by 1.2 percent on average in 2007-2015.
3/ Assumes a 300 basis points increase in interest rates on nonconcessional external and domestic borrowing.

Table 12. Bolivia: Selected Vulnerability Indicators

	2001	2002	2003	2004 1/	2005 1/	Latest Observation
Key Economic and Market Indicators						
Real GDP growth (in percent)	1.7	2.4	2.8	3.6	3.9	Proj.
CPI inflation (period average, in percent)	1.6	0.9	3.3	4.4	5.3	Proj.
Short-term (ST) interest rate (in percent)	12.9	17.2	10.9	10.6	8.5	August
Exchange rate NC/US$ (end of period)	6.8	7.5	7.8	8.0	8.0	September
External Sector						
Exchange rate regime			Crawling peg			
Current account balance (percent of GDP)	-3.4	-4.1	0.6	3.2	2.1	Proj.
Net FDI inflows (percent of GDP)	8.2	8.5	2.4	1.3	1.6	Proj.
Exports (percentage change of US$ value, GNFS)	3.4	2.7	19.8	36.0	14.5	Proj.
Real effective exchange rate (1994 = 100)	111.3	110.1	93.1	87.1	89.2	Proj.
Gross international reserves (GIR) in US$ billion	1.1	0.9	1.1	1.2	1.4	Proj.
GIR in percent of ST debt at remaining maturity (RM)	...	104	126	183	240	Proj.
GIR in percent of ST debt at RM and banks' FX deposits.	30.3	25.6	32.8	42.6	49.6	Proj.
Net international reserves (NIR) in US$ billion	1.0	0.8	0.9	1.1	1.3	Proj.
Total gross external debt (ED) in percent of GDP 2/	36.1	42.4	73.7	66.8	63.4	Proj.
o/w ST external debt (original maturity, in percent of total ED)	8.3	10.5	6.7	4.9	3.9	Proj.
Total gross external debt in percent of exports of GNFS	246	267	319	230	212	Proj.
Public Sector (PS) 3/						
Overall balance (percent of GDP)	-6.8	-8.8	-7.9	-5.5	-3.5	Proj.
Primary balance (percent of GDP)	-4.2	-6.2	-5.1	-2.6	-0.5	Proj.
Gross PS financing requirement (in percent of GDP)	8.3	11.2	11.9	8.8	6.1	Proj.
Public sector gross debt (PSGD, in percent of GDP)	60.0	69.0	73.6	76.4	72.1	Proj.
Public sector net debt (in percent of GDP)	58.5	67.9	72.5	75.3	71.0	Proj.
Financial Sector (FS) 4/						
Capital adequacy ratio (in percent)	14.3	16.1	15.3	14.9	14.8	July
NPLs in percent of total loans	16.2	17.6	16.7	14.0	14.3	July
Provisions in percent of NPLs	63.7	63.7	74.0	84.3	73.7	July
Return on average assets (in percent)	-0.4	0.1	0.3	-0.1	0.2	July
Return on equity (in percent)	-4.1	0.6	2.7	-1.2	1.9	July
FX deposits held by residents (in percent of total deposits)	91.4	91.9	90.6	86.5	85.2	August
FX loans to residents (in percent of total loans)	97.0	97.4	97.8	96.0	94.5	August
Credit to private sector (percent change)	-13.4	-9.2	-4.7	-6.8	3.9	Proj.

Source: Bolivian authorities; and Fund staff extimates.

1/ Staff estimates, projections, or latest available observations as indicated in the last column.

2/ A break in the series occurs starting 2003 due to a new survey on private debt.

3/ Nonfinancial public sector.

4/ Financial sector excludes nonbank institutions.

BOLIVIA: FUND RELATIONS
(As of August 31, 2005)

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	268.78	156.72
Reserve position in Fund	8.87	5.17

III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	26.70	100.00
Holdings	25.96	97.23

IV. Outstanding Purchases and Loans:	SDR Million	Percent Quota
Stand-By Arrangements	106.14	61.89
PRGF arrangements	82.93	48.36

V. Latest Financial Arrangements:

Type of Arrangement	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	4/02/03	3/31/06	171.50	111.50
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 (Expectation Basis)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	18.48	60.84	60.78	32.01	10.14
Charges/Interest	1.23	3.66	1.97	0.67	0.11
Total	19.71	64.50	62.74	32.69	10.25

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

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	11.78	29.35	57.69	55.73	25.28
Charges/Interest	1.25	4.46	3.55	1.88	0.62
Total	13.03	33.81	61.25	57.61	25.90

VII. Implementation of HIPC Initiative:

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

VIII. **Safeguards Assessments:** Under the Fund's safeguards assessment policy, the Central Bank of Bolivia (CBB) was subject to an assessment with respect to the April 2, 2003 Stand-By Arrangement (SBA). A safeguards assessment was completed June 27, 2003, and while no systemic risks with the CBB's safeguards were identified, uncertainties were expressed about the de facto lack of operational independence and program monetary data. An update assessment was completed September 27, 2004 in conjunction with an augmentation of the SBA. This assessment confirmed that measures had been implemented to address all previously identified vulnerabilities, except for those requiring a change in the central bank law.

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. On September 30, 2004, the official selling rate was Bs 8.09 per U.S. dollar.

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[1] Assistance committed under the original framework is expressed in net present value (NPV) terms at completion point, and assistance committed under the enhanced framework is expressed in NPV terms at 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.

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	Modernization of customs administration and follow-up missions including	June 1999May 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
FAD	Tax Administration	August 2004
FAD	PSIA	October 2004
FAD	Decentralization and Public Expenditure Management	October 2004
MFD	Promote Use of Domestic Currency	October 2004
FAD	Public Expenditure Management: the budget process	April 2005

XII. **Resident Representative:** Mr. Simón Cueva, since September 2003.

La Paz, October 7, 2005

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

Dear Mr. de Rato:

1. Since the completion last April of the fifth review of our program supported by the Stand-By Arrangement (SBA), Bolivia has experienced far-reaching political developments, including the resignation of former President Mesa, the changeover to the current government led by President Rodríguez, congressional approval of a constitutional amendment enabling general elections next December, and a political agreement on a constitutional assembly and a referendum on regional autonomy to be held in mid-2006. Despite the complex social and regional factors involved, these developments unfolded strictly within the established political and institutional framework and economic stability has been maintained.

2. The government attaches paramount importance to the SBA-supported economic program. As detailed in the attached Memorandum on Economic and Financial Policies (MEFP), we have fully adhered to the agreed macroeconomic policies—having observed, with margins, all the end-June quantitative performance criteria. We also have met, or expect to have met, all end-September quantitative performance criteria. However, as of today, we have no final information on the combined public sector deficit and domestic financing outturns relative to their end-September 2005 quantitative performance criteria. We are therefore requesting waivers of applicability for those two performance criteria. We have also taken, as described in the MEFP, important structural reform actions in the fiscal and financial sector areas—including approval by Congress of the procedural requirements for appeals before the tax superintendency, an end-June 2005 performance criterion.

3. The revised 2005 budget law that was submitted to Congress as a prior action for the fifth review became inconsistent with the fiscal situation following approval, last May, of the new hydrocarbons law, which has substantially enhanced revenue. This, together with the emergence of the urgent political issues noted above, prevented Congress from approving a revised 2005 budget law by end-June, which constituted a performance criterion. However, we have recently submitted to Congress an updated law and are also strengthening the fiscal target beyond what would have been called for by the original program, with a corresponding modification in monetary targets. We are therefore requesting a waiver for the nonobservance of the end-June performance criterion.

