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Bolivia: Second Review Under the Stand-By Arrangement and Request for Waiver of Applicability and Modification of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Bolivia

In the context of the second review under the stand-by arrangement and request for waiver of applicability and modification of performance criteria, the following documents have been released and are included in this package:

- the staff report for the second review under the stand-by arrangement and request for waiver of applicability and modification of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **September 5, 2003**, with the officials of Bolivia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on September 25, 2003**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **October 6, 2003** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its October 6, 2003 discussion** of the staff report that completed the review and the request.

- a statement by the Executive Director for Bolivia.

The documents listed below have been or will be separately released.

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

*May also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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BOLIVIA

Second Review Under the Stand-By Arrangement and Request for Waiver of Applicability and Modification of Performance Criteria

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

Approved by Charles Collyns and Michael Hadjimichael

September 25, 2003

- **Stand-By Arrangement**. The current arrangement was approved on April 2, 2003, for a 12–month period in an amount equivalent to SDR 85.75million (50 percent of quota). On July 7, 2003, the Executive Board completed the first review. A purchase of SDR 10.7 million would become available upon completion of the second review.

- **Discussions**. The review discussions were held in La Paz from August 18 to September 4. The mission met with Minister of Finance Comboni, Central Bank President Juan Antonio Morales, and other senior officials. The team comprised M. Piñón (Head), S. Cueva, A.García Pascual, O. Williams (all WHD), M. Cortes (MFD), M. Guin-Siu (FAD), and K. Kostial (PDR). The mission was assisted by G. Peraza (Resident Representative). A Segura (OED) attended the closing meetings in September. Minister Comboni and a team of officials continued discussions at headquarters during September 3–5.

- **Program.** In the accompanying Letter of Intent and Memorandum of Economic and Financial Policies, the authorities describe their policies for the remainder of 2003 and prospects for 2004 .

- **Economic and policy developments.** Real GDP growth appears to be picking up. The NIR, NDA, and debt targets for end-June were met with a margin but the fiscal deficit and domestic financing performance criteria were not met. The authorities are now implementing corrective fiscal measures while continuing to advance corporate and financial reforms.

- **Steps to PRGF**. The authorities will issue a draft PRSP report in September ahead of the Consultative Group meeting scheduled for October 8–9. The authorities seek to mobilize concessional financing at this meeting to underpin a prospective three-year PRGF arrangement.

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EXECUTIVE SUMMARY

Background

The political situation remains fragile. The expansion of the ruling coalition gives the government a two-thirds majority in congress. Nevertheless, the opposition remains vocal and has organized renewed protests, complicating a prompt decision on the LNG project.

Macroeconomic developments have been generally favorable, but the fiscal program has gone off track. Economic activity is picking up with an acceleration of GDP growth in the second quarter, while inflation remains low. The financial environment has continued to stabilize. However, there have been fiscal slippages, and the deficit and domestic financing performance criteria for end-June were not observed.

Progress has been made in the implementation of the structural agenda. Achievements include the passage of a new tax code, legislation to broaden the tax base, and an informal corporate workout law.

Policy discussions

Policy discussions focused on the need to contain the deficit to 7 percent of GDP in 2003 and to place the public finances on a sustainable path. Agreement was reached on steps to boost revenue and contain expenditures in 2003, providing the basis for a further strengthen-ing of the fiscal position in 2004 .

The authorities are aiming at a more gradual fiscal adjustment path than had been envisaged at the time of the first review. The path could still be consistent with a sustainable fiscal and external position provided a timely decision on the port of exit of the LNG pipeline project is made and the higher deficit is financed through additional concessional resources. Discussions on the medium-term fiscal and macroeconomic framework that could be supported under the PRGF will continue in mid-October after the CG meeting.

Staff and the authorities were in broad agreement on the approach to address banking and corporate weakness. The recently approved corporate informal workout law is an important structural advance, but needs to be followed up by promptly issuing supporting regulations.

Risks to the program remain substantial. Mitigating factors include corrective fiscal measures already taken in 2003, progress toward establishing the framework for corporate and financial restructuring, and the recent enlargement of the government coalition.

I. Background and Recent Developments

1. **Despite calmer social conditions, the political situation remains fragile**. The conservative *Nueva Fuerza Republicana* party recently joined the ruling coalition, giving the government a two-thirds majority in Congress. However, the opposition remains vocal, and the popularity of the President low. Public resistance—including a recent countrywide series of strikes, demonstrations and road blocks—continues to complicate the prospects for a rapid decision on the routing of the LNG project.

2. **Nonetheless, the authorities have made important progress in implementing their structural agenda in recent months.** In August, Congress approved the new tax code—a key element of the fiscal program—and the informal corporate workout law, both of which were September benchmarks under the program. Congress also approved a tax bill that expands the tax base, including for petroleum products, and a tax regularization scheme. Consideration of the formal bankruptcy law has been delayed to 2004 as explained below.

3. **The main macroeconomic developments are generally encouraging:**

- **Economic activity is picking up.** After a weak first quarter, partly reflecting the tragic events of February, preliminary indicators point to an acceleration of GDP growth in the second quarter consistent with the annual objective of 2.9 percent. The rebound is explained by an exceptional soybean harvest and an increase in agricultural, manufacturing, and hydrocarbon exports.

- **Inflation remains low**. Despite an increase in the 12–month inflation rate to 3.8 percent in August, reflecting in part temporary increases in some prices of basic staples, inflation is expected to come down as programmed to around 3 percent by end-year.

- **The external accounts have strengthened.** The current account deficit in the first half of the year narrowed to 1 percent of GDP, reflecting a 10 percent decline in imports and a modest overperformance of export growth. The drop in imports is partly explained by a real effective depreciation of the exchange rate, estimated at almost 10 percent during the first seven months of 2003 (Figure 1). The strength of exports has reflected rising agricultural exports, and favorable developments in metal and hydrocarbon prices. With neighbors' currencies appreciating significantly, the central bank has slowed the nominal depreciation of the boliviano against the U.S. dollar to an annualized rate of crawl of 4½ percent since end–2002.

4. **However, fiscal performance has fallen short of the program's objectives.** The deficit rose to 3 percent of GDP in the first semester, half a percentage point of GDP higher than targeted, mainly reflecting lower-than-expected imports and, hence, import-related tax revenues. As a result, the deficit and domestic financing performance criteria (PCs) for end-June were not observed. Preliminary data point to further slippages in July-August with

the cumulative deviation during January-August estimated at 1 percent of GDP. Shortfalls in external financing were offset, in part, by increased recourse to domestic financing.[1]

5. **While fiscal performance has been weak, in other respects the program has remained broadly on track.** All monetary and external debt performance criteria for end-June were met with large margins. The build up in NIR reflected improved trade performance, and commercial banks' continued holdings of excess reserves at the central bank.

6. **The financial situation has stabilized although severe vulnerabilities remain in the highly dollarized banking system.** Deposits have recovered since the large withdrawals of mid-February, increasing by 4½ percent by end-August. During the same period, disposable reserve coverage of bank dollar deposits increased from 25.5 percent to 31.2 percent. Nonperforming loans remained stable at 19.3 percent at end-July (20 percent at end-March). In recent weeks, the improved conditions have been reflected in a renewed appetite for government securities at lower interest rates.

II. Policy Discussions

7. **The SBA has helped to provide breathing room to develop the structural and financial reforms needed for sustained growth and poverty reduction, but major difficulties remain.** Despite the implementation problems associated with the difficult political and social situation, progress has been made in establishing a stable economic and financial environment, including by approving key pieces of legislation for the fiscal and financial sectors. However, serious slippages on the fiscal front in 2003, continued social opposition to the implementation of adjustment policies, and resistance to the construction of the pipeline for LNG exports to North America constitute major obstacles for the achievement of a broader set of objectives in the context of a PRGF.

8. **Discussions for the completion of the second review under the SBA centered on**: (i) corrective measures to minimize the fiscal deviations in 2003; (ii) a macroeconomic framework for the medium term that would be consistent with a sustainable fiscal and external position while taking into account the continued social difficulties faced by the authorities; and (iii) the implementation of financial and corporate restructuring.

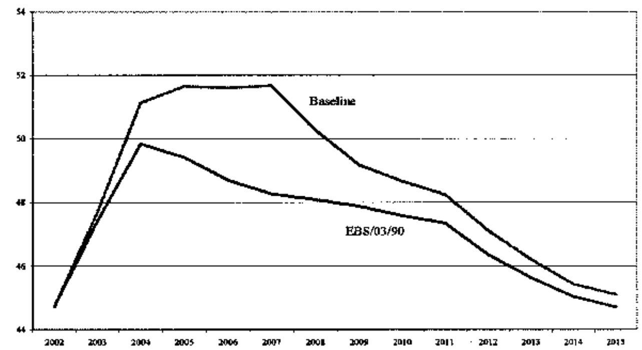
A. Medium-Term Macroeconomic Framework

9. **Estimates of the fiscal and growth impact of the LNG project have been revised to reflect new information on the likely scope of the project (Box 1).** The project is now expected to include a liquids as well as a gas component, implying a larger boost to output

[1] The shortfall in external financing in part reflected delays in disbursement related to poor implementation capacity.

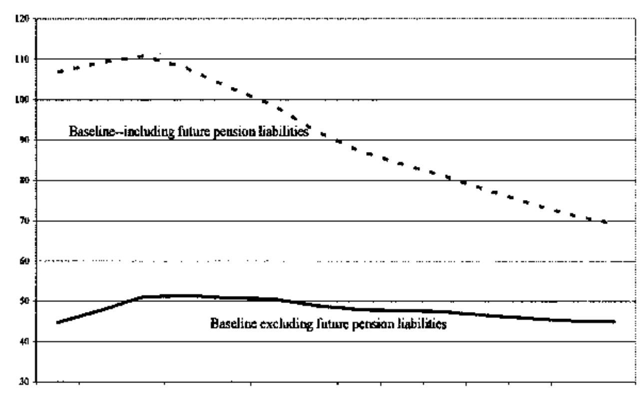
and fiscal revenues, particularly after the expected completion of the project in 2007. Foreign savings and investment are expected to increase substantially during the construction phase of the LNG project, but the impact on growth would be felt mainly after 2008 once exports begin, given the enclave nature of the project. The authorities stressed that, given the advanced stage of the negotiations with the private consortium, they expected the construction of the pipeline to begin in mid–2004. They also indicated that they would announce a port of exit once the purchase-sale agreement is reached between the investment consortium and the buyer, which is expected by end-year. A large public relations campaign has been launched to create public awareness of the benefits of the project.

Bolivia—NPV of debt as a ratio of GDP



10. **The authorities have set a strategic objective of reducing the fiscal deficit to 4 percent of GDP by 2007**. This is a more gradual adjustment than envisaged in the first review. The adjustment path during 2004–06 would be consistent with this objective. Senior officials indicated that a more rapid adjustment was not feasible in light of the fiscal deviations in 2003 and the difficult social context. The staff believes that this revised deficit projection would still be consistent with a sustainable fiscal and external position, provided that it is financed on largely concessional terms and in the context of the timely construction of the gas pipeline. Under this scenario, the public debt to GDP ratio, in NPV terms, would stabilize in 2005 and decline steadily thereafter, particularly once gas exports to North America would come on stream [2]. Moreover, after including the stock of pension obligations into the stock of debt, the decline in

Bolivia: DSA with Future Pension Liabilities
(NPV of debt as a percent of GDP)



[2] Net nonconcessional resources per year are assumed to be below 1¼percent of GDP during 2004–08 and the construction of the gas pipeline is assumed to begin in mid–2004.

public debt is even more apparent and immediate.[3] [4] However, as discussed in Appendix V, in the absence of the LNG project, the public debt indicators would not be sustainable.

11. **The authorities will request strong support from the international community for their medium-term program at the upcoming CG meeting.** In addition to requesting sufficient concessional resources (some 1½ percent of GDP per year) to finance the bulk of their deficit, they plan to request some 1½ percent of GDP in annual external grants to fund pro-poor programs that would place Bolivia in a position to meet the millennium initiative goals by the year 2015. Under this scenario, poverty-reducing spending would reach around 16 percent of GDP by 2006, well above the targets until recently envisaged, notwithstanding the shortfalls observed until 2003.

Table A. Macroeconomic Framework
(In percent of GDP, unless otherwise indicated)

		Rev. Prog.	Proj.				
	2002	2003	2004	2005	2006	2007-10	2011-15
Real GDP growth (in percent) 1/	2.8	2.9	4.4	4.8	5.2	5.8	4.3
Excluding hydrocarbons and mining	2.7	2.7	3.2	3.9	4.3	4.1	4.3
Inflation (in percent; end of period)	2.4	2.8	3.5	3.5	3.0	3.0	3.0
Fiscal deficit	-8.9	-7.0	-6.0	-5.5	-4.8	-2.5	-1.4
External current account	-4.4	-2.0	-5.7	-7.2	-6.6	-0.7	0.1
Excluding exceptional imports 2/	-1.4	-1.3	-2.0	-1.6	-1.7	0.4	0.1
Gross official reserves (US$ millions)	854	993	1,030	1,086	1,128	1,315	1,550
As a percent of broad money	27.6	30.4	31.3	32.8	33.1	34.2	35.0
Capital spending	8.5	7.3	7.3	7.5	7.5	7.5	7.5
NPV of debt as a ratio of GDP 3/	44.7	47.7	51.1	51.4	50.9	48.8	46.0

Sources: Ministry of Finance; and Fund staff estimates.

1/ The projections include (i) a large mining project (San Cristobal) which will start operations in 2006, and (ii) the LNG project for gas exports to North-America, which will start operations by mid-2008.

2/ Imports associated with private hydrocarbon investments. From 2008 onwards, LNG exports start.

3/ End of period.

[3] As a result of pension reform, obligations resulting from previous contributions (under the old system) are explicitly recognized as a government liability. The stock of such obligations decline over time as pensions are paid to those covered under the old system.

[4] The sustainability scenario assumes disbursements of US$70 million in 2004 for corporate restructuring and does not incorporate contingent liabilities from efforts to address weaknesses in the banking system.

B. Fiscal Policy

12. **The authorities have recently taken a number of important actions aimed at containing the deficit at a maximum of 7 percent of GDP in 2003 (compared with a targeted deficit of 6½ percent) and set the basis for continued fiscal adjustment in 2004.** With firm implementation, these measures should yield 0.6 percent of GDP during 2003, sufficient to compensate for a large part of the fiscal overruns that have occurred so far this year, and have a significantly larger impact in 2004 (with an expected yield of 1.0 percent of GDP). However, the deficit for 2003 as a whole would still be 0.6 percent of GDP higher than envisaged at the time of the first review, given the observed deviations during the first half of 2003 and the continued adverse impact of high international oil prices on revenues and lower imports.

13. **Revenue measures include the following:**

- **The tax code, a key element of the reform agenda, was approved in August 2003.** The new tax code significantly strengthens the enforcement capabilities of the tax and custom agencies (yield of 0.3 percent of GDP in 2004). In particular, the tax code (i) facilitates the prompt resolution of tax disputes through administrative procedures, with legal recourse available only after compliance with tax obligations (currently disputes typically end up unresolved for several years in the court system); (ii) significantly stiffens penalties for tax evasion; (iii) allows the seizure of illegally imported merchandise in the interior of the country (currently this procedure can only be applied at the ports of entry); and (iv) provides for the prompt sale of seized merchandise. These added enforcement powers are expected to be instrumental for the successful implementation of several administrative improvements planned for the rest of 2003 and in 2004, including new anti-counterfeit invoice requirements and the introduction of a new tax payer registry. Supporting regulations are scheduled to be issued in November (PC) for the third review, 90 days after the tax code's publication in the official gazette.

