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Bolivia: Fifth Review Under the Stand-By Arrangement, Request for Waiver of Nonobservance of Performance Criteria, Rephasing, Augmentation, and Extension of the Stand-By Arrangement—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Bolivia

In the context of the Fifth Review Under the Stand-By Arrangement, Request for Waiver of Nonobservance of Performance Criteria, Rephasing, Augmentation, and Extension of the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the Fifth Review Under the Stand-By Arrangement, Request for Waiver of Nonobservance of Performance Criteria, Rephasing, Augmentation, and Extension of the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on February 9, 2005, with the officials of Bolivia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 25, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of April 8, 2005 updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during its April 8, 2005 discussion of the staff report that completed the review.

- a statement by the Executive Director for Bolivia.

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

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

*May also be included in Staff Report

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

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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INTERNATIONAL MONETARY FUND

BOLIVIA

Fifth Review under the Stand-By Arrangement, Request for Waiver of Nonobservance of Performance Criteria, Rephasing, Augmentation and Extension of the Stand-By Arrangement

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

Approved by Caroline Atkinson and Michael T. Hadjimichael

March 25, 2005

- **Stand-By Arrangement.** The current arrangement was approved on April 2, 2003, for a 12–month period in an amount equivalent to SDR 85.75 million (50 percent of quota). It was extended on April 1, 2004, until June 15, 2004. On June 10, 2004, the arrangement was augmented by SDR 42.88 million (25 percent of quota) and extended through end–2004. On December 27, 2004, the arrangement was extended again through end-March 2005.

- **Discussions.** The review discussions were held in La Paz from October 25–November 11, 2004, January 24–February 9, 2005, and in Washington during December 6–8, 2004. The mission met with President Carlos Mesa; Mr. José Galindo, Minister of the Presidency; Mr. Horst Grebe, Minister of Economic Development; Mr. Javier Cuevas and Mr. Luis Carlos Jemio, successive Ministers of Finance; Mr. Juan Antonio Morales, Central Bank President; Mr. Fernando Calvo, Superintendent of Banks and Financial Institutions; and other senior officials. The team comprised: M. Piñón (Head), R. Balakrishnan, P. López Murphy, E. Vesperoni, O. Williams (all WHD); S. Dodzin (PDR); S. Heysen (MFD); and P. Medas (FAD); and was assisted by S. Cueva (Resident Representative). H. Franken and J. Cuevas (OED) also participated in discussions. The mission overlapped with EPA, FAD TA missions, and a visit by the Managing Director.

- **Program.** In the attached Letter of Intent and Memorandum of Economic and Financial Policies, the authorities describe their policies for 2005 and medium-term macroframework. An extension of the arrangement until end-March 2006 and an increase in access of 25 percent of quota are requested. An amount equivalent to SDR 9.66 million (5.63 percent of quota) would become available upon completion of the fifth review.

- **Economic and policy developments.** Macroeconomic developments have been positive, with real GDP growth in 2004 expected to be in line with the program. Most quantitative PCs were met, with the exception of the end-September 2004 PC on central bank financing to the NFPS, which was marginally missed. The authorities request a waiver for this and for the nonobserved structural PC on the tax code procedures.

Appendices

Attachments

Annex

EXECUTIVE SUMMARY

Background

Completion of the review has been subject to delays. Discussions were protracted due to the need to reduce implementation risks and bring public spending in line with the program.

Macroeconomic developments have been positive, largely reflecting the favorable global environment, though the economy is still vulnerable. Real GDP growth is estimated to have reached 3¾ percent in 2004 and is projected to reach 4.5 percent in 2005. Inflation has increased, but remains below 5 percent. The current account registered a surplus of around 3 percent in 2004 and is expected to remain in surplus in 2005.

The 2004 program was on track. All quantitative PCs were met, with the exception of the end-September PC on central bank credit to the NFPS, which was marginally missed owing to delays in grant disbursements. The end-September structural PC on the administrative procedures to the tax code was also missed as congressional discussions centered on the hydrocarbons bill.

Policy discussions

Program discussions focused on policies that could be supported by a twelve-month extension and augmentation of the SBA. On fiscal issues, the staff reached understandings on a program that contains the deficit, and on financing assurances to minimize the use of central bank credit, and, more generally, nonconcessional financing. On the structural side, reforms to the tax system and to expenditure management (including changes to budget preparation and execution) were agreed. The staff also reached understandings on measures to strengthen the financial and corporate sectors, and improve debt management. Medium term prospects under alternative scenarios for the hydrocarbons sector were also discussed, and the staff agreed with the authorities on steps toward implementing an appropriate hydrocarbons policy.

The fiscal deficit after grants is to be reduced to 5.2 percent of GDP in 2005. This will be achieved by already adopted fuel price increases, higher gas export royalties, and the full year impact of the financial transactions tax. Cuts in nonpriority spending will allow the initiation of high priority road projects.