4. The interim nature of the current government requires, as detailed in the MEFP, some scaling down and rephasing of certain structural reforms. In this context, we will refrain from submitting to Congress a comprehensive tax reform, an end-September structural benchmark,

although we will prepare a draft tax reform proposal for consideration by the next government. With respect to hydrocarbons policy, any potential review in light of developments under Law 3058 of May 17, 2005, would have to be undertaken by the next government.

5. On the basis of the policy developments, outlook, and proposed prior actions described in the MEFP, we hereby request completion of the sixth review under the SBA, contingent on observance of the quantitative performance criteria for end-September specified in Table 1 of the MEFP, but in respect of which we are requesting waivers of applicability of the performance criteria on the fiscal deficit and domestic financing of the combined public sector. At the same time, taking into account the stronger than anticipated balance of payments in 2005, and the above-noted reprofiling of structural policies, we propose that total access under the SBA be reduced by SDR 25.72 million (15 percent of quota), corresponding to the last purchase, as currently scheduled. We propose that the remaining amount of SDR 17.14 million (10 percent of quota), that would remain available under the SBA after the purchase associated with this sixth review, be rephased and linked to the next and final review, completion of which would be contingent on observance of the performance criteria for end-December 2005 specified in Tables 1 and 2 of the MEFP. Moreover, we intend to treat the arrangement as precautionary. The discussions for the final review would provide an opportunity for the next government to outline its medium-term economic policies and poverty reduction strategy, including its intentions regarding relations with the Fund, as well as the potential implications for Bolivia of the G-8 debt cancellation initiative.

6. We are confident that the policies set forth in the MEFP are adequate to achieve the objectives of the program, and will take any further measures that may become necessary for this purpose. We would consult with the Fund on the adoption of these measures in accordance with the Fund's policies on such consultations.

Sincerely yours,

/s/	/s/
Waldo Gutiérrez	Juan Antonio Morales
Minister of Finance	President, Central Bank of Bolivia

Attachments:
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES

October 7, 2005

1. **The government of Bolivia has held discussions with the Fund staff in the context of the sixth program review under the stand-by arrangement**. The discussions covered: (i) developments under the economic program for 2005 specified in our Memorandum of March 24, 2005; (ii) the macroeconomic outlook for the remainder of the year; (iii) an outline of the macroeconomic framework for 2006; (iv) structural policies; and (v) the medium term outlook

I. DEVELOPMENTS UNDER THE 2005 PROGRAM

2. **Despite the major political developments, macroeconomic stability has been maintained and overall performance in 2005 has been positive**. Buoyed by the hydrocarbons sector, economic growth remained strong during the first half of the year. Temporary supply disruptions associated with road blockades led to an increase in inflation in May-June, which has since been partially reversed. The trade surplus in the first semester of 2005 was broadly in line with program projections. All end-June quantitative performance criteria were observed (Table 1). In particular, the fiscal deficit was smaller than programmed and the NIR target was met with a large margin. While we do not yet have final information on fiscal deficit and domestic financing outturns for end-September, we have met, or expect to have met, all end-September 2005 quantitative performance criteria with margins.

3. **The combined public sector recorded an overall surplus of 0.4 percent of GDP during the first seven months, reflecting both higher hydrocarbon revenues and lower spending**. There has been a large increase in revenue, related to strong gas exports and the changed regime for the hydrocarbons sector, including the introduction of a new tax—the Impuesto Directo a los Hidrocarburos (IDH). The revenue increase, which also reflected improvements in tax administration, more than compensated for a decline in external grants. Spending, on the other hand, has been significantly constrained thus far, in large measure reflecting slower-than-projected execution of capital projects. The events leading up to the changeover to the current government contributed to the low implementation rate, with corresponding delays in loan disbursements.

4. **We have taken monetary and exchange rate policy actions consistent with achieving low inflation and accumulating foreign exchange reserves**. In May/June, we were faced with pressures on the reserve position associated with deposit withdrawals triggered by the political crisis. In response, the central bank raised repo rates (the rates at which it provides liquidity) by over 100 basis points. Following the assumption of the interim government and the agreement on general elections, there has been a marked shift in sentiment. Financial system deposits have recovered from the sharp drop in June and the related liquidity assistance provided to banks has been fully repaid. The net liquid foreign assets of the financial system have increased significantly, including a substantial strengthening of central bank reserves, which are now much higher than programmed. The related monetary impact has been matched, to a large extent, by renewed demand for local currency, as evidenced by significant sales of foreign currency to the central bank.

Nonetheless, in order to forestall possible inflationary pressures, the central bank has placed increasing amounts of local currency paper—which, given the increased preference for local currency, has been achieved with declining interest rates.

5. **On the exchange rate front, we have maintained the bilateral rate virtually unchanged against the U.S. dollar**. This has implied a highly competitive real effective exchange rate, given the appreciation of major regional currencies. In mid-July, we marginally appreciated the Boliviano against the U.S. dollar under the crawling peg, and widened the buy-sell spread, which has been reflected in increased activity in the interbank foreign exchange market. A small additional appreciation was implemented in mid-September.

6. **With respect to debt management, we have taken advantage of the favorable market conditions to improve the currency composition and lengthen the maturity of domestic debt**. Specifically, in our open market operations, we have increased the share of local currency treasury paper by over 20 percentage points since end-2004. Moreover, despite the bunching of maturing treasury bills in the third quarter, we also managed to meet our placement targets and tripled the average maturity of newly issued treasury paper to over three years. The infrastructure of our debt management has been enhanced by the introduction of a new electronic auction system that has improved market transparency and information sharing.

7. **The balance of payments has been substantially stronger than programmed**. With exports benefiting from high energy and metals prices, the current account surplus has been broadly in line with the program, despite supply disruptions in the first half of the year. The capital and financial account has recorded a higher-than-projected surplus, despite a shortfall in disbursements of external loans for public investment projects. This was associated in part with increased demand for Bolivianos and direct foreign investment in the mining sector. Overall, as noted above, these trends have resulted in a higher-than-programmed level of international reserves.

II. UPDATED MACROECONOMIC POLICY FRAMEWORK FOR 2005

8. **We now project, for the year as a whole, somewhat lower growth and higher inflation, and a substantially stronger balance of payments, relative to the program**. Despite reduced economic activity in the second quarter, we still expect growth to increase from 3.6 percent in 2004 to about 4 percent in 2005, underpinned by a still considerable growth in hydrocarbons output. Twelve-month inflation is projected at 4.2 percent, compared with the June peak of 6.4 percent. The overrun vis-à-vis the program inflation target of 3.8 percent is associated, in part, with the depreciation of the Boliviano vis-à-vis regional currencies. The new hydrocarbons taxation regime will bring in higher fiscal revenues in 2005, savings from which will contribute to a lower-than-programmed fiscal deficit. In the financial system, deposits and NIR are expected to maintain the gains recorded thus far.