- **A tax regularization scheme was approved in August 2003.** The scheme involves regularization of illegal vehicles and a tax amnesty that forgives past penalties if tax payers subscribe to one of three payment options. This scheme is expected to yield 0.6 percent and 0.1 percent of GDP in 2003 and 2004, respectively. While the staff expressed concerns about the magnitude of the yield of this scheme and possible moral hazard problems, the authorities expressed confidence that, together with the new tax code, it would raise revenues in 2003–04 above the estimated yields, without unduly jeopardizing prospects for tax compliance in the future. The issuance of the supporting regulations are a prior action.

- **A set of modifications to the tax bill (Law 843) was also approved in August 2003.** The new law (yield of 0.1 percent of GDP in 2003 and 0.6 percent of GDP in 2004) eliminates loopholes; expands tax bases (special oil tax on a broader range of oil derivatives, corporate income tax on cooperatives and other financial institutions, and on business services provided by nonresidents); limits the deduction of corporate income from the transaction tax; and authorizes the government to issue a decree limiting the deduction of VAT invoices from the payroll tax by decree. The implementing regulations are scheduled to be issued by end-September (prior action).

14. **The authorities intend to take the following steps to control expenditures:**

- **Contingencies to cut capital spending by about 0.4 percent of GDP during September-December would be activated (prior action).** This cut is in addition to the 0.6 percent of GDP reduction in investment activated earlier in the year. As before, priority will be given to investment projects financed by grants or concessional loans, and those that are poverty reducing.

- **Pensions.** The authorities are in the process of reducing pension costs through administrative efforts, controlling fraudulent claims, and strictly enforcing eligibility criteria.

15. **In addition, the authorities intend to adopt measures to further contain the deficit in 2004 and beyond.** On the expenditure side, they intend to constrain growth of the wage bill broadly in line with inflation. On the revenue side, they are planning to make the price of gasoline at the pump flexible in early 2004 to reflect market developments, so as to prevent potential losses should international prices be higher than anticipated. Retail prices of gasoline and diesel have been fixed in local currency since July 2000.

C. Monetary and Exchange Rate Policy

16. **Monetary policy will continue to aim at strengthening the central bank's international reserves.** The authorities envisaged further increasing the disposable reserve coverage of deposits in the banking system, while containing inflationary pressures by tightening interest rates if necessary. The central bank would continue to provide collateral-based lender of last resort facilities to the financial system.

17. **The authorities signaled their intention to preserve the recent gains in competitiveness.** The recent gains have placed the real effective exchange rate close to its most depreciated level since 1996. Preliminary results of a joint study by the staff and the authorities suggest that at this point there is no substantial misalignment of the real effective exchange rate and that concerns about Bolivia's competitiveness appear to be more related to structural and institutional factors, several of which are being addressed under the program (corporate restructuring, for example). Nevertheless, while the authorities intend to maintain the exchange rate crawl for now, they are developing a strategy to introduce more flexibility into the exchange arrangement over the medium term.

D. Financial and Corporate Policies

18. **The recently approved corporate informal workout law is an important step toward establishing a suitable framework for financial and corporate restructuring.** There are, however, several concerns, particularly whether the framework provides sufficient

protection for the interests of secured creditors. The regulations, which will be issued by end-September, will address some of these concerns (prior action for completion of review). Remaining difficulties will be identified by initially applying the new informal workout procedures to a pilot sample of firms. Experience gained will provide the basis for possible amendments to the existing Commercial Code by mid–2004. The authorities believe that this approach will provide the basis for a comprehensive and modern formal bankruptcy mechanism without needing to formally approve the bankruptcy law (a structural benchmark for September), but have agreed to revisit the issue next year if warranted.

19. **The authorities have established a high level team to address critical issues in the corporate and financial sectors and are developing an action plan to deal with weak banks by end-October 2003 (Box 2).** The plan would be guided by general principles that avoid any direct or indirect bailout to shareholders and minimizes losses associated with the use of public funds. The authorities are currently designing a framework for specific rules of access, disbursement, and accountability. The authorities aim to establish a fund to support bank restructuring by end-October with World Bank support, and a fund for corporate restructuring by end-December with support from the Andean Development Fund (CAF). Although the CAF recently approved a loan of US$75 million, progress in the establishment of these funds has been slower than planned, ruling out the assessment of the fiscal implications which had earlier been envisaged by the time of the second review.

20. **Staff noted that, despite generally adequate prudential norms and practices, there were deficiencies that need to be addressed in the context of context of corporate restructuring.** One particular issue concerns the approach used to upgrade restructured loans following restructuring. The staff suggested that such upgrading should take place only after a reasonable period of demonstrated payment performance (six months). In addition, the capacity of the Superintendency of Enterprises is weak and needs to be strengthened substantially to carry out workouts among a pilot sample of firms.

E. PRGF Issues

21. **The authorities will issue a draft PRSP in September, ahead of the Consultative Group (CG) meeting scheduled for October 8.** This draft will reflect preliminary input from civil society. The final report will include the CG outcome and further input from the consultation process started in September.

22. **Discussions on 2004 and the medium term are expected to continue after the CG meeting.** In particular, firm agreements on the deficit and other fiscal targets will depend on the levels of available financing, and in particular of grants and concessional loans. The need for additional fiscal measures would be assessed in this context.

F. Program Monitoring

23. **Quantitative performance criteria and reviews.** Quarterly reviews will continue throughout the remainder of the SBA. The authorities have requested upward revisions to the performance criteria for: (i) end-September with respect to the fiscal deficit, net domestic

financing of the public sector, central bank net credit to the non-financial public sector, and net domestic assets of the central bank; and (ii) end-December with respect to the fiscal deficit and net domestic financing of the public sector. The proposed modification of PCs is consistent with the revised macroeconomic framework. Waivers of applicability are also requested for the PCs for end-September, for which data are not available.[5]

24. **Prior actions and structural performance.** Benchmarks on the approval of the tax code and the informal workout law were met ahead of the end-September date. The formal bankruptcy law is not expected to be approved by end-September. Some elements of the law are expected to be addressed through amendments to the Commercial Code in 2004 (structural benchmark). Prior actions for the second review are issuing the implementing regulations for the tax bill amending law 843, tax regularization scheme, the informal workout law, and activating spending cuts equivalent to 0.4 percent of GDP. Structural performance criteria for the third review involve issuing the tax code regulations and approving an action plan for weak banks agreed with the Fund.

G. Program Risks

25. **The program remains subject to considerable risks related to the difficult political environment, the need for fiscal adjustment, and financial system fragilities.**

- Despite the recent enlargement of the ruling coalition, the absence of a broad consensus for the economic program continues to pose a major political risk. While the government has recently been successful in advancing tax legislation, there seems to be little room for additional adjustment measures.

- Prompt implementation of the public investments cuts and the supporting regulations to the tax code and the tax bill will be critical to reverse fiscal slippages in 2003 .

- Failure to implement reform measures designed to bolster growth and to arrest fiscal slippages would seriously jeopardize prospects for growth and poverty reduction over the medium term. Most important, it will be critical to move ahead with the LNG project in a way that maximizes the long-term economic benefits to Bolivia.

- The continued vulnerability of the banking system, and the weak financial conditions of a few banks, represent a major risk to the program both in the near and medium term, especially given the high degree of dollarization of financial intermediation.

[5] As the Board discussion is scheduled after end-September, it is necessary to request waivers of applicability for end-September PCs, for which data would not be available. Completion of the second review is conditional on performance for end-June.

III. STAFF APPRAISAL

26. **The Bolivian authorities' pursuit of structural reforms has begun to yield results despite the difficult social and political context**. There are indications that growth is beginning to pick up, while financial market conditions have stabilized. The approval of the tax code, legislation to broaden the tax base, and informal corporate workout law in recent months represents important progress toward restoring macroeconomic stability and establishing the basis for sustained medium-term growth.

27. **Nevertheless, the fiscal performance under the program needs to be substantially strengthened.** In particular, it is crucial that the agreed compensatory fiscal measures be promptly implemented to contain the deviation from the fiscal program in 2003 and provide the basis for further fiscal consolidation in 2004 and beyond. Sustained fiscal adjustment over the medium term, while protecting pro-poor spending and minimizing the use of nonconcessional resources, will be essential to ensure a viable medium-term fiscal situation.

28. **The recent passage of the informal corporate workout law represents a substantial advance in financial and corporate restructuring.** Issuing the supporting regulations and strengthening the capacity of the Superintendency of Enterprises to implement workouts among a pilot sample of firms will also be critical to further advance the corporate restructuring process.

29. **Staff and the authorities were in broad agreement on the approach to reduce banking system fragility.** To fully restore financial stability, the authorities are developing a detailed action plan to address the problem of weak banks. In parallel, the strengthening of banking supervision and prudential norms, and an enhanced capacity to comprehensively assess credit risk, are needed to minimize risks to the health of the banking system.

30. **In order to sustain economic growth, the authorities will have to invigorate the pace of structural reforms and move ahead, as soon as possible, with the LNG project**. The official exploitation of Bolivia's rich hydrocarbon resources is essential for long-term growth and fiscal prospects and to lowering poverty.

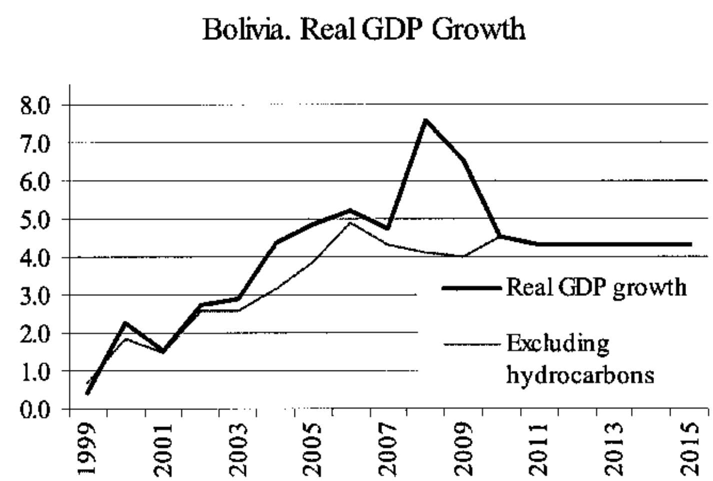
31. **While substantial risks to the program remain, the authorities are taking steps to address concerns.** In particular, while the vulnerabilities associated with the narrow support for the program persist, the government has successfully enlarged the ruling coalition. Fiscal performance should be bolstered by the corrective measures now being implemented by the authorities. Vulnerabilities in the financial sector are being addressed, in part, by putting in place a strategy for corporate and financial restructuring.

32. **Notwithstanding the risks, staff believes that with firm implementation the program can achieve its goals.** The staff therefore recommends completion of the second review and the approval of the authorities' request for waivers of applicability and modification of performance criteria for September and December.

Box 1. Gas Sector Development and its Main Macroeconomic Effects

The hydrocarbons sector is of prime importance for Bolivia's economy. Following the privatization of the sector in 1997, the gas market has received about US$2.5 million between 1997 and 2002. The investment has mainly been channeled to exploration of gas fields, extraction of gas and condensates, and construction of gas pipelines to Brazil. The exploration activities have raised Bolivia's natural gas proven reserves from 5.7 trillion cubic feet (Tcf) in 1997 to 52.3 Tcf by 2002.

The hydrocarbons sector is an "enclave" in the sense that it uses negligible domestic resources. Its main links to the economy are through the fiscal accounts via the revenues from royalties and taxes, and through its effects on the balance of payments—similar to a foreign transfer. (i) For a growth scenario involving natural gas exports from the LNG project by mid-2008, fiscal revenues through 2015 are projected to be around 2 percent of GDP per year. (ii) The development of the gas sector will have a sizeable impact on the balance of payments. The development phase of large gas projects involves large inflows of FDI, and substantial amounts of imported capital-intensive goods; the latter tends to generate large current account deficits without significant effects on the growth performance of the economy.[1] Once the projects become fully operational, rising gas and condensates exports of more than US$500 million per year would improve the current account and boost GDP growth.



A baseline scenario would include the following export-oriented hydrocarbon projects for the period 2003-15 (note that all projects are measured in millions of cubic meters of natural gas per day, MMm^3/day): (i) exports to Brazil, currently at around 16MMm^3/day, will reach 30MMm^3/day by 2010 and remain at that level thereafter; (ii) exports to Argentina and additional exports to Brazil (Madrejones and Cuiaba), currently at 1.1MMm^3/day, will reach 5.8MMm^3/day by 2008 and rise to 19MMm^3/day by 2015; remain at that level thereafter; (iii) the LNG project begins exports in mid-2008, reaching full scale by 2009 at 26.5MMm^3/day.

The Pacific LNG project will develop the Margarita field for natural gas and condensates exports to North America, and will construct pipeline capacity to ship the gas to the Pacific coast. The total cost of the project, including shipping and reception facilities in Mexico, is on the order of US$5.1 billion. The most likely scale of operations is 25MMm^3/day of gas exports, and 35 million barrels per day (MMBbl/day) of condensate. Exports are expected to start by mid-2008 and full export capacity should be reached by 2009. Over the 20-year contract term, the project should produce 8 to 10 Tcf of gas (20 percent of Bolivia's current proven and probable reserves), and up to 500MMBbl of associated liquids (condensate and LPG) for exports to the Asian market.

[1] The construction and development of large gas projects are highly capital intensive generating little employment and using limited national inputs. Some domestic industries related to exploration activities and business services will grow at a relatively faster pace during the development and construction phase of the projects.