Monetary policy will aim to strengthen NIR further, while gradually introducing greater flexibility to the exchange rate. The program targets an NIR accumulation of US$40 million, the enhancement of debt management practices, and the introduction of a two-way foreign exchange auction in 2005.

Measures are being taken to reduce risks in the still-fragile financial system. These include the gradual phase-in of additional loans provisions; moderate increases in average reserve requirements on foreign currency deposits; and the preparation of a draft law on a deposit insurance scheme, which will be submitted to Congress later in the year.

Risks to the program remain substantial. The social and political situation remains fragile, while domestic consensus is weak and calls for regional autonomy are growing. Fiscal and financial risks remain high, with a high level of domestic debt to roll over, and the highly dollarized financial system vulnerable to deposit runs. Considerable uncertainty also surrounds hydrocarbons policy.

I. POLITICAL CONTEXT

1. **Political tensions pose serious challenges to the implementation of the authorities' economic agenda**. With difficult relations between the executive and legislative branches, Congress did not approve the new hydrocarbons framework in 2004, while the 2005 budget—which was not in line with the program—became effective on a lapse of time basis without formal congressional approval.

2. **Moreover, regional pressures intensified after the authorities raised fuel prices at end–2004.** In a long-delayed move, the authorities increased gasoline and diesel prices by 10 percent and 23 percent respectively, while prices of LPG remained unchanged. However, opposition by the rich oil producing eastern regions led to a reduction in the diesel price increase to 15 percent. The price increases also triggered demonstrations and calls for greater regional autonomy.

3. **President Mesa has acceded to demands from different political groups.** The announced, though not yet implemented, cancellation of a contract with a French firm that provided water services assuaged tensions in El Alto, but has created fears of legal stability for private investors and runs the risk of a costly legal process. Pressures are also growing for the creation of a development bank to reactivate credit flows. Demonstrations in Santa Cruz, Bolivia's main economic center, in January, led to the authorities to agree to demands for elections of regional governors in June 2005, and a planned referendum on regional autonomy. Against this background, in early February, President Mesa swore in a new cabinet, replacing key ministers, including the Minister of Economic Development.

4. **Following continuing political difficulties, President Mesa offered to resign and call early elections.** The presidential offer followed steps by Congress toward approving a nonviable hydrocarbons bill and demonstrations and road blockades called by an opposition party.

5. **After Congress refused to accept his resignation, President Mesa agreed to stay in office.** Domestic conditions have since improved somewhat, as roads and airports have now been cleared. Congress is continuing to consider a controversial hydrocarbons bill, but the authorities has made clear that they will work toward an acceptable bill.

II. Recent Economic Developments and Program Performance

6. **Recent macroeconomic developments continue to be positive and the 2004 targets were largely achieved, but the economy remains vulnerable. Key economic developments are as follows:**

- **Economic activity picked up in 2004**. Real GDP growth in 2004 is estimated to have been in line with the program projection of 3¾ percent, buoyed by hydrocarbon and mineral exports. Twelve-month inflation reached 4.6 percent by end-year, exceeding the target of 3.5 percent, owing to high imported inflation, and larger than expected transportation costs in anticipation of fuel price increases (Figure 1).

Figure 1. 12-Month inflation

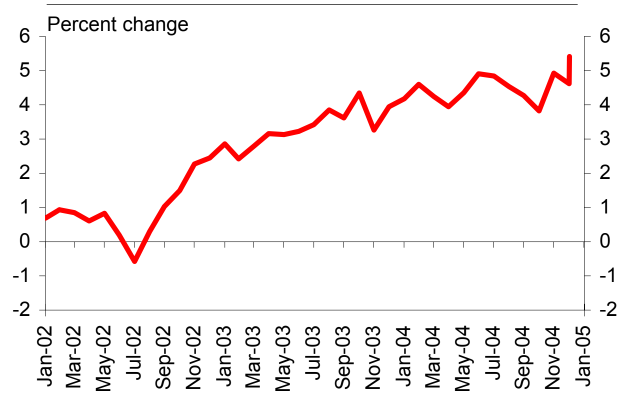
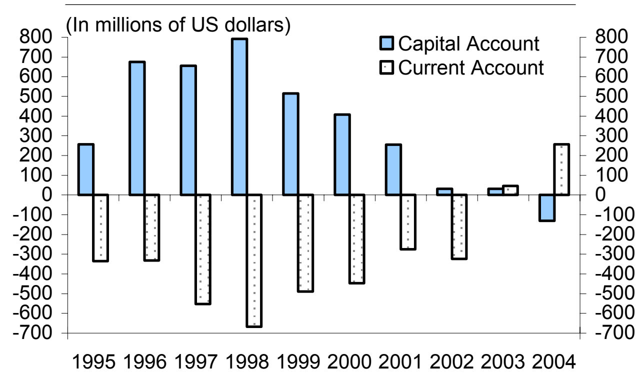
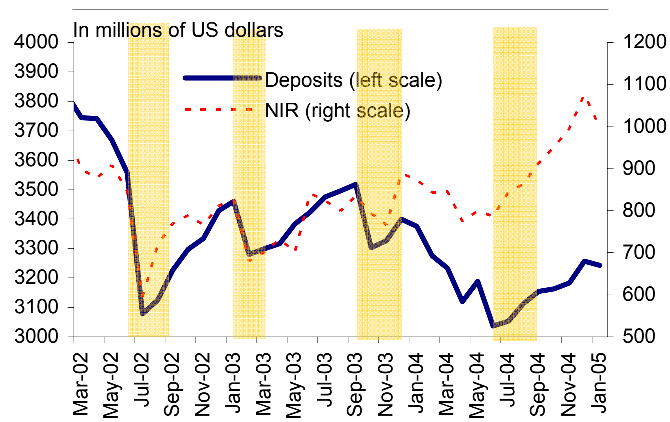