A. Fiscal Policy

9. **We expect that the fiscal deficit will continue its declining trend from the peak of nearly 9 percent of GDP in 2002 to 3.5 percent of GDP in 2005**. While we expect a recovery in the execution rate of investment projects in the remainder of the year, the fiscal deficit should remain well within the limit established at the time of the fifth review of the program. We have sent a revised budget to Congress, which will allow us to increase the implementation rate of infrastructure and social projects, thereby using a share of the new hydrocarbons tax revenue and promoting a recovery in the disbursement of external project loans, with particular attention to pro-poor initiatives. In addition, current spending will also increase due to higher fuel subsidies and transfers to a low-income housing program. Nevertheless, in light of the surplus recorded in the first seven months, hydrocarbons revenues not contemplated in the program, and lower-than-programmed pension payments, we expect that the fiscal deficit in 2005 will amount to at most Bs 2,728 million (3.5 percent of GDP, i.e., 2 percent of GDP lower-than-programmed before grants), compared with the original program target of Bs 3,763 million (4.8 percent of GDP).[1] Thus, we propose a corresponding downward adjustment to the end-December 2005 ceiling on the deficit of the combined public sector (Table 1).

B. Monetary and Exchange Rate Policy

10. **The gains made thus far in strengthening international reserves have positioned us better to handle vulnerabilities, including those associated with political uncertainties**. Accordingly, in the period ahead, monetary and exchange rate policy will be geared towards maintaining those gains while further reducing inflation. In this context, we will take action as needed to reduce the 12-month growth in currency issue from the high of over 30 percent in June to 26 percent by December 2005, and will maintain the exchange rate under review. Given developments thus far, we are now projecting a US$230 million increase in NIR during 2005, compared with the programmed increase of US$40 million. This would be consistent with an increase in financial system liquid foreign asset coverage of deposits to around 54 percent. Taking into account the revised projection, but also the potential need for a margin (given the experience with deposit withdrawals around the time of previous elections), we propose to raise the end-December program floor on the increase in NIR only partially—to US$135 million, the mid-point between the original target and the current projection (Table 1). Finally, we intend to make further progress in improving the currency composition and maturity structure of domestic debt.

III. Preliminary Macroeconomic Framework for 2006

11. **We envisage for 2006 real GDP growth in the range of 4–4½ percent, lower inflation, and a further reduction of financial sector vulnerabilities**. Achievement of the growth objective is predicated on an acceleration of growth in the mining and

[1] These ratios are based on a revised GDP. In relation to the programmed GDP, the corresponding ratios are 3.7 and 5.2 percent, respectively.

construction sectors, reflecting large ongoing mining investments, and higher capacity utilization in the hydrocarbons sector. Lower inflation will be facilitated by prudent management of the revenue windfall from the hydrocarbons sector, some of which will again be saved to reduce the fiscal deficit and avoid creating expenditure rigidities for the medium term. The proposed fiscal stance and competitive exchange rate, together with strong prices for hydrocarbons products and metals, will help maintain external current account and overall balance of payments surpluses. Thus, we expect a further increase in the reserve coverage of financial sector deposits.

12. **We intend to submit to Congress, prior to the Executive Board meeting, a 2006 budget that will raise infrastructure and social capital spending while providing for a further reduction in the fiscal deficit**. The main elements of the budget proposal will be:

- ***Tax revenue***. An increase in public sector revenue by 0.3 percent of GDP, including 1 percent of GDP in hydrocarbon revenues. The revenue projection includes the elimination of the financial transactions tax (FTT) on local currency sight deposits. The FTT on foreign currency sight and savings deposits will be maintained at the current rate as part of our efforts to promote de-dollarization.

- ***Expenditure***. The budget proposal incorporates a 1½ percent of GDP increase in public investment relative to the projected 2005 level. We will continue to contain current spending in relation to GDP, including the wage bill, and expect a further reduction in pension costs.

- ***Deficit***. The limit on the deficit of the combined public sector authorized in the government's proposal will be equivalent to 3.7 percent of GDP. This is consistent—based on the Fund staff's revenue projection and assuming an implementation rate of 93 percent[2] of the investment budget—with a projected fiscal deficit of 3 percent of GDP. We expect that the 2006 budget will be approved by Congress or on a lapse-of-time basis by end-December 2005, and we request that such approval be converted into a structural benchmark (currently an end-December PC).

IV. STRUCTURAL POLICIES

13. **Despite the unexpected political changeover, and the interim nature of the current administration, we have made significant progress in implementing the structural actions envisaged in the program**. In the fiscal area, Congress elevated to law the new tax code procedures. In the financial sector, provisioning and reserve requirements were tightened and Congress approved a law setting up the Financial Restructuring Fund (FRF) and enhancing the autonomy of the banking superintendency and the central bank.

[2] The average of the last six years, excluding the highest and lowest observations.

14. **With respect to hydrocarbons policy, Congress enacted a new law in May, which the current administration has moved on to implement and regulate as mandated, including as regards the tax-related provisions**. Given the far-reaching changes introduced, the altered energy price outlook, and the ongoing contacts with oil companies on the implementing regulations, the impact of the new law still needs to be fully assessed. Hence, no further legislative adjustments are contemplated at this stage and any potential review of hydrocarbons policy would need to be conducted by the next government.

15. **Looking ahead, we intend to make significant additional progress within our mandate**. As detailed in Table 2, some scaling down and rephasing of structural actions relative to the original program is proposed under the circumstances. In sum, we are in a position to advance as follows:

Fiscal reforms

- ***Budget framework***. Prior to the Executive Board meeting, we will submit to Congress a draft Budget Framework Law aimed at enhancing the budget process at all levels of government. The enhancements are all of a technical nature and consistent with any degree of fiscal decentralization or regional autonomy.

- ***Expenditure and debt management***. In the context of our broader program to register all public sector employees and pensioners, we expect to complete, by end-December 2005, 50 percent of the registry on health and education sector employment, as well as the implementation of a registry system on subnational debt for nine regional governments (prefecturas) and 17 municipalities (benchmark).

- ***Tax reform***. Submission/approval of a broad tax reform package (currently with corresponding end-September/end-October benchmarks) is not advisable during the current administration in view of the need for such a reform to be fully owned by the next government. Nonetheless, with a view to expediting the process, we will prepare a draft tax reform bill for consideration by the new government, taking into account technical assistance recommendations received from the Fund's Fiscal Affairs Department. The proposal will include, inter alia, the introduction of a personal income tax that would exempt about 80 percent of the population, and will be at least revenue neutral and anchored on the objectives of equity and efficiency. We plan to finalize our draft proposal by end-December (benchmark).

Financial sector reforms

- ***Deposit insurance***. Prior to the Executive Board meeting, we will submit to Congress a draft law introducing a partial coverage deposit insurance scheme with adequate contributions by financial institutions, to strengthen depositor protection in the context of bank liquidation and resolution procedures.

- ***Corporate restructuring and bankruptcy***. The lack of an appropriate corporate restructuring and bankruptcy framework compounds the vulnerabilities in Bolivia's financial system. By end-December, we plan to submit to Congress draft legislation to improve the corporate restructuring and bankruptcy framework (benchmark).

- ***Privatization***. By end-year, we plan to sell the remainder of the state's assets in banks where the public sector holds a majority ownership (performance criterion).