Box 2. Corporate and Financial Restructuring

The Bolivian financial sector has been under stress for a number of years, with a deterioration in the loan portfolio reflecting the poor ability of highly indebted corporations to generate cash-flow. The recent FSAP study found that banks' balance sheets had been adversely affected by a decline in deposits arising from deposit runs and a deterioration in credit quality linked to insolvency problems in the corporate sector. In order to address these problems, Congress approved, in August 2003, a law on informal corporate workouts that facilitates out-of-court resolution through creditor committees. In addition, the authorities are developing a framework, in collaboration with the World Bank and Andean Development Corporation, for the use of public funds for bank restructuring and corporate workouts. Bolivia's action plan for the banking system will be guided by the following general principles:

- **Inclusion of broad criteria** for the operation of a bank restructuring fund using publicly guaranteed resources;

- **Identification of viable and unviable banks** based on stress tests that examine the impact on solvency and key financial indicators over a three year period;

- **Prohibition on the use of public funds** for the direct or indirect bailout of a bank's shareholders;

- **Limits on the use of public or publicly guaranteed resources** to undercapitalized but viable banks, and to support the resolution of unviable banks as envisioned by the banking law, including through purchase and assumption operations;

- **Developing a contingency component** to address an unforeseen systemic liquidity run and/or the failure to attract an interested party when a purchase and assumption operation is being arranged;

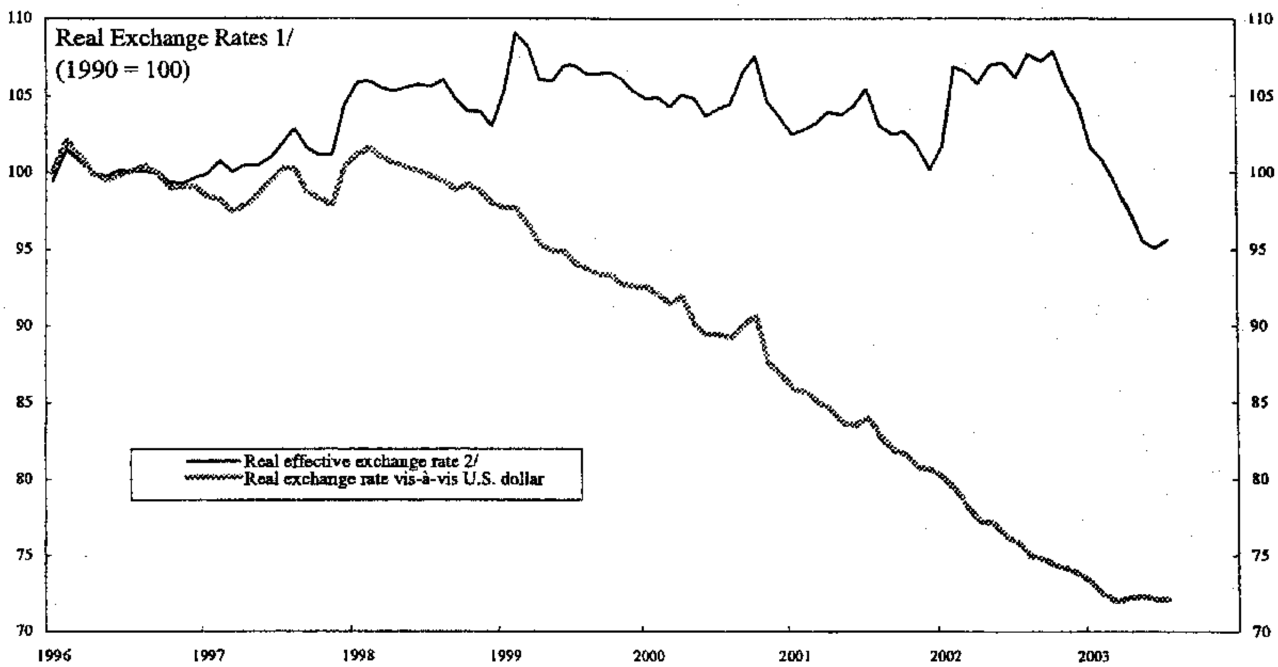
- **Avoiding undue delay of action on unviable banks** to reduce the risk of increasing the fiscal cost of the solution, reduction in asset value, and increasing the chances of a deposit run;

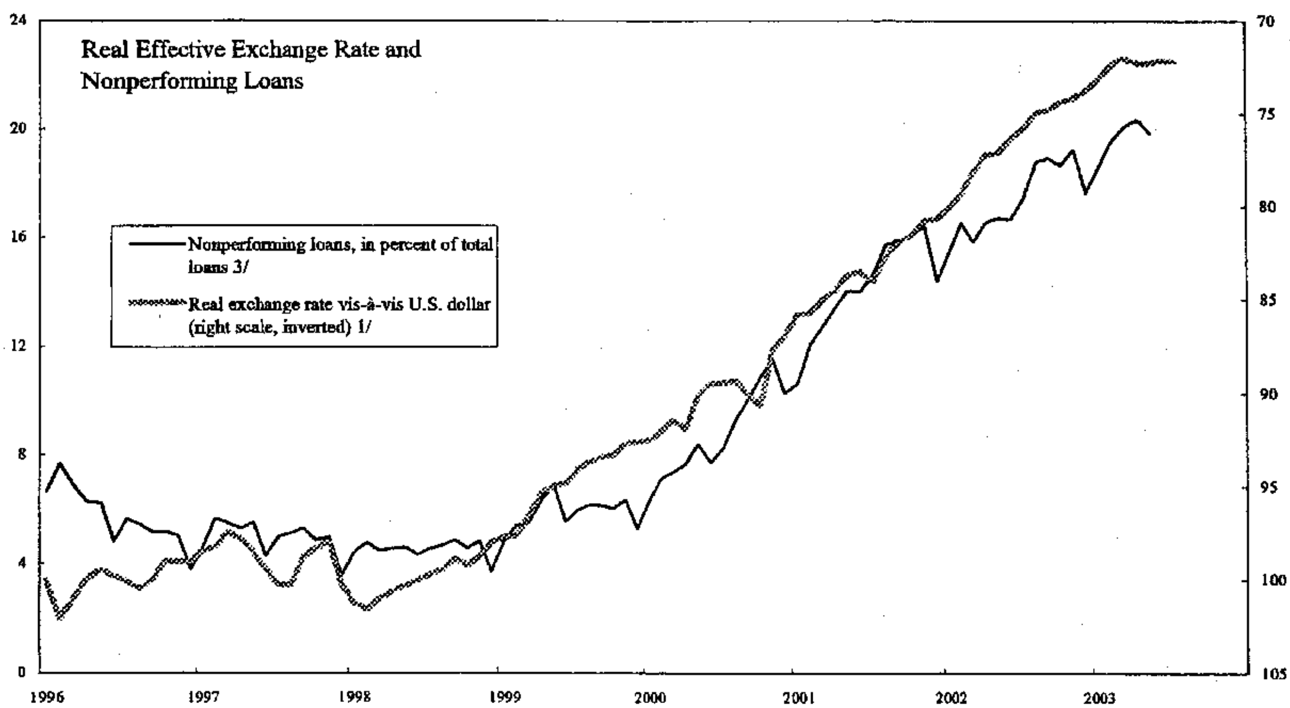
- **Communicating to the public in a transparent manner**, whenever the use of public resources is required—coupled with a clear accountability framework;

- **Developing alternative solutions to unviable banks** that are consistent with the current legal framework—clearly identifying the fiscal implications; and

- **Developing options for the strengthening of viable but undercapitalized banks**, combined with a timetable for implementation.

Figure 1. Bolivia: Real Exchange Rate and Quality of Bank Portfolio, 1996-2003





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

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

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

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

Table 1. Bolivia: Selected Economic and Financial Indicators

	2000	2001	2002 Prel.	2003 Prog. 1/	2003 Proj.
(Annual percentage change)					
Income and prices					
Real GDP	2.3	1.5	2.8	2.9	2.9
Real domestic demand	1.2	-2.5	1.6	1.0	0.3
GDP deflator	5.3	0.7	2.7	3.0	3.4
CPI inflation (period average)	4.6	1.6	0.9	2.6	2.6
CPI inflation (end-of-period)	3.4	0.9	2.4	2.8	2.8
(In percent of GDP)					
Investment and savings					
Gross domestic investment	18.3	14.2	14.7	14.4	13.0
Public	5.2	5.8	5.4	5.0	4.6
Private, including stockbuilding	13.1	8.5	9.4	9.4	8.4
Gross national savings 2/	13.0	10.8	10.3	11.5	11.0
Public	2.8	1.4	-0.4	1.2	0.3
Private	10.2	9.4	10.7	10.3	10.6
Combined public sector 2/					
Overall balance	-3.7	-6.9	-8.9	-6.5	-7.0
External financing 2/	2.0	3.1	6.1	6.4	5.9
Domestic financing	1.8	3.9	2.8	0.1	1.1
Nonpension balance	0.7	-2.1	-3.9	-1.6	-2.1
Pension-related balance	-4.5	-4.8	-5.0	-4.9	-4.9
Nonfinancial public sector debt	58.6	53.6	61.4	69.3	68.0
External 3/	47.1	36.0	42.2	49.1	46.9
Domestic 3/	11.5	17.6	19.2	20.2	21.1
(Annual percentage change, unless otherwise stated)					
Money and credit					
Broad money (in U.S. dollars at current exchange rates)	-3.3	-3.1	-11.7	3.8	2.8
Credit to private sector (in U.S dollars at current exchange rates)	-9.0	-14.3	-9.4	1.5	-1.3
Interest rates (percent, end-of-period)					
Commercial banks lending rate in U.S. dollars 4/	15.3	13.5	11.9	9.4	10.3
Yield on treasury bills in local currency 4/	14.7	12.9	17.2	12.6	10.1
Yield on treasury bills in U.S. dollars 4/	9.1	5.6	4.9	2.4	3.6
External sector (US$ million) 2/					
Current account	-446	-276	-347	-218	-156
(Percent of GDP)	-5.3	-3.4	-4.4	-2.8	-2.0
Excluding exceptional imports (in percent of GDP)	-3.4	-1.6	-1.4	-1.5	-1.3
Capital and financial account	408	255	54	265	205
Of which: foreign direct investment	701	666	674	600	305
Overall balance	-39	-21	-292	48	48
Exceptional financing 5/	15	9	17	17	17
Merchandise export volume, percent change	13.2	6.0	7.9	2.0	1.7
Merchandise import volume, percent change	3.1	-3.5	9.1	-6.4	-11.9
Terms of trade, percent change (deterioration -)	3.6	0.5	-1.3	2.8	4.5
Gross international reserves 6/					
(Months of imports of goods and services)	8.7	8.1	6.5	6.9	6.2
(In percent of broad money)	39.7	39.2	34.6	38.2	38.6
Disposable reserves in percent of dollar deposits 7/	39.5	39.4	31.6	36.1	36.7
Public sector external debt (US$ billion) 3/	4.5	3.3	3.7	4.2	4.2
Exchange rates					
Bolivianos/U.S. dollar (end-of-period) 8/	6.40	6.83	7.50	7.63	7.69
REER (percentage change during year) 9/	-1.5	-3.4	4.4	-11.1	-11.1
REER, period average (percentage change) 9/	-1.6	-1.8	3.0	-6.3	-6.3
Memorandum items:					
Overall fiscal balance (in percent of GDP) 10/	-0.1	-2.9	-4.7	-7.2	-3.4
External current account balance (in percent of GDP) 10/	-6.0	-4.4	-5.8	-4.1	-3.3

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

1/ Proposed program for 2003.

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

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

4/ Yields are those of the latest auction held; July 30 (July 24 for the commercial bank lending rate in U.S. dollars) for 2003.

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

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

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

8/ Official (sell) exchange rate.; September 12 for 2003.

9/ Weights based on average trade, excluding trade related to natural gas, in 1996-97. Preliminary estimates for December 2002. Data for 20 refers to July (or average January-July) based on exchange rate data available as of September 12, and Fund staff CPI projections. Positive variation is an appreciation.

10/ According to previous accounting conventions (before HIPC)

Table 2. Bolivia: Operations of the Combined Public Sector

(In percent of GDP)

	2000	2001	Prel. 2002	Prog. 2003	Proj. 2003
Balance excluding pensions (deficit -)	**0.7**	**-2.1**	**-3.9**	**-1.6**	**-2.1**
Current revenue	22.8	22.9	22.5	23.2	22.2
General government	22.3	22.1	21.9	23.0	22.1
Taxes	18.7	18.1	18.0	19.6	18.7
Hydrocarbons	5.1	5.1	4.7	5.0	4.7
Other	13.6	13.0	13.4	14.6	13.9
Nontax revenue	3.6	3.9	3.8	3.4	3.4
Public enterprise operating balance	0.0	0.3	0.1	-0.1	-0.1
Central bank operating balance	0.5	0.5	0.5	0.3	0.3
Current expenditure of general government	17.8	19.2	20.2	20.1	19.9
Wages	8.3	8.8	9.0	9.5	9.4
Interest	2.3	2.6	2.6	2.9	2.9
Other	7.2	7.7	8.6	7.8	7.6
Official grants	2.2	2.5	2.3	3.0	2.9
Of which: HIPC assistance from grants	0.9	0.9	0.7	0.9	0.7
Capital revenue	0.6	0.1	0.0	0.2	0.0
Capital expenditure	7.1	8.5	8.5	7.9	7.3
General government	6.9	8.3	8.4	7.9	7.3
Public enterprises	0.2	0.2	0.2	0.0	0.1
Pension-related balance (deficit -)	**-4.5**	**-4.8**	**-5.0**	**-4.9**	**-4.9**
Revenue	0.0	0.0	0.0	0.0	0.0
Expenditure	4.5	4.8	5.0	4.9	4.9
Pensions	4.1	4.4	4.6	4.5	4.5
General government employer contributions	0.3	0.4	0.4	0.4	0.4
Overall balance (deficit -)	**-3.7**	**-6.9**	**-8.9**	**-6.5**	**-7.0**
Financing	**3.7**	**6.9**	**8.9**	**6.5**	**7.0**
External 1/	2.0	3.1	6.1	6.4	5.9
Of which: HIPC assistance from refinancing	0.2	0.1	0.2	0.2	0.2
Domestic	1.8	3.9	2.8	0.1	1.1
Central bank	0.4	-0.5	1.7	-0.4	-0.4
Commercial banks	0.1	0.0	0.0	-0.1	0.0
Pension funds	1.7	1.7	1.7	1.9	1.8
Other	-0.5	2.7	-0.5	-1.2	-0.3
Memorandum items:					
Overall balance before grants (deficit -)	-6.0	-9.4	-11.2	-9.5	-9.9
Overall balance excluding grants and hydrocarbons (deficit -)	-11.1	-14.5	-15.9	-14.5	-14.6
Primary deficit (-)	-1.5	-4.3	-6.3	-3.6	-4.1
Savings	2.8	1.4	-0.4	1.2	0.3
Poverty reducing expenditure 2/	10.8	12.1	12.6	12.7	12.9
Total assistance under the HIPC Initiative	1.0	1.1	1.6	1.7	1.7
Original HIPC	0.9	0.7	0.5	0.5	0.5
Enhanced HIPC	...	0.3	1.1	1.2	1.2
HIPC assistance from stock-of-debt reduction	0.1	0.2	0.4	0.5	0.5
On interest	0.1	0.1	0.2	0.2	0.2
On amortization	0.0	0.1	0.2	0.3	0.3
GDP (in billions of bolivianos)	51.9	53.0	55.9	58.4	59.5

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

1/ Includes a US$100 million (1.3 percent of GDP) transfer of foreign liabilities from the central bank to the central governi

2/ Preliminary data for 2001, estimates for 2002, and projections for 2003-06.