V. Medium-Term Outlook

16. **We believe our medium-term fiscal prospects have improved since the discussions with the Fund staff for the fifth program review in early 2005**. The combination of higher hydrocarbons taxation, stronger international commodity prices, and the tax reform to be proposed, would boost fiscal revenue over the medium-term, despite the current uncertainties regarding investment in the hydrocarbons sector. The enlarged revenue envelope will allow a further reduction in the fiscal deficit, and hence a more rapid reduction in the debt ratio than previously projected, without undermining Bolivia's poverty-reduction and growth-enhancing efforts. To facilitate the formulation of a poverty-reduction strategy by the next government, we are coordinating with the international community with a view to consolidating the conclusions of the National Dialogue completed in December 2004, which we intend to publish. Finally, we look forward to the implementation of the G-8 debt relief initiative, which should further enhance Bolivia's medium-term economic outlook.

Table 1. Bolivia: Quantitative Performance Criteria Under the SBA, 2005 1/

			December	
	Jun.	Sep.	Prog. 2/	Proposed
(Cumulative flows from December 31, 2004, in millions of bolivianos)				
Deficit of the combined public sector 3/				
Unadjusted limit	1,351	2,123	3,763	2,728
Adjusted limit	1,241			
Actual--projected	436			
Margin	805			
Net domestic financing of the combined public sector 4/				
Unadjusted limit	122	347	1,174	1,174
Adjusted limit	622			
Actual--projected	-64			
Margin	686			
Central Bank net credit to the NPFS				
Unadjusted limit	-391	-298	137	-30
Adjusted limit	-391	-298		
Actual--projected	-608	-1,206		
Margin	217	908		
Net domestic assets of the central bank 5/				
Unadjusted limit	-168	-106	102	10
Adjusted limit	-209	51		
Actual--projected 4/	-451	-1,498		
Margin	242	1,549		
(Cumulative flows from December 31, 2004, in millions of US dollars)				
Net international reserves of the central bank 6/				
Target	-43	-21	40	135
Adjusted target	-38	-40		
Actual--projected 4/	26	220		
Margin	64	260		
Net nonconcessional external debt 7/				
Limit	13	23	14	14
Adjusted limit	13	17		
Actual--projected	8	-13		
Margin	5	29		
External debt with maturities up to one year				
Limit	25	25	25	25
Actual--projected	24	0		
Margin	1	25		

Table 1. Bolivia: Quantitative Performance Criteria Under the SBA, 2005 1/

	Jun.	Sept.	December Prog. 2/	December Proposed
(Cumulative flows from December 31, 2004, in millions of US dollars)				
Adjuster to the nonconcessional external debt limit for financial and corporate restructuring				
WB and CAF nonconcessional financing for financial and corporate restructuring				
Program baseline	1	8	10	6
Actual	1	1		
Adjuster to the net domestic financing of the NFPS				
Net external financing of the NFPS 8/				
Program baseline	128	188	273	180
Actual	42			
Adjuster for the deficit of the CPS				
Financing through HIPC and beyond-HIPC debt relief (program) 9/				
Program baseline	23	30	45	40
Actual	20			
External financing for social spending				
Program baseline	0	0	0	0
Actual	0			
Projected program grants				
Program baseline	4	4	45	45
Actual	3			
Projected concessional program loans				
Program baseline	34	34	54	54
Actual	1			
Tax Revenues				
Program baseline	966	1,459	1,948	n.a.
Actual	999			
Adjuster for NDA of the BCB				
Overdue obligations to foreign official creditors				
Program baseline	0	0	0	0
Actual	0			
Adjuster for NIR of the BCB				
Increase in foreign currency financial system deposits in the BCB	5	-19		
(Cumulative flows from December 31, 2004, in millions bolivianos)				
Adjustment to limit on domestic financing of combined public sector				
Maximum adjustment in the program	500	500	500	500
Actual shortfall	707			
Adjustor for NDA of the BCB				
Decrease in foreign currency financial system deposits in the BCB	-41	157		
Adjuster for NIR on currency issue				
Currency issue (program)	-518	-277	428	1,110
Maximum adjustment to NIR target	25	50	75	75

Source: Data provided by the Bolivian authorities.

1/ Definitions of the targets and adjusters as in the TMU attached.
2/ as in Country Report No. 05/146
3/ The limits on the deficit of the combined public sector will be adjusted downward by the difference between actual and projected program grants. They will be adjusted downward (upward) by the amount of the shortfall (excess) between actual and projected HIPC debt relief.
4/ The limits on the net domestic financing of the NFPS will be adjusted upward by the difference between projected and actual net external financing to the 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.
5/ The limits on the NDA of the BCB will be adjusted downward by the amount of any overdue obligations to foreign official creditors. The ceiling will be adjusted for the flow of the Central Bank financial system foreign currency deposits.
6/ The ceiling on NIR will be adjusted upwards by the amount of any overdue obligations to foreign official creditors and adjusted downward by shortfalls relative to the projected currency issue, up to the designated ceiling. The ceiling will be adjusted for the flow of the Central Bank financial system foreign currency deposits.
7/ The limit is reduced by shortfalls between actual and projected disbursements of loans for financial and corporate restructuring.
8/ Does not include the HIPC debt relief through rescheduling or the amortization component of stock of debt reduction operations.
9/ Comprises refinancing and the amortization component of stock of total public debt reduction operations under HIPC.

Table 2. Bolivia: Structural Conditionality for the Sixth and Seventh Reviews Under the Stand-By Arrangement

Condition	Measure	Date	Status/Proposal
	Fiscal Area		
Benchmark	Approval by Congress of a Hydrocarbons Law and its regulations, which should provide an appropriate framework for developing the large hydrocarbon reserves.	June 30, 2005	Not observed. *No further legislative adjustments contemplated at this stage.*
Performance Criterion	Passage of a revised budget law for 2005 with spending levels consistent with staff's revenue projections and the program deficit target after grants of the combined public sector of 5.2 percent of GDP.	June 30, 2005	Breached. *Grant waiver.*
Performance Criterion	Approval by Congress of the law regulating the procedural requirements of the recursos de alzada and jerárquico before the Tax Superintendency.	June 30, 2005	Observed.
Benchmark	With Fund technical assistance, submit to Congress an Organic Budget Law that sets hard budget constraints on all levels of government guided by the principles of budget unity, transparency, comprehensiveness, and appropriations determined by Congress.	June 30, 2005	Not observed. *Modify and convert into prior action for sixth review.*
Proposed prior action for sixth review	*Submission to Congress of a Budget Framework Law that sets hard budget constraints on all levels of government guided by the principles of budget unity, transparency, comprehensiveness, and appropriations determined by Congress.*	--	
Benchmark	Submission to Congress of a comprehensive tax reform, including the introduction of a personal income tax, which will exempt 80 percent of the population.	September 30, 2005.	*Modify benchmark.*
Benchmark	Approval by Congress of a comprehensive tax reform including the introduction of a personal income tax, which will exempt 80 percent of the population.	October 31, 2005	*Modify benchmark.*
Proposed modified benchmark	*Preparation of draft bill for consideration by the next government on a tax reform that is at least revenue neutral, including the introduction of a personal income tax, which would exempt about 80 percent of the population.*	*December 31, 2005*	