Table 3. Bolivia: Summary Balance of Payments

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

	2000	2001	2002	Prog. 2003	Proj. 2003
Current account	**-446**	**-276**	**-347**	**-218**	**-156**
Trade balance	-584	-423	-471	-305	-189
Exports, f.o.b.	1,246	1,285	1,299	1,436	1,452
Of which: gas	122	237	266	346	359
Imports, c.i.f.	-1,830	-1,708	-1,770	-1,741	-1,641
Of which: capitalization and pipeline	-161	-153	-235	-84	-55
Services (net)	-24	-36	-43	-54	-89
Income (net)	-226	-210	-202	-252	-280
Of which: interest due on external public sector debt 1/	-130	-115	-98	-107	-104
Of which: investment income (net)	-146	-165	-177	-197	-199
Transfers (net)	387	393	369	393	400
Of which: HIPC assistance from grants	57	65	80	69	73
Capital and financial account	**408**	**255**	**54**	**265**	**205**
Capital transfers	0	3	0	0	0
Direct investment (net)	701	666	674	600	305
Of which: from capitalization	194	171	47	46	37
Portfolio investment (net)	55	-23	-83	-185	-104
Public sector loans	112	189	321	430	424
Disbursements	292	364	577	733	758
Amortization 1/	-180	-175	-256	-303	-334
Banks' net foreign assets, excl. liquid asset requirement	-369	-401	16	-137	-100
Nonbank private sector loans	-16	-50	59	167	110
Other, including errors and omissions	-75	-128	-934	-610	-431
Overall balance	**-39**	**-21**	**-292**	**48**	**48**
Exceptional financing	**15**	**9**	**17**	**17**	**17**
Of which: HIPC assistance from rescheduling	15	9	17	17	17
Net international reserves (increase -)	**23**	**29**	**275**	**-65**	**-65**
Memorandum items:					
Gross official reserves (end-of-period)	1,162	1,116	854	993	993
(In months of imports of goods and services) 2/	7.0	6.5	5.2	5.6	5.0
Gross international reserves (end-of-period) 3/	1,436	1,375	1,073	1,227	1,227
(In months of imports of goods and services) 2/	8.7	8.1	6.5	6.9	6.2
Gross Fund Financing	14.6	24.2	0.0	102.5	104.6
Total HIPC assistance and beyond HIPC relief	80	99	159	171	180
Original HIPC framework	79	59	43	39	38
Of which: assistance from debt reduction	7	8	7	10	10
Enhanced HIPC framework	1	28	84	87	91
Of which: assistance from debt reduction	1	5	22	30	29
Beyond HIPC and other debt relief	0	12	32	44	51
(In percent)					
Export volume growth	13.2	6.0	7.9	2.0	1.7
Import volume growth	3.1	-3.5	9.1	-6.4	-11.9
Nonexceptional import volume growth	22.7	-3.6	4.0	9.7	-1.8
Terms of trade change	3.6	0.5	-1.3	2.8	4.5
(In percent of GDP)					
Current account	-5.3	-3.4	-4.4	-2.9	-2.0
Current account, excluding exceptional imports	-3.4	-1.6	-1.4	-1.5	-1.3
Current account before HIPC assistance 4/	-6.0	-4.4	-5.8	-4.1	-3.3
Merchandise exports	14.8	16.0	16.6	19.0	18.7
Merchandise imports	21.8	21.3	22.7	23.1	21.1
Of which: capitalization and pipeline	1.9	1.7	3.0	1.1	0.7
Direct investment (net)	8.3	8.3	8.6	7.9	3.9
Grants and loans 5/	5.7	6.8	9.7	12.7	12.7
NPV of debt to GNFS exports (3-year backward moving avg	199.3	100.2	119.4	137.0	134.9
External debt service to GNFS exports	20.4	18.1	12.5	17.9	17.0

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

1/ Reflects lower scheduled debt service, starting in 1998, owing to original HIPC assistance in the form of stock
2/ In months of imports of goods and services in the following year.
3/ Commercial banks' liquid asset requirement (RAL) held overseas added to central bank gross official reserves.
4/ Before any assistance under the HIPC Initiative.
5/ Official transfers and loans to the public sector, excluding HIPC debt relief.

Table 4. Bolivia: Monetary Survey 1/

	2000	2001	2002 Prel.	2003 Prog.	2003 Proj.
I. Central Bank					
(In percent of currency issue at beginning of period)					
Net international reserves	-6.0	-7.7	-71.7	16.5	16.5
(Flow in millions of U.S. dollars)	-23.4	-28.5	-275.4	65.0	65.0
Net domestic assets	6.2	19.1	84.2	-8.1	-8.1
Net credit to nonfinancial public sector	8.5	-11.1	34.6	-8.5	-8.5
Net credit to financial intermediaries	-20.6	4.1	4.0	-6.3	-1.0
Of which: open market operations	16.0	6.7	5.8	-7.3	-5.7
Medium- and long-term net foreign liabilities	8.7	16.6	39.1	1.6	-0.5
(Flow in millions of U.S. dollars, increase -)	33.9	61.0	150.1	6.2	-2.1
Other	9.6	9.6	6.4	5.2	2.0
Currency issue	0.2	11.4	12.5	8.5	8.5
II. Banking System					
(In percent of broad money at beginning of period)					
Net short-term foreign assets	6.6	9.1	-10.8	6.4	5.0
(Flow in millions of U.S. dollars)	244.4	329.3	-379.2	198.7	154.2
Net domestic assets	-8.6	-11.1	0.7	-1.4	-1.3
Net credit to the public sector	1.7	0.8	4.2	-1.2	-0.8
Credit to the private sector	-10.7	-15.2	-9.3	1.8	-1.2
Medium- and long-term net foreign liabilities	3.3	1.5	4.7	-1.1	0.4
(Flow in millions of U.S. dollars, increase -)	122.7	54.2	164.7	-33.8	12.7
Other	-2.9	1.8	1.1	-0.9	0.3
Broad money	-2.0	-2.0	-10.1	5.0	3.7
(12-month percentage change)					
Broad money 2/	-2.0	-2.0	-10.1	5.0	3.7
Liabilities in bolivianos (M2)	3.8	13.7	2.6	11.0	13.1
Foreign currency deposits 3/	-2.6	-4.6	-12.3	3.7	1.6
Credit to private sector	-8.8	-13.4	-9.2	1.7	-1.2
Credit in bolivianos	-2.3	-14.8	-15.4	1.7	-1.2
Foreign currency credit 3/	-9.0	-13.4	-9.1	1.7	-1.2
Memorandum items:					
(Average stock in percent of GDP)					
Currency issue	3.8	4.0	4.1	4.2	4.2
Broad money 2/	43.3	43.6	38.8	38.4	37.8
Credit to private sector	52.3	46.9	42.0	40.3	39.0
(In percent of total deposits or credit at current exchange rates)					
Dollarization (end-period stocks)					
Foreign currency deposits 3/	92.6	91.5	91.9	91.9	91.3
Foreign currency credit 3/	96.3	97.1	97.5	97.7	97.6
(12-month percentage change at current exchange rates)					
Broad money 2/	3.4	3.4	-3.0	10.7	7.7
Credit to private sector	-2.6	-8.5	-0.5	8.3	3.5
(12-month percentage change in U.S. dollars at current exchange rates)					
Broad money 2/	-3.3	-3.1	-11.7	3.8	2.8
Credit to private sector	-9.0	-14.3	-9.4	1.5	-1.3

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

1/ Flows in foreign currency are valued at the accounting exchange rate for the corresponding period. The banking system com
central bank, commercial banks, the National Financial Institution of Bolivia and FONDESIF, which are state-owned second-ti
2/ Includes special certficates of deposits (CDDs) issued by the central bank during the liquidation of failed banks.
3/ Includes deposits and credits in bolivianos that are indexed to the U.S. dollar.

Table 5. Bolivia: Medium-Term Macroeconomic Framework

	2001	2002	2003	2004	Projections 2005	2006	2007	2008
	(Annual percentage change)							
Economic growth and prices								
Real GDP at market prices	1.5	2.8	2.9	4.4	4.8	5.2	4.7	7.6
Of which: Excluding hydrocarbons	1.5	2.6	2.6	3.2	3.8	4.9	4.3	4.1
Real domestic demand 1/	-2.5	1.6	0.3	6.0	5.8	3.9	2.5	0.4
GDP deflator	0.7	2.7	3.4	2.1	3.6	3.2	3.2	2.4
CPI (period average)	1.6	0.9	2.6	3.1	3.5	3.2	3.0	3.0
CPI (end of period)	0.9	2.4	2.8	3.5	3.5	3.0	3.0	3.0
	(In percent of nominal GDP)							
Gross investment	**14.2**	**14.7**	**13.0**	**18.2**	**21.1**	**21.7**	**21.1**	**16.5**
Public investment 2/	5.8	5.4	4.6	4.7	4.7	4.7	4.7	4.7
Private investment, including stockbuildin;	8.5	9.4	8.4	13.5	16.4	17.0	16.4	11.7
Savings	**14.2**	**14.7**	**13.0**	**18.2**	**21.1**	**21.7**	**21.1**	**16.5**
Gross national savings	10.8	10.3	11.0	12.5	13.9	15.1	15.8	16.7
Public savings	1.4	-0.4	0.3	1.7	2.9	3.6	4.1	4.7
Private savings	9.4	10.7	10.6	10.8	11.1	11.4	11.7	12.0
External savings	3.4	4.4	2.0	5.7	7.2	6.6	5.3	-0.2
Consolidated public sector								
Non-pension balance	-2.1	-3.9	-2.1	-0.7	0.3	0.8	1.1	1.5
Pension-related balance	-4.8	-5.0	-4.9	-4.8	-4.8	-4.6	-4.5	-4.3
Overall balance	-6.9	-8.9	-7.0	-6.0	-5.5	-4.8	-4.0	-2.8
Net domestic financing	3.9	2.8	1.1	0.6	0.5	0.4	0.4	0.2
Net external financing	3.1	6.1	5.9	5.4	5.5	4.4	3.6	1.6
External sector								
Current account balance	-3.4	-4.4	-2.0	-5.7	-7.2	-6.6	-5.3	0.2
Excluding exceptional imports	-1.5	-1.4	-1.3	-2.0	-1.6	-1.7	-2.0	1.3
Net foreign direct investment	8.3	8.6	3.9	10.3	12.6	12.2	10.3	7.7
Memorandum items:								
Nominal GDP (millions of U.S. dollars)	8,036	7,812	7,768	7,883	8,237	8,702	9,170	9,849

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

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

Table 6. Bolivia: Debt Sustainability Analysis Debt Service Indicators

(In percent)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
SBA														
NPV of debt as a ratio of GDP	44.7	47.4	49.8	49.4	48.7	48.3	48.1	47.9	47.6	47.3	46.4	45.6	45.0	44.7
NPV of debt as a ratio of revenue (excl. grants)	198.4	204.6	199.0	194.9	192.7	191.1	188.3	186.6	186.9	187.7	185.2	185.2	184.3	185.3
Debt service as a ratio of revenue (excl. grants)	34.1	39.4	24.4	27.3	22.6	20.4	18.8	17.3	18.1	21.0	23.7	23.3	22.2	22.2
External	9.4	14.3	14.0	14.0	14.5	12.6	12.5	12.2	13.0	12.9	12.4	11.8	11.9	13.0
Internal	24.7	25.2	10.4	13.3	8.2	7.8	6.3	5.1	5.2	8.1	11.3	11.5	10.3	9.2
NPV of external debt as a ratio of exports	119.4	134.9	141.5	137.1	136.8	138.0	139.7	136.9	133.4	129.6	125.3	122.1	119.3	116.5
External debt service as a ratio of exports	10.9	16.0	16.1	15.6	15.8	13.7	13.7	13.1	13.5	12.9	12.0	10.9	10.7	11.2
IMF Baseline scenario: nonconcessional financing limited to 1.2 percent of GDP														
NPV of debt as a ratio of GDP	44.7	47.7	50.9	51.0	50.5	50.2	48.8	47.8	47.4	47.1	46.2	45.4	44.8	44.6
NPV of debt as a ratio of revenue (excl. grants)	198.4	214.1	219.4	207.8	204.9	200.8	190.9	185.4	178.7	178.0	174.0	171.3	169.0	168.3
Debt service as a ratio of revenue (excl. grants)	34.1	40.6	26.1	31.8	22.9	19.3	15.3	15.6	15.4	18.4	20.3	19.9	19.1	19.2
External	9.4	14.6	14.8	14.4	15.1	13.2	12.9	12.7	13.2	13.0	12.3	11.6	11.7	12.6
Internal	24.7	25.9	11.3	17.4	7.9	6.1	2.4	2.9	2.2	5.3	8.0	8.3	7.3	6.5
NPV of external debt as a ratio of exports	119.7	132.7	146.3	150.9	156.4	155.6	152.5	144.8	139.1	135.3	133.8	132.7	131.6	130.1
External debt service as a ratio of exports	11.0	16.0	16.1	15.9	16.4	14.4	14.2	13.6	14.1	13.6	12.8	12.0	12.1	12.8

Source: Fund staff estimates and projections.

Bolivia: Financial Position in the Fund

As of August 31, 2003

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

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	171.50	100.00
Fund holdings of currency	216.24	126.09
Reserve position in Fund	8.87	5.17

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	26.70	100.00
Holdings	27.44	102.76

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
Stand-by arrangements	53.60	31.25
ESAF/PRGF arrangements	133.89	78.07

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	Apr 02, 2003	Apr 01, 2004	85.75	53.60
ESAF/PRGF	Sep 18, 1998	Jun 07, 2002	100.96	63.86
ESAF	Dec 19, 1994	Sep 09, 1998	100.96	100.96

VI. Projected Payments to Fund (Expectations Basis) [1]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	11.46	26.60	36.74	49.45	34.24
Charges/Interest	0.85	1.67	1.49	0.92	0.30
Total	12.40	28.26	38.28	50.33	34.50

[1] This schedule presents all currently scheduled payments to the IMF, including repayment expectations where applicable and repayment obligations otherwise. The IMF Executive Board can extend repayment expectations (within predetermined limits)upon request by the debtor country if its external payments position is not strong enough to meet the expectations without undue hardship or risk (see repayment schedules and IMF lending for details).

Projected Payments to Fund (Obligations Basis) [2]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	11.46	26.60	24.68	34.71	46.30
Charges/Interest	0.61	1.69	1.56	1.39	0.82
Total	12.07	28.29	26.24	36.10	47.13

[2] This schedule is not the currently applicable schedule of payments to the IMF. Rather, the schedule presents all payments to the IMF under the illustrative assumption that repayment expectations-except for SRF repayment expectations-would be extended to their respective obligation dates by the IMF Executive Board upon request of the debtor country (see repayment schedules and IMF lending for details). SRF repayment expectations can be extended by a maximum of one year, to either a new expectation date or an obligation date. Therefore, SRF repayments are shown on their current expectation dates, unless already converted to an obligation date by the IMF Executive Board.

VII. Implementation of HIPC Initiative:

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

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

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

Decision point - point at which the IMF and the World Bank determine whether a country qualifies for assistance under the HIPC Initiative and decide on the amount of assistance to be committed.

Interim assistance - amount disbursed to a country during the period between decision and completion points, up to 20 percent annually and 60 percent in total of the assistance committed at the decision point (or 25 percent and 75 percent, respectively, in exceptional circumstances).

Completion point - point at which a country receives the remaining balance of its assistance committed at the decision point, together with an additional disbursement of interest income as defined in footnote 2 above. The timing of the completion point is linked to the implementation of pre-agreed key structural reforms (i.e., floating completion point).

VIII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, Central Bank of Bolivia (CBB) is subject to a full assessment with respect to the arrangement, which was approved on April 02, 2003 and is scheduled to expire on April 01, 2004. The on-site assessment was completed on June 27, 2003 and found no systemic risks in the safeguards of the CBB. The assessment identified, however, a few anomalies in the CBB's reporting and control system and made recommendations, as reported in Supplement 2 to EBS/03/90. Implementation of the recommendations needs to be monitored by staff.

The previous assessment, which was limited to the external audit assessment, was completed on October 19, 2000.

IX. Resident Representative: Mr. Simon Cueva starts his assignment August 31, when Mr. Gerardo Peraza leaves the post as resident representative.

BOLIVIA: RELATIONS WITH THE WORLD BANK

Recognizing Bolivia's current difficulties, the World Bank's strategy has been to help the country with actions that balance the need to respond to the February crisis with the need to continue with medium-term development objectives. By the end of August, the Bank expects the Government to have revised its PRSP, which would form the basis for the World Bank's Country Assistance Strategy (CAS) over the next four years. The Consultative Group meeting planned for October 2003, that will be supported by the Bank, will also provide input for the CAS. Provided the Government is indeed able to complete this task, the World Bank would be able to present the CAS to the Board on December, 2nd.

Recent actions

In June the WB Board approved three projects. One is this Social Cushion SAC aimed at keeping the situation from deteriorating further. This project focuses on budget protection of key social sector interventions and includes measures to ensure that the budget will be executed as planned. The project also supports the temporary employment programs. The second project is the Decentralization Programmatic Structural Adjustment Credit (PSAC) aimed at deepening the reforms in decentralization and to help control the build-up of municipal debt. The third project is an investment APL that will increase electrification and telecommunications in the rural areas. The APL has a strong emphasis on helping to develop adequate policies to accelerate coverage rates in these important areas.

Additional WB actions aimed at helping the Government achieve medium-term objectives

- Prepare its CAS that would be based on revisions to Bolivia's PRSP (which will take place after the third National Dialogue planned sometime in August). The CAS will be prepared jointly with the IFC, which is expected to take on a larger role in promoting more effective private sector development. Work on the CAS has already begun. Two lending projects will accompany the CAS, that, as indicated will be presented at the Board in December: the Poverty Reduction Strategy Credit (PRSC) and the Banking and Corporate Restructuring Project (FSAL).
    - The PRSC will be an important instrument to support Bolivia's PRSP. Current plans for the PRSC are to have three main components that support: (a) pro-poor growth; (b) achievement of MDGs; and (c) participatory monitoring and evaluation of the PRSP, with a heavy focus on tracking results;
    - The FSAL aims at helping the Government with its planned banking and corporate restructuring. This project is potentially risky and would only go forward after a careful analysis of the benefits and risks of operating in this area.
- Help the Government manage more effectively the existing stock and future flows of donations from bilateral agencies and credits from multilateral agencies so as to finance their initiatives to get out of the crisis. There are approximately US$ 1.6 billion in undisbursed funds in existing projects and a yearly flow of approximately US$ 700 million that is expected to be provided to Bolivia over the next four years. Currently, these resources are not adequately aligned to current needs. The World Bank is working with the Government and other donors to bring about a more effective alignment. This

will undoubtedly require some restructuring on the part of several donors and the restructuring options will be discussed at a Consultative Group meeting scheduled for early FY04.

- Prepare a Public Expenditure Review (PER) to be discussed with the Government by September 2003. In this PER there will be an update of the analysis of the fiscal sustainability of the existing major reforms, including the pension reform, institutional reforms that modified civil service salaries and education and health reforms. While some analysis of the sustainability of the reforms was carried out at the moment when they were launched, the situation has changed with the drop in the rate of growth and the unexpected outcomes of negotiations with different sectors. The PER will also provide guidance on implementation of a Medium-Term Expenditure Framework and will review the efficiency, equity and sustainability of government programs in health, education, social protection and infrastructure.
- Update the 2001 Poverty Report. Given the likely emphasis that Bolivia's revised PRSP will place on improving the productive capabilities of the poor, the update will include an expanded treatment of the problems of generating pro-poor growth.

The Bank's work on the CAS, PRSC and PER will provide inputs for budget negotiations that will take place in Bolivia from late October to the middle of December. The Government will attempt to use these negotiations to reach agreement with different sectors on the direction that Bolivia will take not only for 2004, but for the next 3-4 years.

Bank-Fund collaboration in specific areas

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

Overall Financial Sector Assessment: This assessment was presented at the IMF Board in July. As a complement, the Bank prepared a Report on the Observance of Standards and Codes (ROSC) focusing on insolvency and creditor rights systems, contingent on government approval.

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

Joint Staff Assessment (JSA) of the Government's PRSP Progress Report. The Bank and the Fund will reviewed the authorities' PRSP progress report.. The JSA will be prepared on the basis of the final version of the PRSP progress report.

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

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

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

BOLIVIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

Background

As of July 15, 2003, the Inter-American Development Bank (IDB) had approved loans to Bolivia amounted to US$3.2 billion, of which cumulative disbursements amounted to US$2.3 billion. Bolivia's outstanding debt to the IDB was US$1.5 billion.

The lending program

The IDB´s lending program for Bolivia is aimed at supporting the government's efforts to reduce poverty, as reflected in the Poverty Reduction Strategy Paper presented to the IDB on June 2001. This strategy, focuses on: (i) promoting sustained growth and increased employment opportunities in the productive infrastructure sectors, micro enterprise, and rural development; (ii) supporting direct actions to improve access to the basic social services; and (iii) governance. The impact of the regional crisis on Bolivia's economic performance since 1999, has weakened growth in labor intensive sectors pushing unemployment to 11.9 percent and increasing poverty incidence in urban and rural areas. The economic slowdown together with higher than expected pension related fiscal deficit and increased fragility of the financial system, has amplified the exposure of the country to an extended period of economic, social and political distress. In this context, the Bank assistance in 2003 will focus on supporting efforts to stabilize the economy, protect investments in key sectors from further deteriorating (roads and basic infrastructure), continue programs that are in the critical path to achieve the Millennium Development Goals, and create better conditions for rural and urban development.

The proposed IDB lending program for Bolivia for 2003 consists of ten loans for a total of US$219.0 million, of which US$100.0 million will support policies to promote fiscal sustainability and competitiveness. The IDB Board of Directors has assigned US$229 million in concessional resources for Bolivia for the period 2002–03, US$18.8 million of which were approved in the year 2002.

Recent economic and sector work

The Board of Directors approved the Country Paper for Bolivia, which outlines the Bank's strategy with the country, in June 9, 1999. The IDB is currently working on a new strategy for the period 2003–07. Economic studies have been completed on fiscal sustainability, HIPC debt relief and poverty, pension reform and descentralization.

IDB nonreimbursable technical cooperation and small projects

The IDB portfolio also includes active projects for US$27.0 million in nonreimbursable technical cooperation, and US$1.9 million in non-reimbursable small projects.

ANNEX III

Bolivia: Relations with the Inter-American Development Bank

(In millions of U.S. dollars)

Reference	Projects	Number of Loans	Approved	Disbursed	Undisbursed
	I. Statement of IDB loans (as of July 15, 2003)				
Totally disbursed (less cancellations)			**1,852.0**		
Sectors		35	**1,057.6**	**421.1**	**613.0**
Roads		4	222.0	110.1	111.9
698/OC	Beni-La Paz Peruvian Border Corridor		55.0	52.9	2.2
893/SF	Cotapata - Santa Barbara		40.0	39.8	0.2
1039/SF	Ventilla-Tarapaya		52.0	17.5	34.5
1101/SF	Trade Corridor Sta. Cruz - Puerto Suarez		75.0	-	75.0
Tourism		1	10.0	-	10.0
1098/SF	Sustainable Tourism Development Program		10.0	-	10.0
Agriculture and Envrionment		5	102.1	35.6	43.1
1099/SF	Env-Soc. Protection Santa Cruz - Pto. Suarez		21.0	0.0	21.0
1116/SF	Emergency Attention Plan: Fire Cordillera Sama-Tarija		2.5	-	2.5
929/SF	Protection of environment		19.0	13.6	5.5
964/SF	Irrigation and drainage		25.6	15.6	10.0
1057/SF	Agricultural Services Program		34.0	6.4	27.6
Sanitation		2	110.0	44.2	65.8
987/SF	Urban Sanitation PRODURSA		70.0	41.8	28.2
1050/SF	Urban Sanitation Small Municipalities		40.0	2.3	37.7
Social sectors		8	289.5	141.3	148.2
931/SF	Education Reform		80.0	61.8	18.2
995/SF	Programa de Atención al Menor		20.0	7.3	12.8
1006/SF	Apoyo a Política de Vivienda		60.0	18.8	41.2
1031/SF	Epidemiological Shield and Sector Reform		45.0	12.5	32.5
1093/SF	Strengthening Technical Education		6.0	1.0	5.0
1116/SF	Emergency Attention Plan		2.5	-	2.5
1126/SF	Education Reform II		36.0	-	36.0
1097/SF	Support Poverty Reduction Strategy		40.0	40.0	0.0
Institutional strengthening		12	177.0	67.8	109.2
1127/SF	Fiscal Sustainability Program		63.0	30.0	33.0
1128/SF	TC Fiscal Sustainability Support Program		2.0	-	2.0
976/SF	Governability Support		12.0	11.9	0.1
993/SF	Descentralization SNIPPRE		7.0	3.4	3.6
1038/SF	Loan TC Civil Society Access to Justice		2.7	1.0	1.7
1043/SF	Institutional Stregthening National Tax Agency		3.2	2.0	1.2
1046/SF	National Census Preparation Support		7.4	7.2	0.2
1056/SF	Customs reform and Modernization		5.0	3.0	2.0
1075/SF	Local Development and Fiscal Adjustment		47.0	3.4	43.6
1091/SF	Modernization Municipal Financial Administration		20.0	5.8	14.2
1121/SF	Disaster Prevention Program		2.7	-	2.7
1118/SF	Institutional Support to Strengthen Trade		5.0	-	5.0
Multisectoral onlending		1	35.0	22.3	12.7
1020/SF	Micro and Small Enterprises		35.0	22.3	12.7
Private Sector		2	112.0	-	112.0
1431/OC	Telecomunication Network Redibol		37.0	-	37.0
1444/OC	Transredes (Gas)		75.0	-	75.0
Technical assistance		52	**27.0**	**17.2**	**9.8**
Total			**2,936.6**	**2,290.3**	
Repaid				**769.1**	
Outstanding				**1,504.0**	

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

	Amount	In Percent of Total
II. Proposed IDB Lending Program 2003		
Number of loans	**10**	
Total loan amounts	**219.0**	**100.0**
Human development and access to social services	**36.0**	**16.4**
Education Reform II (*)	36.0	16.4
Growth and creation of opportunities	**113.0**	**51.6**
Rural Development Program	10.0	4.6
Land titling	20.0	9.1
Revitalization of the Center of La Paz	20.0	9.1
Support to Competitiveness	37.0	16.9
Support to Bolivian Competitiveness System	10.0	4.6
Roads maintenance and Rehabilitation	16.0	7.3
Governance and consolidation of reforms	**70.0**	**32.0**
Justice Sector Reform	5.0	2.3
TC Support to Fiscal Sustainability (*)	2.0	0.9
Support to Fiscal Sustainability (*)	63.0	28.8

(*) Approved.

Source: Inter-American Development Bank.

Bolivia: Debt Sustainability Analysis

Bolivia's debt indicators are less favorable than envisaged in the staff report for the first review of the SBA (EBS/03/90) and much less favorable than envisaged in 2001 at the completion point under the Enhanced HIPC Initiative.

- Historically, this reflects the large increases in the fiscal deficit in 2001–02 that were financed by domestic and nonconcessional external borrowing. Despite the enhanced HIPC debt relief received in June 2001, the NPV of nonfinancial public sector debt returned to its end-2000 level of about 45 percent of GDP in 2002, compared with a sharp drop to 34 percent of GDP that was envisaged under the enhanced HIPC Initiative.

  For the medium term, this reflects a more gradual fiscal adjustment to take into account the difficult political situation. Public sector debt is now projected to decline over the medium term more gradually than envisaged in EBS/03/90, but still requires substantial fiscal adjustment. If the LNG project fails to materialize the NPV of the debt would continue rising to over 60 percent of GDP in 2015 making the debt unsustainable.

Medium-term stress tests

The stress tests presented in EBS/03/90 were repeated to analyze the impact of the more gradual fiscal adjustment.[1] The critical assumption in the baseline scenario is that the higher fiscal deficit is mostly financed by concessional resources (see text box).

The sensitivity of the debt path to selected stress tests is quite similar to that discussed in EBS/03/90. As in EBS/03/90, the stress tests show that debt could become unsustainable in the absence of a fiscal adjustment, but also that debt indicators are sensitive to low growth rates, current account adjustments, export prospects, and an exchange rate depreciation.

In the program projections, the net present value (NPV) of public debt relative to GDP peaks in 2005, but falls subsequently and the ratios of debt service and interest to revenue improve (Figure 1, top right and bottom panels). Stress tests show the following results (Figure 2 and Table 2):

- A "GDP shock" (stress test 3), which reduces the growth rate to the historical average of five years (2.4 percent) minus two standard deviations (one standard deviation is 1.7 percent) in 2003 and 2003, has the least impact.

[1] It is assumed that a loan of $70 million is contracted in 2004 to finance banking and corporate restructuring.

- Under a "fiscal shock" (stress test 4), the fiscal program goes off track by one standard deviation (2.1 percent of GDP) in each year through 2008. In this case, the debt to GDP ratio rises to over 80 percent, but levels off in the medium term.

- A large shock to the debt stock would come from the "status quo" stress test (stress test 1) assuming that the real interest rate, the real GDP growth rate, and the primary balance would remain in 2003-08 at their average of the past five years. In this case, public debt would continue to rise, exceeding 90 percent of GDP by 2008.

- In an "exchange rate shock" stress test, the exchange rate depreciates by 30 percent in 2003 (stress test 6). Since 95 percent of public debt is denominated in foreign currency, this shock has a large impact on the debt to GDP ratio, which rises to 89 percent in 2005.[2] The ratio subsequently falls, assuming that the program's fiscal adjustment path is achieved, but remains high at 82 percent in 2008.

- A picture similar to that with the "exchange rate shock" emerges from a stress test that assumes that the debt ratio in 2003 would rise by an additional 30 percent of GDP (stress test 7). While the debt stock would still stand at about 92 percent of GDP in 2008, it would decline from over 100 percent in 2004 and 2005.

Similar stress tests were applied to the external debt projections (Table 1).

- If natural gas exports remain constant at the level of 2003, rather than expanding as projected in the baseline (stress test 1), the ratio of the NPV of debt to exports in 2007 would increase from 133 percent in 2003 to almost 180 percent in 2008, rather than falling to about 150 percent under the program projection. The nominal external debt to GDP ratio would increase from 53 percent in 2003 to 57 percent in 2008 (compared with 54 percent in the program), reflecting the impact of lower exports on GDP.

- If interest rates, growth, inflation, the non-interest current account, and non-debt flows remain during 2003-08 at the average of the past five years (stress test 2), the nominal debt to GDP ratio increases sharply from 49 percent in 2003 to almost 70 percent in 2008, with the increase mostly due to the non-adjustment of the current account.

- If real GDP growth in 2003-4 is set to the average of the preceding five years (2.4 percent) minus two standard deviations (one standard deviation is 1.7 percent) (stress test 3), the debt to GDP ratio increases to 64 percent in 2005, but then falls to 59 percent in 2008.

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

- If the current account deficit excluding interest in 2003-04 is set to the program projection minus two standard deviations (one standard deviation is 1.4 percent of GDP) (stress test 4), the debt to GDP ratio falls from 2005 onward, but remains high at 60 percent in 2008 compared with 56 percent in 2003.

- A 30 percent depreciation in 2003 enlarges the ratio of debt to GDP (stress test 5), peaking at 76 percent in 2004, but debt remains sustainable and falls to 69 percent in 2008.