Condition	Measure	Date	Status/Proposal
Benchmark	Complete a comprehensive survey and setup a registry on health and education sector employment, as well as an audit on sub-national debt, including floating debt, based on FAD TA.	September 30, 2005	Progress made on setting-up a registry. *Modify and reschedule to December 31, 2005.*
Proposed modified benchmark	*Complete 50 percent of the registry on health and education sector employment, as well as the implementation of a registry system on subnational debt for nine regional governments (prefecturas) and 17 municipalities.*	*December 31, 2005*	
Benchmark	Submission to Congress of a 2006 budget with spending levels consistent with staff's revenue projections and a deficit target after grants for the combined public sector of 4.1 percent of GDP.	October 31, 2005	*Modify and convert into prior action for sixth review.*
Proposed prior action for sixth review	*Submission to Congress of a budget law for 2006 with a deficit after grants of 3.7 percent of GDP. The budget proposal will be consistent with a projected deficit after grants of the combined public sector equivalent to 3 percent of GDP, based on Fund staff revenue projections and assuming a 93 percent implementation rate of the investment budget.*	--	
Benchmark	Approval by Congress of an Organic Budget Law that sets hard budget constraints on all levels of government guided by the principles of budget unity, transparency, comprehensiveness, and appropriations determined by Congress.	October 31, 2005	*Modify benchmark.*
Proposed modified benchmark.	*Approval by Congress of a Budget Framework Law that sets hard budget constraints on all levels of government guided by the principles of budget unity, transparency, comprehensiveness, and appropriations determined by Congress.*	*December 31, 2005*	
Performance Criterion	Passage of the 2006 budget law with spending levels consistent with staff's revenue projections and a deficit target after grants for the combined public sector of 4.1 percent of GDP.	December 31, 2005	*Modify and convert into benchmark.*
Proposed benchmark	*Congressional approval, or enactment on a lapse-of-time basis, of a budget law for 2006 with a deficit after grants of 3.7 percent of GDP. The budget will be consistent with a projected deficit after grants of the combined public sector equivalent to 3 percent of GDP, based on Fund staff revenue projections and assuming a 93 percent implementation rate of the investment budget.*	*December 31, 2005*	

Condition	Measure	Date	Status/Proposal
	Financial and Corporate Sectors		
Benchmark	Submit a draft law creating a deposit insurance scheme with partial deposit coverage and establishing its proper functioning.	September 30, 2005	*Convert into prior action for sixth review.*
Benchmark	Submit to Congress draft legislation to improve the corporate restructuring and bankruptcy framework, including through enhanced protection of creditor rights.	September 30, 2005	*Reschedule to December 31, 2005.*
Performance Criterion	Sale and transfer on final basis of the ownership of the state's participation in banks majority-owned by Nafibo.	December 31, 2005	*Maintain PC.*

BOLIVIA—TECHNICAL MEMORANDUM OF UNDERSTANDING

September 16, 2005

1. **This memorandum consolidates the original (March 2003) Technical Memorandum of Understanding (TMU) under the Stand-By Arrangement with the various changes introduced in the context of the five previous reviews**. It presents the definitions of the macroeconomic variables subject to quantitative performance criteria under the SBA-supported program, the related adjusters, and reporting requirements. No changes are being introduced in the context of the sixth review, except for a re-specification of quantitative performance criteria for end-December 2005 (Table 1 of the MEFP), minor clarifications and updates, and the suppression of previous requirements that are no longer applicable.

I. QUANTITATIVE PERFORMANCE CRITERIA

2. **Quantitative performance criteria are set with respect to**: (a) the deficit of the combined public sector (CPS); (b) net domestic financing of the CPS; (c) Central Bank of Bolivia (BCB) net credit to the nonfinancial public sector (NFPS); (d) net nonconcessional external debt of the public sector; (e) external debt of the public sector with maturities up to one year; (f) the change in the net international reserves (NIR) of the BCB; and (g) the change in the net domestic assets (NDA) of the BCB.

a. **The deficit of the CPS** is the sum of the net external financing of the NFPS and the net domestic financing of the CPS, where the CPS is defined to include the operations of the NFPS and the proceeds from the operating balance of the BCB.

- **The NFPS** comprises: (i) the general government (central administration, public sector social security, prefectures, municipalities, and other decentralized agencies); and (ii) the nonfinancial public enterprises.

- **The net external financing** of the NFPS comprises: (i) external disbursements to the NFPS; (ii) total HIPC debt relief from refinancing operations; (iii) net disbursements of funds for the NFPS administered by the BCB as trust funds; and (iv) unpaid current interest obligations; less (v) amortization due by the NFPS after HIPC debt relief for the amortization component of the stock of debt reduction operations; (vi) net payments in settlement of the external arrears of the NFPS; and (vii) shareholder contributions to the Corporación Andina de Fomento (CAF).

- **HIPC debt relief** includes that provided under the original and enhanced initiatives from the reduction in amortization arising from stock of debt reduction operations and rescheduling. It also includes beyond HIPC relief, i.e. debt relief granted by HIPC creditors beyond that agreed within the enhanced HIPC framework.

b. **The net domestic financing of the CPS** is the sum of: (i) the increase in the net claims of the domestic financial system on the NFPS (excluding deposits in the

BCB related to foreign loans administered as trust funds); (ii) the cash operating results of the BCB (before distribution to the treasury's account, with negative sign); (iii) the change in the NFPS liabilities to the private sector in the form of fiscal certificates; (iv) the increase in the domestic floating debt of the NFPS; and (v) all domestic borrowing by the NFPS, including net disbursements to the NFPS related to any new domestic debt instruments issued by the government and held outside the NFPS. Valuation changes (due to changes in inflation) in the stock of domestic debt denominated in inflation-indexed units (UFVs) are excluded from the computation of net domestic financing of the CPS.

- **The cash operating result of the BCB** is calculated as the sum of (i) interest on deposits abroad; (ii) earnings on the BCB portfolio with the NFPS and the financial system; (iii) interest payments by the treasury on government paper held by the BCB; (iv) interest on LAIA accounts; (v) commissions and realized foreign exchange gains; and (vi) other current receipts, excluding any sale of fixed assets, including gold; minus current payments to: (i) the IMF, excluding repurchases and SAF, ESAF and PRGF loan repayments; (ii) other international organizations, excluding amortization and interest on loans administered by the BCB as trust funds for the NFPS; (iii) the domestic financial institutions on account of reserve requirements; (iv) interest on certificates of deposit and treasury bills B and D; and (v) administrative and other current expenditures. In consolidating the BCB cash operating result with the NFPS accounts, transfers to the treasury out of operating profits will be excluded from expenditure.

- **The domestic floating debt of the NFPS** comprises the liabilities incurred for goods and services received but not yet paid for, excluding claims on and liabilities to other entities within the NFPS. The floating debt with respect to public sector wages at the end of each month includes: (i) unpaid wage increases; and (ii) wages for work performed in a previous month but not yet paid. Floating debt includes the floating debt of the departmental capitals, El Alto, and those municipalities having subscribed an adjustment program (PRF) with the government as of December 31, 2002.

c. **BCB net credit to the NFPS** is defined as the BCB's gross credit to the Treasury (including emergency and liquidity assistance, and any holdings of treasury bills and bonds by the BCB) minus the deposits of all NFPS entities with the BCB. It excludes net disbursements of foreign loans administered by the BCB as trust funds for the NFPS.

d. **The nonconcessional external debt of the public sector** is defined as the outstanding external debt of the public sector, excluding: (i) concessional loans with a grant element—based on the interest rate and repayment schedule of each loan and any grants or other external concessional loans in connection to the loan in question—of at least 35 percent using the OECD commercial interest reference rates as of August 15, 2005; (ii) changes in BCB liabilities included in the definition of NIR; (iii) debt reprogrammed with official creditors; (iv) the use of Fund resources; and (v) the effect of any stock-of-debt operations under the enhanced HIPC Initiative or beyond-HIPC relief.