Annex IV Table 1. Bolivia: External Sustainability Framework, 2000-08

	Actual			Projections					
	2000	2001	2002	2003	2004	2005	2006	2007	2008
I. Baseline Medium-Term Projections									
1 Nominal external debt/Exports of G&NFS	303.4	218.7	242.8	244.9	250.9	246.9	245.5	238.5	201.4
2 Nominal external debt/GDP 1/	53.1	41.4	47.7	53.4	58.3	59.9	60.2	59.2	56.7
3 Change in external debt/GDP	-2.0	-11.7	6.3	5.8	4.8	1.7	0.2	-1.0	-2.5
4 Net debt-creating external flows/GDP (5+9+12)	-3.6	-3.1	-3.7	-0.2	-5.9	-7.9	-8.8	-8.1	-11.9
5 Current account deficit, excluding interest payments/GDP	4.2	2.5	3.7	1.1	4.6	6.0	5.3	3.9	-1.6
6 Deficit in balance of G&NFS/GDP	9.5	7.4	7.8	3.8	8.5	9.8	9.0	7.0	1.2
7 Exports of G&NFS/GDP	17.5	18.9	19.6	21.8	23.2	24.3	24.5	24.8	28.2
8 Imports of G&NFS/GDP	27.0	26.3	27.4	25.6	31.8	34.1	33.5	31.8	29.3
9 Minus net non-debt creating capital inflows/GDP	-8.3	-8.3	-8.6	-3.9	-10.3	-12.6	-12.2	-10.3	-7.7
10 Net foreign direct investment, equity/GDP	8.3	8.3	8.6	3.9	10.3	12.6	12.2	10.3	7.7
11 Net portfolio investment,equity/GDP	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
12 (r-g-(r+gr))/(1+g+r+gr))debt/GDP (14/13)	0.6	2.8	1.2	2.7	-0.2	-1.3	-1.9	-1.7	-2.7
13 Adjustment factor: 1+g+r+gr	1.0	1.0	1.0	1.0	1.0	1.0	1.1	1.1	1.1
14 (r-g-(r+gr))debt/GDP (15+16+17)	0.6	2.7	1.2	2.6	-0.2	-1.4	-2.0	-1.8	-2.9
15 r (interest rate) times debt/GDP	1.2	0.9	0.7	1.0	1.1	1.3	1.4	1.5	1.5
16 minus g (real GDP growth rate) times debt/GDP	-1.3	-0.8	-1.1	-1.4	-2.3	-2.8	-3.1	-2.8	-4.5
17 minus (r + gr) (r = US dollar value of GDP deflator, growth rate) times debt/GDP	0.7	2.5	1.7	2.9	1.0	0.2	-0.3	-0.4	0.1
18 Residual, incl. change in gross foreign assets/GDP (3-4)	1.5	-8.6	10.0	5.9	10.8	9.6	9.0	7.1	9.5
Memorandum Items: Key macro and external assumptions									
Nominal GDP (In billions of Bolivianos)	51.9	53.0	55.9	59.5	63.4	68.8	74.7	80.7	88.9
Nominal GDP (In billions of U.S. dollars)	8.4	8.0	7.8	7.8	7.9	8.2	8.7	9.2	9.8
Real GDP growth (in percent per year)	2.3	1.5	2.8	2.9	4.4	4.8	5.2	4.7	7.6
Nominal GDP deflator (in U.S. dollars, change in percent per year)	-1.3	-4.7	-3.9	-6.0	-1.9	-0.3	0.4	0.6	-0.1
External interest rate (percent per year)	2.1	1.8	1.7	2.1	2.0	2.2	2.3	2.4	2.5
Growth of exports of G&NFS (U.S. dollar terms, in percent per year)	12.2	3.4	0.9	10.5	8.0	9.2	6.7	6.7	21.9
Growth of imports of G&NFS (U.S. dollar terms, in percent per year)	7.2	-6.9	1.4	-7.1	25.7	12.2	3.7	0.1	-1.0
NPV of external debt (In billions of U.S. dollars)	2.7	1.4	1.8	2.1	2.5	2.8	3.2	3.4	3.6
NPV of external debt to exports of GNFS (three-year backward moving average)	199.3	100.2	119.7	132.7	147.1	153.3	160.0	160.2	152.2
Debt service to exports ratio	20.4	18.1	12.6	16.8	17.0	17.4	19.4	16.3	12.6
II. Sensitivity Analysis for Nominal External Debt-to-GDP Ratio									
1. Natural gas exports remain at the level in 2003				53.4	59.1	61.5	61.9	61.0	59.5
NPV of external debt to exports (three-year backward moving average)				*132.7*	*150.5*	*162.9*	*176.7*	*180.7*	*176.4*
2. If interest rate, real GDP growth rate, US$ GDP deflator growth, non-interest current account, and non-debt flows (in percent of GDP) are at average of past 5 years				49.1	55.4	60.6	65.3	68.2	73.5
NPV of external debt to exports (three-year backward moving average)				131.8	148.1	161.0	177.2	186.7	190.2
3. If real GDP growth rate in 2003 and 2004 is average minus two standard deviations, others at baseline				55.4	63.3	64.8	64.9	63.8	61.1
NPV of external debt to exports (three-year backward moving average)				133.3	153.5	160.0	167.0	167.2	158.8
4. If current account is average plus two standard deviations for two years				56.2	63.8	65.3	65.4	64.2	61.5
NPV of external debt to exports (three-year backward moving average)				139.5	161.0	167.1	173.9	173.9	165.1
5. One time 30 percent depreciation in year 2003 (-30% GDP deflator shock), others at baseline.				70.7	75.5	76.8	76.5	75.0	71.8
NPV of external debt to exports (three-year backward moving average)				132.7	147.1	153.3	160.0	160.2	152.2
Memorandum Items									
Current account deficit, excluding interest payments (percent of GDP, average of past 5 years)			4.3	4.3	4.3	4.3	4.3	4.3	4.3
Current account deficit, excluding interest payments (percent of GDP, standard deviation of past 5 years)			1.4	1.4	1.4	1.4	1.4	1.4	1.4
Net non-debt creating capital inflows (percent of GDP, average of past 5 years)			9.7	9.7	9.7	9.7	9.7	9.7	9.7
Interest rate (average of past 5 years)			2.1	2.1	2.1	2.1	2.1	2.1	2.1
Interest rate (standard deviation of past 5 years)			0.6	0.6	0.6	0.6	0.6	0.6	0.6
Real GDP growth rate (average of past 5 years)			2.4	2.4	2.4	2.4	2.4	2.4	2.4
Real GDP growth rate (standard deviation of past 5 years)			1.7	1.7	1.7	1.7	1.7	1.7	1.7
GDP deflator, U.S. dollar terms (average of past 5 years)			-2.2	-2.2	-2.2	-2.2	-2.2	-2.2	-2.2
GDP deflator, U.S. dollar terms (standard deviation of past 5 years)			2.9	2.9	2.9	2.9	2.9	2.9	2.9

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

Annex IV Table 2. Bolivia: Public Sector Debt Sustainability Framework, 2000-08

		Actual			Projections					
		2000	2001	2002	2003	2004	2005	2006	2007	2008
	I. Baseline Medium-Term Projections									
1	Public debt (nominal)/revenues 1/	233.3	208.5	236.2	262.9	275.0	267.7	267.6	265.7	254.0
2	Public debt (nominal)/GDP 1/	58.6	53.6	61.4	68.0	73.0	74.4	74.7	74.4	71.5
3	Change in public debt/GDP	-9.2	-5.1	7.9	6.5	5.0	1.4	0.3	-0.3	-2.9
4	Net debt-creating flows/GDP (5+6)	-0.2	5.5	7.1	3.8	1.1	-0.3	-1.1	-1.4	-4.6
5	Overall deficit, excluding net interest payments/GDP (=primary deficit)	1.9	4.8	6.6	4.5	3.5	3.0	2.4	1.7	0.4
	Revenue and grants/GDP	25.1	25.7	26.0	25.9	26.5	27.8	27.9	28.0	28.1
	Noninterest expenditure/GDP	27.1	30.5	32.6	30.3	30.1	30.8	30.4	29.6	28.5
6	((r - p) - g (1+p))/(1+g+p+gp))debt/GDP (8/7) 2/	-2.1	0.7	0.5	-0.7	-2.4	-3.3	-3.5	-3.0	-4.9
7	Adjustment factor: 1+g+p+gp	1.1	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1
8	((r - p) -g (1+p))debt/GDP (9+10)	-2.3	0.7	0.5	-0.7	-2.6	-3.6	-3.8	-3.3	-5.5
9	(r - p) times debt/GDP	-0.6	1.6	2.0	1.1	0.5	0.0	0.1	0.3	0.3
10	minus g (1 + p) times debt/GDP	-1.6	-0.9	-1.5	-1.8	-3.1	-3.7	-4.0	-3.6	-5.8
11	Residual, incl. asset changes and privatization receipts (negative)/GDP (3-4)	-9.1	-10.6	0.8	2.7	3.9	1.8	1.3	1.1	1.7
	Memorandum Items: Key macro and external assumptions									
	Nominal GDP (in billions of Bolivianos)	51.9	53.0	55.9	59.5	63.4	68.8	74.7	80.7	88.9
	Real GDP growth (in percent per year)	2.3	1.5	2.8	2.9	4.4	4.8	5.2	4.7	7.6
	Exchange rate (Bolivianos per U.S. dollar)	6.4	6.8	7.5	7.9	8.3	8.5	8.7	8.9	9.2
	Nominal appreciation of Boliviano against U.S. dollar	-6.3	-6.3	-8.9	-4.6	-4.8	-2.9	-2.4	-2.4	-2.4
	CPI (change, in percent per year)	4.6	1.6	0.9	2.6	3.1	3.5	3.2	3.0	3.0
	Average interest rate on public debt (percent per year)	3.7	4.4	4.7	4.5	3.8	3.5	3.4	3.4	3.4
	Average real interest rate (nominal rate minus change in CPI, percent)	-0.9	2.8	3.7	1.8	0.7	0.0	0.2	0.4	0.4
	Growth of revenues (deflated by GDP deflator, in percent per year)	-1.0	3.8	4.1	2.3	7.1	9.8	5.6	5.0	8.2
	Growth of noninterest expenditure (deflated by GDP deflator, in percent per year)	0.2	14.3	9.8	-4.3	3.5	7.5	3.6	2.3	3.4
	NPV of debt (in billions of U.S. dollars)	3.7	3.1	3.5	3.7	4.0	4.3	4.5	4.7	5.0
	Budgetary debt service to revenue	24.8	31.6	31.0	35.8	23.4	28.5	20.6	17.6	14.2
	II. Stress Tests									
	1. If real interest rate, real GDP growth rate, and primary balance (in percent of GDP) in 2003-2008 are at average of past 5 years				66.3	73.3	78.1	82.5	86.7	91.4
	(In NPV terms)				*46.5*	*51.3*	*54.2*	*57.0*	*60.2*	*64.3*
	2. If real interest rate in 2003 and 2004 is average plus two standard deviations, others at baseline				70.7	79.6	80.8	80.8	80.2	76.9
	3. If real GDP growth rate in 2003 and 2004 is average minus two standard deviations, others at baseline				70.3	78.8	80.0	80.0	79.5	76.3
	4. If primary balance (in percent of GDP) in 2003-08 is at baseline plus one standard deviation				69.9	77.0	80.3	82.4	83.9	82.5
	5. Combination of 2-4 using one standard deviation shocks				71.8	83.8	84.8	84.5	83.8	80.3
	6. One time 30 percent real depreciation in 2003, others at baseline 3/				84.8	89.2	89.9	89.4	88.5	84.7
	7. If debt ratio in 2003 rises by (additional) 30 percent of GDP, others at baseline				97.9	101.8	101.9	100.9	99.5	94.9
	Memorandum Items									
	Primary deficit excluding interest (percent of GDP, average of past 5 years)			3.5	3.5	3.5	3.5	3.5	3.5	3.5
	Primary deficit excluding interest (percent of GDP, standard deviation of past 5 years)			2.1	2.1	2.1	2.1	2.1	2.1	2.1
	Real interest rate (nominal rate minus change in GDP deflator, average of past 4 years)			1.9	1.9	1.9	1.9	1.9	1.9	1.9
	Real interest rate (nominal rate minus change in GDP deflator, standard deviation of past 4 years)			2.5	2.5	2.5	2.5	2.5	2.5	2.5
	Nominal interest rate (average of past 5 years)			4.2	4.2	4.2	4.2	4.2	4.2	4.2
	Nominal interest rate (standard deviation of past 5 years)			0.5	0.5	0.5	0.5	0.5	0.5	0.5
	Real GDP growth rate (average of past 5 years)			2.4	2.4	2.4	2.4	2.4	2.4	2.4
	Real GDP growth rate (standard deviation of past 5 years)			1.7	1.7	1.7	1.7	1.7	1.7	1.7
	GDP deflator (average of past 5 years)			3.4	3.4	3.4	3.4	3.4	3.4	3.4
	GDP deflator (standard deviation of past 5 years)			2.1	2.1	2.1	2.1	2.1	2.1	2.1

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

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

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

La Paz, Bolivia
September 24, 2003

Dear Mr. Köhler:

Our program supported by a Stand-By Arrangement (SBA) has been successful in calming social tensions and stabilizing the economy. We are conducting a national dialogue to develop a broad national consensus on medium-term reforms to enhance growth and reduce poverty. The strategy will be laid out in a new PRSP and presented in a Consultative Group meeting in October. In this letter, we report on progress made under the SBA in the last quarter and supplement the understanding specified in our letters of March 21 and June 20, 2003.

The 2003 program remains broadly on track, except for a deviation in the fiscal area. All monetary and external debt performance criteria (PCs) for end-June 2003 were met. Deviations with respect to the fiscal deficit and domestic financing PCs for end-June 2003 equivalent to about ½ percent of GDP, are mainly explained by lower-than-projected tax revenue resulting largely from sluggish imports. While we have taken additional strong corrective measures on both the expenditure and revenue side, we expect the fiscal deficit to exceed the 2003 program target as a result of continued revenue weaknesses during the second half of the year. We are developing an action plan for banks that avoids any bailout of shareholders (PC).

In support of the policies described in the supplementary memorandum of understanding, the Government of Bolivia requests the completion of the second review under the SBA and modifications (upward revisions) to the performance criteria (Table 1 of the attached Supplementary Memorandum of Economic Policies) for: (i) end-September with respect to the fiscal deficit, net domestic financing of the public sector, central bank net credit to the non-financial public sector, and net domestic assets of the central bank; and (ii) end-December with respect to the fiscal deficit and net domestic financing of the public sector. We also request a waiver of applicability for the PCs for end-September, since the relevant information will not be available at the time the Board completes the second review.

We remain determined to meeting the program objectives, but stand ready to take additional measures in consultation with the IMF if necessary. To strengthen private sector confidence and enhance transparency, the government agrees to publish this letter and the attached memorandum.

Sincerely yours,

/s/
Javier Comboni
Minister of Finance

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

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

Attachment: Supplementary Memorandum of Economic Policies

Supplementary Memorandum of Economic Policies of the Government of Bolivia Second Review Under the Stand-By Arrangement

September 24, 2003

1. The program continues to be guided by the macroeconomic and structural reform policies described in our Memorandum of March 21, 2003 and modified by the Supplementary Memorandum of June 20, 2003. Despite difficult economic and social conditions, social tensions have gradually eased, allowing us to increase the government's majority in Congress and broaden support for the program. Our policies have helped to rebuild deposits in the banking system, advance banking and corporate sector reforms, and adopt legislation to rein in the fiscal deficit. We are conducting a national dialogue to develop consensus on medium-term reforms to enhance growth and reduce poverty, which will be incorporated into an updated PRSP.

2. The macroeconomic framework for 2003 remains broadly on track. GDP growth is expected at 3 percent, led by hydrocarbon and manufacturing sectors and a large soybean harvest, while inflation would remain at about 3 percent. Following a large real effective depreciation of the boliviano in 2003, the current account is expected to narrow below 2 percent of GDP, reflecting both higher exports and lower-than-programmed imports.

A. Fiscal Policy

3. During the last few months, we have made substantial progress in fiscal reform (Table 2). Notably, a new tax code, the cornerstone of our medium-term tax reform agenda, was approved by Congress in August (benchmark for September). The code provides the tax and customs authorities with strong enforcement powers and facilitates prompt resolution of tax disputes. A new tax bill (modifying law 843), also approved in August, is expected to raise revenue, among other things, by adjusting the tax base for fuel excises and increasing the taxation of businesses.

4. We are taking strong actions to contain the fiscal deficit at 7 percent of GDP in 2003 (2.1 percent of GDP excluding pension costs), compared to 6.4 percent under the program. The target for the first semester was exceeded by 0.4 percent of GDP, mainly due to lower-than-projected tax revenue resulting from sluggish imports. Moreover, we expect further revenue shortfalls of ¾ percent of GDP during the second semester, reflecting lower import taxes and higher international oil prices. Thus, to achieve the revised fiscal target, we have activated expenditure cuts equivalent to 0.4 percent of GDP and enlarged the scope of the previously planned revenue measures to yield additional revenues of ¼ percent of GDP (0.6 percent of GDP in 2003, compared with 0.4 percent of GDP in the program). Specifically, we have adopted or will adopt prior to the Board discussion of the second review the following actions, to enhance the fiscal performance in 2003 and provide a stronger base for the following years:

- We will issue in September the regulations to the amendments to law 843 (prior action) enlarging the base of certain taxes. This is expected to yield 0.1 percent of GDP in 2003 and 0.6 percent of GDP in 2004.
- We have issued by mid-September the regulations of the tax regularization scheme (prior action)—approved jointly with the tax code—which was broadened to include individual taxpayers and illegally imported vehicles. Revenues are expected to be 0.5 percent of GDP in 2003, 0.2 percent higher than in the program, and 0.1 percent of GDP in 2004. These projected yields, however, remain conservative in view of historical experience.
- We will issue the regulations of the tax code by early November 2003 (performance criterion). The added tax enforcement power for the domestic tax authorities will enhance the effectiveness of ongoing complementary actions. These actions are expected to yield 0.3 percent of GDP in 2004 and include switching to the general tax regime large taxpayers previously registered under the simplified regime. Also, we will enhance invoice security features so as to reduce fraud.
- We have activated additional contingency cuts in public investment (prior action) of at least 0.4 percent of GDP in 2003 (beyond the 0.6 percent of GDP cuts already effected). In making these cuts, we have continued to observe the agreed selection criteria, which protect projects that are already under way, aim at reducing poverty, or are tied to concessional financing.
- We are adopting measures to contain pension costs. We have aligned the minimum pension closer to the minimum wage for those employees that may still retire under the old pay-as-you-go scheme. We have also taken administrative measures to reduce pension costs by controlling fraudulent claims and enforcing strictly streamlined eligibility criteria. A special unit in charge of these actions is being strengthened with IDB support.

5. To further ensure the observance our revised fiscal program for 2003, we have taken steps to enhance our monitoring of fiscal performance during the last months of the year. Specifically, we have set indicative monthly targets for September-December for both fiscal revenue and expenditure (Table), so as to be in a position to adopt corrective measures on a timely basis, if necessary, to meet the fiscal objectives.

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

	2003			
	Sept.	Oct.	Nov.	Dec.
Total revenue and grants	10,873	12,281	13,629	14,997
Total expenditure 1/	13,823	15,431	16,979	19,146
Deficit	-2,950	-3,150	-3,350	-4,149

1/ Includes pension costs

B. Monetary and Exchange Rate Policies

6. Monetary policy will continue to aim at strengthening the central bank's international reserves by US$65 million in 2003 and to contain inflationary pressures. The current coverage of the dollar liabilities in the banking system with gross international reserves will increase to 36.9 percent. The BCB would continue to provide lender of last resort facilities to solvent financial institutions against appropriate collateral. Regarding Safeguard Assessment recommendations, we have now excluded restricted deposits from the BCB's reserves and have reclassified liabilities to Brazil and Argentina. Discussions between the BCB and the Ministry of Finance regarding budgetary independence of the central bank are ongoing.

7. In the context of the current exchange rate crawl with respect to the U.S. dollar, we intend to preserve the recent gains in competitiveness. The boliviano has depreciated by about 10 percent in real effective terms since the beginning of the year, mainly owing to a strengthening of the currencies of our main regional trading partners. This depreciation has more than offset the real effective appreciation of the boliviano in 2002 and brought it to its lowest level since 1996.

C. Financial and Corporate Sector Restructuring

8. Good progress is being made to put in place a viable framework for corporate restructuring. In August, Congress approved a law on voluntary corporate workouts, which will expedite procedures by moving responsibilities from the judicial to the administrative sphere and allowing flexible out of court workouts centered on creditor committees. We have issued in September the regulations to the law and set up the administrative bodies. We expect to carry out pilot cases of corporate restructuring, which should highlight the benefits of this approach as well as any remaining shortcomings. Drawing lessons from the pilot cases, we will amend the Commercial Code in mid–2004 as needed to ensure a modern and efficient formal framework for bankruptcy procedures. On this basis, we believe that the current insolvency law would not need to be amended.

9. Under the leadership of the high-level team established in June 2003:

- the government will complete an assessment of the impact of corporate restructuring on banks by end-October 2003; and

- the government will adopt by end-October 2003 a clearly-defined plan of action to deal with weak banks (structural performance criterion). This plan will be guided by the following general principles: (i) identify viable banks, based on stress tests that provide for the reclassification and the full provisioning of loans as required by current regulations on loan classification; (ii) provide new funds only to viable banks, as defined above; (iii) avoid direct or indirect bailouts and other forms of rescuing owners, including by injecting capital to banks prior to a thorough cleanup of the balance sheet; (iv) safeguard the accountability and transparency of the public funds; and (v) any public funds involved will be included and monitored in the public debt.

10. We are developing a framework, in collaboration with the Inter American Development Bank (IDB) and the Andean Development Corporation (CAF), for the use of public or publicly-guaranteed funds for corporate workouts. This framework will be guided by the following general principles: (i) provide new funds only to viable corporations; (ii) avoid any bailouts and other forms of rescuing owners; (iii) safeguard the accountability and transparency of the public funds; and (iv) any public funds involved will be included and monitored in the public debt.

D. Medium-Term Policies and Progress toward a PRGF Arrangement

11. The government will soon finalize a new PRSP based on a broad dialogue with domestic stakeholders and discussions with the donor community. On this basis, we intend to reach understandings with the Fund staff on a policy framework for the next three years and request a new PRGF arrangement before year-end. The strategy will be presented to donors at a Consultative Group meeting in October 2003, with a view to mobilizing sufficient concessional financing, including grants from bilateral donors, to ensure a sustainable debt path while increasing pro-poor and investment spending.

12. The government will implement a sound macroeconomic and structural strategy aimed at reaching a sustainable fiscal and external position and removing barriers to growth. Our medium-term strategy seeks to reduce poverty levels in Bolivia by achieving sustained growth rates of about 4 percent per annum (after a few years of higher growth boosted by large energy projects), and implementing pro-poor policies. Specifically, we intend to adopt policies so as to ensure an important reduction of the fiscal deficit in 2004 while limiting the use of nonconcessional external resources in net terms.

13. We intend to further strengthen the financial system, including by the adoption of the FSAP recommendations and proposed timing regarding prudential norms. We plan to foster private agreements for corporate restructuring and we will monitor and report progress in these areas while disclosing any use of public funds for banking or corporate restructuring.

14. We are committed to facilitating the implementation of the large energy projects, which we consider essential to our medium-term strategy. Negotiations with a private consortium are at an advanced stage, and we expect the construction phase of the largest of these projects, an LNG pipeline that would allow exports of natural gas to North America, to begin in mid–2004, with exports starting in 2008.

Table 1. Bolivia: Quantitative Performance Criteria Under the SBA 1/ 2/

	2003					
	Mar.	Jun.	EBS/03/90 Sept.	Revised Sept.	EBS/03/90 Dec.	Revised Dec.
(Cumulative amounts from December 31, 2002 in millions of bolivianos)						
Deficit of the combined public sector						
Unadjusted limit	800	1,450	2,250	2,950	3,793	4,149
Adjusted limit	828	1,472	...	...	...	...
Actual	646	1,690	...	...	...	...
Margin	182	-218	...	...	...	...
Net domestic financing of the combined public sector						
Unadjusted limit	500	-200	-25	700	73	652
Adjusted limit	650	300	...	...	...	...
Actual	552	511	...	...	...	...
Margin	98	-211	...	...	...	...
Central Bank Net Credit to the NPFS						
Unadjusted limit	350	175	-325	49	-82	-82
Actual	311	-276	...	...	...	...
Margin	39	451	...	...	...	...
(Cumulative changes from December 31, 2002 in millions of bolivianos)						
Net domestic assets of the central bank						
Unadjusted limit	725	250	-500	-400	-245	-245
Adjusted limit	725	250	...	...	...	...
Actual 3/	250	-610	...	...	...	...
Margin	475	860	...	...	...	...
(Cumulative changes from December 31, 2002 in millions of U.S. dollars)						
Net international reserves of the central bank						
Target	-170	-90	0	0	65	65
Adjusted target	-170	-90	...	...	...	...
Actual 3/	-109	30	...	...	...	...
Margin	61	120	...	...	...	...
Nonconcessional external debt 4/						
Limit	15	50	100	100	150	150
Actual	-44	-17	...	...	...	...
Margin	59	67	...	...	...	...
External debt with maturities up to one year 4/						
Limit	15	10	10	10	0	0
Actual	6	0	...	...	...	...
Margin	9	10	...	...	...	...
(Cumulative amounts from December 31, 2002 in millions of U.S. dollars, unless otherwise specified)						
Adjuster for net external financing of the nonfinancial public sector						
Net external financing of the nonfinancial public sector (program) 5/	26	199	262	245	433	386
Actual	-4	123	...	...	...	...
Maximum adjustment to limit on domestic financing of combined public sector (Bs. Millions)	150	500	500	500	500	500
Financing through HIPC and beyond-HIPC debt relief (program) 6/	14	31	45	46	64	66

Source: Data provided by the Bolivian authorities.

1/ Revised targets for the deficit and the net domestic financing of the combined public sector by end-September and end-December and for the central bank net credit to the NPFS and NDA by end-September; revised programmed levels for the net external financing of the nonfinancial public sector and for financing through HIPC and beyond-HIPC debt relief by end-September and end-December. The other projections for calculation of adjusters to the program are unchanged from the TMU; the TMU footnotes apply.

2/ Program limits and targets adjustable for the shortfalls in currency issue, any overdue obligations to foreign official creditors, net external financing shortfalls and actual cumulative net external financing, subject to a maximum, and for the difference between actual interest relief from HIPC over projected interest relief.

3/ NIR will be adjsuted upwards by the amount of any overdue obligations to foreign official creditors.

4/ The debt limit will be reduced by the amount, if any, of the shortfall between actual and projected disbursements of loans for financial and corporate restrcuturing.

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

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

Table 2. Bolivia: Status of Structural Conditionality Under the Stand-By Arrangement, 2003 1/

Condition	Policy Measure	Date	Comments
	Public Sector Reform and Financing		
Performance Criterion	Approval of 2003 budget, which together with the proposed revenue measures described in para. 11 of the TMU is consistent with a combined public sector deficit equal to or less than 6.5 percent of GDP	April 15, 2003.	Tax bill delayed, alternative measures. Waiver granted in first review.
Performance Criterion	Submission to congress of a tax procedures code consistent with para. 12 of the TMU	April 30, 2003	Observed
Benchmark	Approval by congress of a tax procedures code consistent with para. 12 of the TMU	Sept. 30, 2003	Observed
Prior Action for 2d SBA review	Issuance of the regulations to the amendments to law 843 enlarging the base of certain taxes approved by Congress in August		Paragraph 4, bullet 1
Prior Action for 2d SBA review	Issuance of the regulations to the tax regularization scheme—approved jointly with the tax code—which was broadened to include individual taxpayers and illegally imported vehicles.		Paragraph 4, bullet 2
Prior Action for 2d SBA review	Activation of additional cuts in public investment of at least 0.4 percent of GDP in 2003 (beyond the 0.6 percent of GDP cuts already activated).		Paragraph 4, bullet 4
Performance Criterion	Issuance of regulations to the tax procedures code, consistent with para. 12 of the TMU	Nov. 5, 2003	Paragraph 4, bullet 3
	Financial Sector and Corporate Sector		
Performance Criterion	Issuance of the final regulations for the bank resolution and prompt corrective action mechanisms introduced by the financial sector law of 2001 consistent with para. 14 of the TMU	April 30, 2003	Implemented on May 9, 2003. Waiver granted in first review.
Performance Criterion	Issuance of supreme decree(s) (i) clarifying the roles of the different institutions with oversight over the financial sector (includes ensuring a technical basis for issuing prudential norms), and (ii) defining certain areas of banking regulation that should be determined by the superintendency consistent with para. 13 of the TMU	April 30, 2003	Implemented on May 6, 2003. Waiver granted in first review.
Performance Criterion	Submission to congress of draft bankruptcy law and draft law for corporate debt workout mechanism, prepared in consultation with Fund staff and consistent with paras. 15 and 16 of the TMU	April 30, 2003	Observed
Benchmark	Approval by congress of law on corporate workout mechanism consistent with para. 16 of the TMU	Sept. 30, 2003	Observed
Benchmark	Approval by congress of bankruptcy law consistent with para. 15 of the TMU	Sept. 30, 2003	Not met. Some elements to be in place by Sep. 30, 2003; others by June 2004
Prior Action for 2d SBA review	Issuance of regulations to the informal workout law approved in August.		
Performance Criterion	Adopt an action plan to strengthen weak banks consistent with Fund staff advice and the principles stated in paragraph 9 of the MEP.	Oct. 31, 2003	Paragraph 9, second bullet

1/ References in the table are to the relevant paragraphs of the Technical Memorandum of Understanding (TMU) or to the Supplementary Memorandum of Economic Policies of September 24, 2003.

Statement by the IMF Staff Representative
October 6, 2003

This statement provides information that has become available since the staff report was issued on September 25. This information does not affect the thrust of the staff appraisal.

Recent civil unrest. Following the death of seven demonstrators two weeks ago, protests and blockades around La Paz have continued in recent days. The disturbances have been catalyzed by the pending decision on the LNG pipeline project. The government is working on a public relations campaign to make the population more aware of the potential benefits of the project.

Economic activity and inflation. Broadly consistent with the program, real GDP rose by 2.3 percent in the second quarter of 2003, compared with a year earlier, with significant contributions from agricultural exports and manufacturing products. While indicators of private investment remain sluggish, preliminary data for cement sales and agricultural exports in July are encouraging. The 12–month CPI inflation rate declined to 3.6 percent in September.