- **The public sector** is defined to include: (i) the NFPS; and (ii) the Central Bank of Bolivia (BCB) and other financial public sector entities, including NAFIBO and FONDESIF.

- **External debt** has the meaning set forth in point No. 9 of the Fund's Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000, and will include any public debt instruments held by foreign official institutions.

- **External debt** will be valued at the end–2004 U.S. dollar exchange rates of 0.73351 Euro = US$1,104.12 Japanese yen = US$1, and for other currencies according to the corresponding end–2004 exchange rates published in the IMF's International Financial Statistics.

e. **The external debt of the public sector with maturities up to one year** excludes: (i) normal import credits; (ii) reserve liabilities of the central bank; and (iii) the use of Fund resources.

f. **NIR of the BCB is defined as:** (i) BCB liquid foreign assets; <u>less</u>: (ii) BCB liabilities to nonresidents (including swaps and the net position under the Latin American Integration Association, LAIA, clearing mechanism) with an original maturity of at most one year; (iii) outstanding purchases and disbursements from the Fund (excluding disbursements from the trust fund); and (iv) BCB net liabilities to the Latin American Reserve Fund (FLAR), including bridging loans (even those obtained by the NFPS) and those obtained by pledging gold. **The change in NIR of the BCB** will be measured by differences in stocks.

- **The NIR definition excludes**: (i) gains resulting from the conversion of monetary gold into foreign exchange; (ii) gains resulting from the acquisition of domestically produced gold; and (iii) any of the financial institutions' liquid asset requirement holdings (RAL), whether or not included in the BCB balance sheet.

- **The BCB's assets and liabilities denominated in foreign currencies other than the U.S. dollar** will be converted to U.S. dollars at the market exchange rates for the respective currencies in effect at the date of the NIR measurement, except for: (i) gold, to be valued at the accounting rate of US$375 per troy ounce; and (ii) SDR holdings and the net Fund position which will be converted into US$1.55301 **=** SDR1.

- **NIR will be valued at the accounting exchange rate** of Bs 8.15 = US$1 in 2005.

g. **The NDA of the BCB** is defined as currency issue less the NIR of the BCB.

II. ADJUSTERS

3. **The limits on the deficit of the CPS** will be adjusted downward by the difference between actual and projected program grants (i.e., grants not earmarked for projects or "transferencias de libre disponibilidad") if actual grants exceed projected program grants.[1] The adjustment will be limited to the shortfall in actual concessional program loans from projected concessional program loans.

4. **The limits on the deficit of the CPS** shall be reduced (increased) by the shortfall (excess) between actual and projected HIPC debt relief.

5. **The limits on the deficit of the CPS for June 30 and September 30, 2005** will be reduced by 33 percent of any excess of actual tax revenue over the programmed levels specified in Table 1 of the MEFP.

6. **The limits on the net domestic financing of the CPS** will be adjusted upward by the shortfall in cumulative net external financing to the NFPS, excluding any medium- and long-term liabilities transferred from the BCB to the treasury and from other financial public sector institutions, and also excluding HIPC debt relief, up to the designated ceiling.

7. **The limits on the net domestic financing of the CPS** will be adjusted downward by (1) any medium- and long-term liabilities transferred from the BCB to the treasury; and (2) any liabilities transferred from other financial public sector institutions to the treasury.

8. **The limits on the net domestic financing of the CPS and on the change in the NDA of the BCB** will be adjusted downward, and the target for NIR of the BCB will be adjusted upward, by the amount of any overdue obligations to foreign official creditors.

- **Foreign official creditors include, but are not limited to:** (i) multilateral organizations; (ii) bilateral official creditors excluding debts covered under Paris Club or other bilateral rescheduling or debts under negotiation including service on rescheduling but excluding old debts to countries in the region; (iii) supplier's creditors without official guarantee excluding already rescheduled debt service; and (iv) holders of private bonds excluding zero-coupon bonds used in debt conversion schemes.

9. **The limits on the central bank net credit to the NFPS** will be adjusted downward by any transfer of cash from the BCB to the treasury associated with the transfer of any medium- and long-term liabilities.

10. **The limits on net nonconcessional external debt** will be reduced by the amount of the shortfall between actual and projected external financing for financial and

[1] The EU grant for water and sanitation is classified as a program grant as corresponding spending had already been in the budget.

corporate restructuring, up to the ceiling indicated in Table 1 of the MEFP.

- **Loans** for financial and corporate restructuring comprise CAF credits of US$10 million for 2005 and would be guided by the following principles: (i) all parties agreed on guidelines for the Corporate Restructuring Fund(s) to be structured in accordance to market based principles, consistent with those governing the creation of the fund for supporting the financial system (FASF); (ii) only viable companies (based on financial fundamentals and future business plans and prospects) with strong restructuring plans are eligible to participate; (iii) the Funds' Boards reaching these decisions must be safeguarded from political influences; (iv) government to provide safeguards from claims, in case a company ultimately fails; (v) the operation of the funds must be well coordinated with the regulations governing the voluntary workout law; (vi) the provision of funds should not constitute subsidies in the long run; and (vii) the funds are to be managed by international managers with demonstrated expertise.

11. **The floors on the change in the NIR of the BCB** will be adjusted downward for shortfalls relative to the projected currency issue, up to the designated ceiling indicated in Table 1 of the MEFP.

12. **The floors on the change in the NIR of the BCB** will be adjusted upward/downward by the net increase/decrease in the legally required and excess reserves denominated in foreign currency by financial institutions held with the BCB. **Conversely, the limits on the change in the NDA of the BCB** will be adjusted downward/upward by the net increase/decrease of the legally required and excess reserves denominated in foreign currency by financial institutions held with the BCB.

III. Selected Reporting Requirements

13. **Monthly updates for fiscal and monetary information** will be provided at most 25 calendar days after the end of each month. The quantitative targets and limits will be measured as cumulative flows from December 31, 2004.

14. **The treasury will remit to the BCB, on a weekly basis**, information on all **placements of treasury bonds other than open market operations**, necessary to monitor the deficit and net domestic financing of the CPS.

15. **Floating debt of the departmental capitals**, El Alto, and those municipalities having subscribed a PRF with the government as of December 31, 2002 will be reported semiannually, with at most a 90–day lag; and will be included in the floating debt figures as soon as available.

16. **A quarterly estimate of pro-poor spending and pro-poor spending excluding wages** of the NFPS will be provided at most 90 calendar days after the end of each quarter (reporting agency: Fiscal Programming Unit of the Ministry of Finance (UPF)).

- **The pro-poor spending of the SPNF** includes current and capital spending on health (excluding payments to “beneméritos”) and education (excluding universities); and capital spending on basic sanitation, urban development and rural development (including spending on PLANE). It excludes pension outlays.