Financial system. The social protests have not significantly affected gross official reserves or bank deposits so far. The financial system remains highly liquid, with low interbank and market interest rates. The central bank lender of last resort facilities have not been used in recent months (tabulation below).

Bolivia: Gross Official Reserves and Financial System Deposits

(In millions of U.S. dollars)

	12/31/02	3/31/03	6/30/03	9/24/03
Gross official reserves	854	743	915	934
Financial system deposits	3,429	3,299	3,423	3,491
Banks	2,725	2,591	2,666	2,700
Local banks	1,847	1,793	1,840	1,900
Foreign banks	877	798	826	801
Nonbank institutions	704	708	757	791

Source: Central Bank of Bolivia.

Program performance. Recent data received from the authorities show that the targets for net international reserves and central bank net domestic assets for end-September were met. According to information through September 23, all the other proposed revised quantitative performance criteria through end-September appear likely to be met with some margin.

Prior actions. All prior actions for the second SBA review have been met. Public investment cuts equivalent to at least 0.4 percent of GDP were activated on September 16 through instructions from the Ministry of Finance. Implementing regulations for the tax regularization scheme, the informal workout law, and the tax legislation amending law 843 were published on September 2, September 26, and September 30, respectively.

Press Release No. 03/162
FOR IMMEDIATE RELEASE
October 6, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review of Bolivia's Stand-By Arrangement, Approves US$15 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Bolivia's performance under a one-year, SDR 85.75 million (about US$123 million) Stand-By Arrangement that was approved on April 2, 2003 (see Press Release No. 03/46). This decision enables the release of SDR 10.7 million (about US$15 million) to Bolivia, which brings total disbursements under the program to SDR 64.2 million (about US$92 million).

The Executive Board also approved Bolivia's request for the modification of performance criteria for end-September with respect to the fiscal deficit, net domestic financing of the public sector, central bank net credit to the non-financial public sector, and net domestic assets of the central bank, as well as the modification of performance criteria for end-December in relation to the fiscal deficit and net domestic financing of the public sector. The Executive Board also approved Bolivia's request for waivers of applicability until October 30, 2003 of the performance criteria for end-September, for which data was not available.

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

"Bolivia's economic program is broadly on track. Despite a difficult political and social environment, inflation remains low and indications are that economic growth is picking up and that financial market conditions have stabilized. Although the fiscal outturn has fallen short of the program's objectives, the authorities have taken corrective measures. Moreover, encouraging progress has been made with the government's reform agenda.

"The authorities' corrective steps to contain the fiscal deficit in 2003 and to facilitate continued fiscal consolidation in 2004 and beyond will require firm and consistent implementation to achieve higher economic growth and lasting poverty reduction. Recent measures that will be of crucial importance in this context include reductions in low-priority spending, and the implementation of legislation to introduce a new tax code, broaden the tax base, and apply a tax regularization scheme.

"The recent approval of the out-of-court workout law and the issuing of the supporting regulations represent important steps that will help to put in place an appropriate framework for corporate and financial restructuring. The law will now be applied to a pilot sample of firms. The authorities also intend to develop an action plan to improve the resiliency of the banking system and address any potential weaknesses, and to implement recommendations made by the recent Financial Sector Assessment Program study.

“Building on recent policy initiatives and progress toward stabilizing the economy, the authorities are working to put in place a strong policy framework for the next three years that will incorporate comprehensive reforms aimed at strengthening the basis for sustained growth and poverty reduction. The Fund is working closely with the authorities, who plan to develop and implement the program on the basis of a broad dialogue with domestic stakeholders and discussion with the donor community. On this basis, the authorities have reiterated their intention to seek support under the IMF's Poverty Reduction and Growth Facility before the end of the year,” Ms. Krueger stated.

Statement by Guillermo Le Fort, Executive Director for Bolivia and Alonso Segura, Advisor to Executive Director October 6, 2003

Key Points

- *After years of significant economic reforms, Bolivia is facing a difficult transition with an unstable political and social situation, thus support from the international community is crucial for final success.*
- *The program remains on track despite some deviations in the fiscal area originated in a revenue shortfall, hence modification of performance criteria is requested.*
- *Decisive fiscal consolidation is taking place. A sizable fiscal adjustment of 2% of GDP is expected for 2003, with further sizable adjustments to be implemented through 2006, and beyond.*
- *Financial and corporate restructuring remain a priority, and major advances in both fronts have already taken place.*
- *An updated PRSP has been circulated to the international community as the basis for the CG Meeting, to be further enriched in this forum and with inputs from the ongoing dialogue process prior to the request for a new PRGF Arrangement.*

Background and Overview

1. We thank the Staff for a focused report identifying the main challenges and risks faced by Bolivia at the current juncture, comprising an extremely difficult political and social transition. As stated previously, the Stand-By Arrangement underway is envisioned by the Bolivian authorities as a bridge towards a three-year PRGF, to be requested before year-end. Moreover, the endorsement by the Fund on the status of implementation of the economic policies under the program, by satisfactorily concluding the second review, is essential for Bolivia in its forthcoming task of gathering increased donor support for their medium-term strategy at the Consultative Group Meeting (CG) that will take place in Paris, October 8th and 9th, 2003.

2. Bolivia is struggling to emerge from its most serious crisis of the past twenty years. After successfully attaining macroeconomic stabilization in the mid-eighties, Bolivia launched a widespread first and second-generation structural reform program leading to an average rate of economic growth of 4.7% between 1993 and 1998. However, after this brief window of success, a sequence of international adverse shocks, including negative developments in neighboring countries, led to a prolonged economic slump that has translated in an average rate of growth of only 1.6% from 1999 to 2002 (implying -0.8% per capita growth). Over this period, fiscal accounts have become under stress in large part due to an expensive pension reform; adverse terms of trade have affected exports performance; the banking and corporate sectors have weakened considerably due to mounting NPLs and a

subsequent contraction in credit availability; social discontent in rural areas has been growing, due, in part, to the lack of viable alternative crops for former coca-growers; employment in urban areas has been lagging amid a growing young population, and political fragmentation has increased.

3. In this context, after five successive governments committed to the implementation of economic reforms, the continuation of such a process has been put into question by political and social sectors aiming at reversing them. The recent bouts of violent protests, mainly in the highlands, are a sign of erosion in the support for reforms, due in part to unfulfilled expectations. While the full benefits of the reforms are still to be reaped, and the future looks promising, due to the expected significant increase in revenues from gas exports and a decline in the burden of the pension cost, it is nevertheless true, that Bolivia needs the international community's support to satisfactorily bridge the next few years.

4. The current government is doing their utmost efforts to deal with the delicate inherited situation, both in the economic, social and political fronts. In this regard, despite its many obstacles and constraints, it has been able to implement, with the support of the Fund, an economic program aimed at attaining short-run stabilization, while designing a medium-term strategy geared towards sustainable growth and significant poverty reduction Along these lines, broad compliance with the structural conditionality under the SBA, and several prior actions agreed for the second review, are proof of the authorities' commitment to the program. The fact that two QPCs for end-June have been missed and others for end-September and end-December need to be revised, as proposed by the Staff, is just a recognition of the difficult situation, in the midst of an unstable political and social juncture. Nevertheless, even in these circumstances, and despite the fact that the economic cycle has been unsupportive, significant advances in fiscal consolidation are being achieved, albeit at a slightly slower pace than originally anticipated under the program. In my authorities' view, the speed of adjustment is sufficient to effectively guarantee fiscal sustainability without compromising the incipient recovery or endanger poverty reduction goals.

Fiscal Policy, Pension Reform and Debt Dynamics

5. As stated above, fiscal consolidation is being attained, albeit it constitutes a gradual process given the magnitude of inherited imbalances, and it is justified by the cyclical downturn and complicated severe political and social pressures. The current government took office with a deteriorated fiscal situation, the overall fiscal deficit for 2002 was 8.9% of GDP, and the underlying passive deficit for 2003 would have reached 9.1%. Hence the revised fiscal deficit target of 7% of GDP implies a significant adjustment of 2% of GDP in only one year and when cyclical conditions continue to be weak Nevertheless, in the case of Bolivia, analyzing the fiscal numbers without considering the cost of the pension reform would be misleading. In this regard, there is a strong case in favouring the fiscal deficit before pension costs, as a better indicator to assess Bolivia's structural fiscal position. If this were the case, the fiscal outlook would certainly show a considerably greater strength, as will be explained in detail later. Notwithstanding the above arguments, our Bolivian authorities remain committed to continue implementing further consistent fiscal adjustments in coming

years so as to ensure the sustainability of the public sector financial position. The magnitude of an additional fiscal adjustment planned by the Bolivian authorities, well over 4% of GDP up to 2006, should help build a solid macroeconomic framework to support the forthcoming PRGF request. The targeted fiscal deficits take into account hard, but realistically attainable goals, that will guarantee a sustainable path for the public debt.

6. Extensive efforts to put in place a long-lasting tax reform succeeded in 2003. A new Tax Code, together with a revised Tax Bill (Law 843) which expands the coverage of many taxes, most notably on hydrocarbons, were enacted. The effects of these measures on tax collection and compliance rollover into the future and constitute a crucial building block in the fight against fiscal informality and tax evasion. In addition, the tax amnesty provides a one-shot relief on tax collection, to impact considerably in 2003 and to a lesser extent in 2004. All regulations to jumpstart these initiatives, which were regarded as prior actions for this review, are already in place. Nevertheless, given the 1.2% of GDP shortfall in revenues with respect to the original projections, non-priority capital expenditure cuts had to be activated further (an additional 0.4% of GDP to total almost 1% over the year), despite the enormous needs to develop infrastructure. Fortunately, so far poverty reduction outlays could be protected.

7. As indicated in our previous Buff, actions to control the rising pension costs are being taken, and will continue in the future, as initiatives on this front indicate (creation of a recent specialized Vice-Ministry, assistance from the IADB). However, in order to understand the fiscal reality of Bolivia, and its implications for debt sustainability, it is essential to fully grasp the pension issue. With the advice of the international community, Bolivia designed and implemented an across-the-board pension reform back in 1997, that shifted the system from a pay-as-you-go regime to one of individual capitalization accounts. While the reform has been successful in making the pension liabilities fully transparent, and guaranteeing the long-term solvency of the system, the costs involved have been much higher than originally anticipated, and current social security contributions are no longer available to finance the pay-as-you-go-system as they are deposited in privately administered individual accounts. As a result, Bolivia is facing front-loaded pension obligations that have been totaling almost 5% of GDP annually since 2000. These are expected to remain above 4.5% of GDP for the next three years, and start a sharp and sustained decline from then on. As a result of these steep payments, the present value (in US$) of the stock of pension liabilities has been declining over the past five years, and will continue to do so at an accelerating rate. Therefore, as opposed to most advanced and developing countries, Bolivia is adding pressure to its fiscal accounts in the present, in order to reap important benefits in the future. Looking at the fiscal deficit excluding pension payments would reveal a much more optimistic, as well as accurate fiscal outlook, given that, because of the reform, current outlays amortize what would otherwise be considered as contingent pension liabilities.

8. The flip side of the coin is to analyze the total liabilities faced by the Bolivian public sector. The standard analysis on debt sustainability updated by the Staff continues to show, under the baseline scenario, a sustainable medium-term path, albeit with slightly higher debt accumulation, provided fiscal consolidation is attained. The main result is that debt ratios show a gradual but slow decline. However, if pension liabilities are added to the public debt, while the total debt-ratios would start at a higher level (with total debt understood as public

debt plus pension liabilities), due to the frontloaded pension payments, they would indeed show a steep and sustained decline over time, starting as soon as next year. There is no clearer indication of the sustainability of public finances than the behavior of these pension adjusted ratios.

9. Two other issues warrant comment due to their impact on debt sustainability. First, as it is expected in a dollarized economy, debt indicators are sensitive to sudden shifts in the value of the currency. In this regard, the finding of the joint study by the Staff and authorities, in the sense that there is no substantial misalignment of the real effective exchange rate is a reason for comfort, since it minimizes the likelihood of this source of potential risk, actually materializing. Second, we reaffirm our previous claim that sustained access to multilateral and alternative (bilateral) sources of concessional funding would significantly ease the pressure on fiscal accounts. Conscious of this effect, my authorities have agreed to continue limiting the use of non-concessional financing, and are actively looking for incremental concessional resources and grants. Nevertheless, the non-concessional resources that Bolivia will be accessing, would come mostly from multilateral sources (World Bank's IDRB included), given the limited availability of concessional lending.

Structural Reforms and the Gas Issue

10. The Bolivian authorities have kept their focus in dealing with the fragile situation of corporate and banking sectors. Beyond the actions on the corporate front, the law on out-of-court workout mechanisms, a benchmark of the program, was approved by Congress, as well as the regulations to implement it, which was agreed as a prior action to the present review. Therefore, all legal bodies are in place to start with pilot cases of corporate restructuring. These cases will provide the necessary information to round up the amendments to the Commercial Code in the first semester of next year, thus avoiding the passage of an untested law. This would be the last legal step in the implementation of a revamped bankruptcy framework. With respect to weak banks, my authorities are developing an action plan, which has been preliminary discussed with the Staff, and its guidelines are included in the report. This action plan, which will be a central element of the PRGF request and a performance criterion under the current program, aims at avoiding the transmission of individual institution's instability to the system, as well as to preserve and minimize the use of fiscal resources. In the meantime, it is worth mentioning that the Central Bank has an effective, empirically tested and up-to-date framework that enables it to deal with any institution facing liquidity problems. Earmarked funds to allocate to both, bank and corporate restructuring, would come from the World Bank and the Andean Development Fund (CAF), respectively.

11. The gas issue is critical to the future of Bolivia, as stressed by the Staff. As indicated previously, negotiations between Pacific-LNG and potential buyers in the United States and Mexico are on good track, and a purchase-sale agreement is expected before year-end. Once this first stage is satisfactorily concluded, the authorities would announce their selection of the port of shipment based on efficiency considerations. In this respect, it is important to emphasize that despite the unstable environment, the government is gradually gaining support in social and political fronts, specially for the gas project. The ruling coalition now has broadly a two-thirds majority in Congress, with the inclusion of a new party (*Nueva*

Fuerza Republicana). The originally Catholic Church sponsored *Reencuentro Nacional* (National Reencounter), containing a blueprint of the development road plan for Bolivia, after facing some obstacles, has been signed last month by most major political parties. This is not so say that there will not be opposition to the gas exports, as was clearly evidenced by the recent violent incidents. However, the government's campaign to anchor the benefits of the project in the population's awareness is gradually gaining ground. Construction of the pipeline is scheduled to start by mid 2004, with LNG exports projected for 2008.

Consultative Group Meeting (CG)

12. An updated PRSP has been designed and circulated to the multilateral and donor community. This document lays out the poverty reduction strategy for Bolivia in the medium-term and aims at reaching the Millennium Development Goals (MDG) as scheduled. An enriched document, including further inputs from the ongoing dialogue process and the CG will serve as the basis for the PRGF request before year-end.

13. The outcome of the CG meeting is crucial for Bolivia's development strategy. There is a financing gap that needs to be bridged, until the LNG project starts operations in 2008, to allow the achievement of the MDGs. My authorities are confident that the successful conclusion of the second review, before the CG meeting, would constitute a decisive factor to preserve and strengthen the partnership with the international community. This needed support, on the other hand, has never been as crucial as in today's difficult times for Bolivia.