Statement by the IMF Staff Representative
October 31, 2005

This statement provides information on three laws submitted to Congress by the Bolivian government as prior actions for the sixth review under the Stand-By Arrangement: (i) the budget proposal for 2006; (ii) the budget framework law; and (iii) the law establishing a deposit insurance scheme. The prior actions were all in line with what had been envisaged in the MEFP, and do not affect the thrust of the staff appraisal.

Budget proposal for 2006

The budget proposal incorporates an overall deficit amounting to Bs 3.1 billion (3.7 percent of projected GDP). After making the adjustments envisaged in the MEFP—using the staff's higher revenue projections and applying the agreed assumption on the implementation rate of the capital budget (93 percent)—the projected fiscal deficit amounts to Bs 2.6 billion (3.0 percent of GDP). By submitting the 2006 budget to Congress before the 30th meeting of the current Congressional session, which started on August 4, the constitutional provision that the budget will be approved on a lapse of time basis if Congress does not vote on the proposal within 60 calendar days is applicable.

Budget Framework Law

The draft law is aimed at improving the budget process at all levels of government. It is intended to establish a framework to prepare the budget under a medium-term macro-fiscal framework, which would help strengthen its role as a tool for setting priorities and applying hard budget constraints. Furthermore, the law would enhance transparency, in particular by setting out minimum reporting requirements for all levels of government, including the use of economic and functional classifications based on international standards.

Deposit Insurance Law

The draft law would create a deposit insurance fund; determine the sources of financing of this fund; and specify conditions under which deposits would be insured if a bank had to be forcibly liquidated or resolved. The law would specify contributions from banks to the fund according to their risk classification and the currency composition of deposits; and protect depositors up to a limit of US$15,000 in the event that a bank were forcibly liquidated. The law would also derogate Article 38e of the Central Bank Law, which constitutes an implicit "blanket guarantee" to all financial institutions, and modify Article 38d of the same law to introduce strengthened procedures for the authorities to declare a state of systemic risk to the financial system, thereby enabling the adoption of emergency measures.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 05/245
FOR IMMEDIATE RELEASE
October 31, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Sixth Review Under Stand-By Arrangement for Bolivia

The Executive Board of the International Monetary Fund (IMF) today completed the sixth review of Bolivia's performance under an SDR 171.5 million (about US$248.9 million) Stand-By Arrangement that was originally approved for SDR 85.75 million (about US$124.5 million) on April 2, 2003 (see Press Release No. 03/46) and subsequently augmented and extended through March 31, 2006 (see Press Release No. 05/78).

The Board also granted the authorities' request to reduce the size of the current arrangement by SDR 25.72 million (about US$37.3 million) to SDR 145.78 million (about US$211.6 million). The reduction in total access under the Stand-By Arrangement reflects Bolivia's stronger than envisioned balance of payments outcome under the IMF-supported economic program. Completion of this review makes an amount equivalent to SDR 17.14 million (about US$24.9 million) available to Bolivia immediately. The remaining SDR 17.14 million under the arrangement could be made available for disbursement subject to Board approval during the next and final review of Bolivia's performance. However, the authorities have indicated that they intend to treat the arrangement as precautionary henceforth.

In completing the sixth review, the Board also granted the authorities' request for waivers of applicability of performance criteria on the combined public sector deficit and domestic financing outturns relative to their end-September quantitative performance criteria, and for the non-observance of the end-June 2005 performance criterion on passage of a revised 2005 budget law.[1]

Following the Board's discussion on Bolivia, Ms. Anne O. Krueger, First Deputy Managing Director and Acting Chair, made the following statement:

"Despite the difficult political developments, and aided by a favorable external environment, macroeconomic stability in Bolivia has been maintained and overall economic performance in 2005 has been positive. Economic activity has picked up despite the negative impact of social

[1] The staff report for the Sixth Review of the Stand-By Arrangement with Bolivia may be made available at a later stage if the authorities consent.

tensions early in the year, inflation remains in single digits, and the external current account continues to show a surplus. Financial system deposits have recovered and central bank reserves have strengthened. Risks remain for the authorities' economic program, but the recent strong performance has lessened economic vulnerabilities.

"The authorities are committed to maintaining the fiscal deficit on its declining trend. This will be achieved by saving part of the large increase in hydrocarbons revenue resulting from an increase in the tax rate and strong gas export prices. The recently-submitted 2006 budget aims at reducing the fiscal deficit further, thereby consolidating the fiscal adjustment effort pursued in recent years.

"Aided by a better-than-programmed fiscal position, the central bank has been implementing a measured and appropriate monetary policy during the difficult political transition. International reserves are being rebuilt in the context of a decline in policy interest rates and a welcome improvement in the maturity structure and currency composition of the domestic debt. The authorities' prudent financial management is allowing them to adhere to the quantitative targets of the program.

"Looking ahead, the macroeconomic policy targets for 2005 and 2006 have been strengthened, and the structural policy component of the program has been reprofiled in light of the interim nature of the current government. On the structural front, the authorities have submitted to Congress a draft budget framework law aimed at strengthening the budget process at all levels of government; and a draft law introducing a partial coverage deposit insurance scheme. However, the hydrocarbons law enacted by Congress last May risks undermining the development of the sector, especially in light of tax rigidities and legal uncertainties. The authorities believe that more time is needed for a full assessment of the impact of that law given the altered energy price outlook and the ongoing contacts with oil companies on the implementing regulations.

"Continued macroeconomic stability and sustained growth and poverty reduction over the medium term depend on prudent management of hydrocarbons-based revenue together with a removal of impediments to investment in the sector. It will also be important to achieve a balance between revenue allocations and spending responsibilities at all levels of government, to make progress with the tax reform, to implement a more market-based petroleum product pricing mechanism, to appropriately focus poverty-reducing spending, and to reduce further vulnerabilities in the financial sector," Ms. Krueger said.

Statement by Javier Silva-Ruete, Alternate Executive Director for Bolivia and Javier Cuevas, Advisor to Executive Director
October 31, 2005

1. On behalf of the Bolivian authorities, we thank Management for their engagement and support, and the staff for a comprehensive and well-balanced report on Bolivia's performance and prospects. In particular, the authorities underscore that the Stand-By Arrangement (SBA) is critical to preserve macroeconomic stability in the context of the political transition and value the constructive policy discussion with the Fund and the continued provision of technical assistance.

Political Developments

2. Bolivia has faced difficult political circumstances. President Mesa resigned due to social unrest, and subsequently both presidents of the Senate and the Lower Chamber declined to take over. As a result, the President of the Supreme Court Eduardo Rodríguez was sworn in as President on June 9. Congress amended the constitution to allow general elections on December 4, and a political settlement was reached to hold a constitutional assembly and a referendum on regional autonomy in mid-2006. We highlight that the presidential succession and all other political arrangements were carried out within the legal framework.

Economic Performance under the SBA

3. Despite adverse social and political conditions, macroeconomic stability has been maintained and overall performance has been positive in 2005. Economic growth remained strong during the first half of the year, boosted by the hydrocarbons sector, and the balance of payments in the first semester has been substantially stronger than programmed.

4. The Bolivian authorities have shown a strong commitment to the economic program under the SBA. All the end-June quantitative performance criteria were observed. In particular, the fiscal deficit was smaller than programmed, and the target for the accumulation of net international reserves was met with a large margin. According to preliminary information, all end-September quantitative performance criteria were also met.

5. The authorities also made important progress in carrying out the structural reforms envisaged under the program. Congress passed new tax code procedures and a law enhancing the Financial Restructuring Fund and enhancing the autonomy of the banking superintendency and the central bank. Also, provisioning and reserve requirements were tightened. In addition, the authorities submitted three draft bills to Congress: the budget law for 2006, consistent with a reduction in the programmed fiscal deficit to 3 percent of GDP; the Budget Framework Law, aimed at enhancing the budget process at all levels of government; and a law introducing a partial-coverage deposit insurance scheme, with contributions from financial institutions.

Economic Performance in 2005

6. Real growth in 2005, underpinned by a significant increase in hydrocarbons output, is forecast at 4 percent, lower than envisaged under the program, but higher than in 2004 (3.6 percent). Twelve-month inflation would decrease to 4.2 percent, from a peak of 6.4 percent in June. The overrun of the program inflation target (3.8 percent) is associated mainly with temporary supply disruptions caused by road blockades and the depreciation of the Boliviano vis-à-vis regional currencies. The balance of payments will likely be substantially stronger than originally expected.

Fiscal Policy

7. The public sector recorded an overall surplus of 0.4 percent of GDP during the first seven months of the year, reflecting both higher revenues and lower spending. The increase in revenues reflected improvements in tax administration, strong gas exports, and the introduction of a new tax on hydrocarbons. Spending has been contained, due mainly to the slow implementation of public investment.

8. In view of the fiscal surplus recorded in the first seven months of the year, hydrocarbon revenues not contemplated in the program, and lower pension payments, the projected fiscal deficit for 2005 has been adjusted downward to 3.5 percent of GDP, 2 percentage points lower than the programmed deficit before grants. A recovery in public investment implementation is expected in the remainder of the year —especially in infrastructure and social projects— through the use of a share of revenue from the new tax on hydrocarbons and the upturn in project-financing external disbursements. In addition, current spending will also increase due to fuel subsidies and transfers to a housing program targeted to low-income families.

9. In order to improve control on wage and pension layouts and on sub-national debt, the authorities are creating registers for public sector employees and pensioners (they expect to cover 50 percent of the health and education sector employees by end-December 2005) and a register system for the debt of 9 regional governments and 17 municipalities, which has been presented to sub-national government.

10. A tax reform is contemplated under the SBA. However, given the interim nature of the current government and the need for such a reform to be fully owned by the next government, the submission and approval of a tax reform is not possible for the moment. Nevertheless, the authorities will prepare a draft tax reform law by end-December for consideration by the new government. The proposal will include, *inter alia*, a personal income tax, and will be anchored on the objectives of equity and efficiency.

Monetary and Exchange Rate Policies

11. Monetary and exchange rate policies have been consistent with low inflation and accumulation of foreign exchange reserves. During May and June, deposit withdrawals associated with the political crisis introduced pressures on the reserve position. In response, the central bank temporarily raised interest rates on liquidity loans. Once confidence was

restored, financial system deposits recovered from the sharp drop in June, and liquidity assistance extended to banks was fully repaid. Moreover, the net liquid foreign assets of the financial system have increased significantly —including central bank reserves, which are now much higher than programmed. The monetary impact has been matched by renewed demand for local currency. At the same time, in order to prevent possible inflationary pressures, the central bank has increased its placements of local currency paper. It should be noted that local currency interest rates have declined, given the increased preference for local currency.

12. The crawling peg regime has contributed to keeping a highly competitive real effective exchange rate, given the appreciation of the region's main currencies. In mid-July, the monetary authorities marginally appreciated the Boliviano against the U.S. dollar and widened the bid-offer spread, thus prompting increased activity in the interbank foreign exchange market. A small additional appreciation was introduced in mid-September.

13. Favorable market conditions have allowed the authorities to improve the currency composition and the maturity structure of domestic debt. The share of local-currency Treasury paper in open market operations has increased by over 20 percentage points since the end of 2004, and the average maturity of new issuances has tripled to over three years. Furthermore, the introduction of a new electronic auction system has improved transparency and information-sharing. The authorities have stated their intention to persist in their efforts to improve the currency composition and maturity of domestic debt.

14. The strength of international reserves has contributed significantly to limiting vulnerabilities, including those associated with political uncertainties. Given this positive performance, the projected increase in net international reserves has been revised upwards to US$230 million in 2005, compared with US$40 million, as originally programmed. However, in light of the risk of deposit withdrawals during the electoral period, the proposed target for end-December has been set at US$135 million. In addition, the authorities will take action to reduce 12-month growth in currency issuance, from 30 percent in June to 26 percent by December 2005, and will keep developments in the foreign exchange market under close review.

15. By end-December, the authorities will submit draft legislation to Congress aimed at expediting corporate restructuring and bankruptcy procedures. By the end of the year, they plan to sell the remainder of the state's assets in a bank where the public sector holds a majority ownership.

Prospects and Vulnerabilities

16. The authorities project a real GDP growth rate in the range of 4-4½ percent in 2006, lower inflation, and a further reduction of financial sector vulnerabilities. The growth objective is underpinned by an acceleration of activity in the mining and construction sectors, and by higher capacity utilization in the hydrocarbons sector. With respect to this sector, the current administration is implementing and regulating the new law approved by Congress in May. Given the significant energy price distortions and the fact that discussions with oil companies on implementation issues are still ongoing, the impact of the new law is yet to be

fully assessed. Hence, no further legislative adjustments are contemplated at this stage, and any review of the hydrocarbons policy would be conducted by the next government.

17. Inflation control will be eased by prudent management of hydrocarbon revenues, some of which will be saved to reduce the fiscal deficit and avoid creating expenditure rigidities in the medium term. The fiscal stance and competitive exchange rate, together with high prices for hydrocarbons and metals, will contribute to maintaining current account and overall balance of payments surpluses. Hence, a further increase in international reserves is expected.

18. The strength of international reserves and the reduction of the fiscal deficit from almost 9 percent of GDP in 2002 to 3.5 percent in 2005 have placed the economy in a better position. Medium-term fiscal prospects are expected to improve, and the decline in the fiscal deficit —due mainly to the increase in hydrocarbon revenues— would result in a lower debt ratio. Nevertheless, the Bolivian economy faces vulnerabilities that may jeopardize these prospects. In this regard, the authorities and the staff concur that the financial system is still highly dollarized and is very sensitive to political crises; that the current distribution of revenues and spending responsibilities between the central and sub-national governments is inadequate, with some regions calling for more fiscal decentralization and autonomy; and that subsidies on fuel are rising hazardously.

19. The authorities acknowledge the challenge to design an adequate fiscal decentralization policy and to modify the current distribution of revenues and spending to ensure fiscal sustainability. In addition, a flexible price-setting mechanism for fuel is needed, but not politically feasible in the current circumstances. It is expected that consultations during the final review will provide an opportunity for the new authorities to outline their medium-term economic policies and future arrangements with the Fund.

20. Given Bolivia's improved performance and progress to date, we look forward to favorable consideration by the Executive Board of the authorities' request for (i) the conclusion of the sixth review; (ii) waivers of nonobservance and applicability, and modification of performance criteria, and (iii) rephasing and reduction of access under the SBA, and precautionary treatment henceforth.