Figure 2. External current and capital account



- **The current account surplus is expected to be 3 percent of GDP in 2004, partly offset by capital outflows (Figure 2)**. Exports rose by about 35 percent, largely reflecting a favorable external environment for hydrocarbon products. A recovery in deposits during the second semester reduced the large capital account deficit in the first semester, and resulted in an overall balance of payments surplus of US$125 million (1½ percent of GDP).

Figure 3. Financial system deposits and NIR



- **Financial system deposits have recovered somewhat, but the system remains highly vulnerable (Figure 3).** Deposits partially recovered from losses experienced in the context of the introduction of the financial transactions tax (FTT). Still, end–2004 deposits were 4¼ percent lower than a year earlier, while financial system liquid reserve coverage of deposits stood at 45 percent. As of February 23, 2005, deposits had declined slightly further (by less than 1 percent) relative to end–2004.

Figure 4. Stock of government paper in local currency

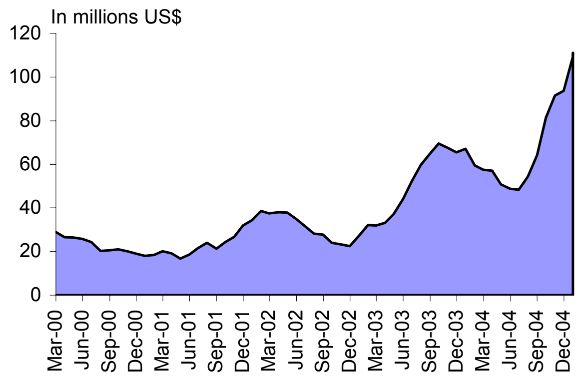
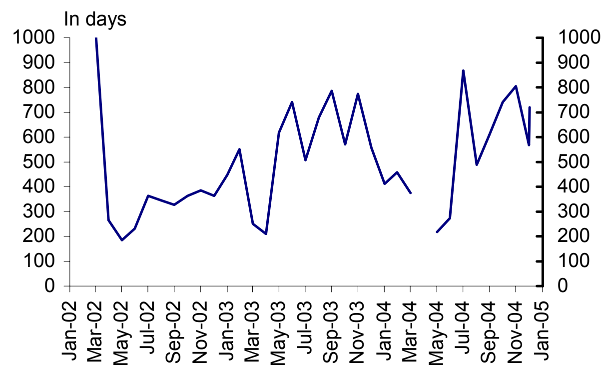


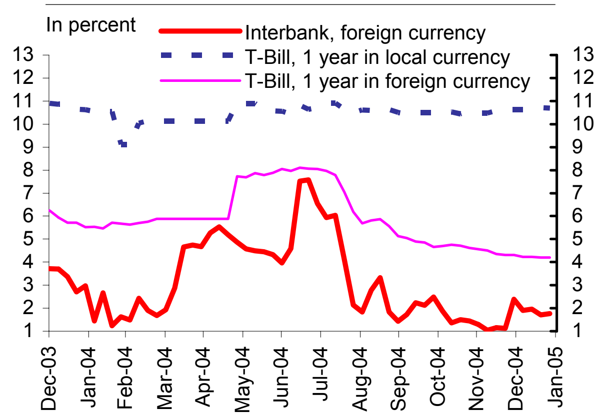
Figure 5. Average maturity of treasury paper placements (TGN)



- **Reflecting improving liquidity conditions, placements of government paper in local currency and at longer maturities increased in the latter part of 2004 (Figures 4 and 5).** Weekly placements of government paper averaged around US$10 million from mid-July through end–2004 with: (i) the proportion of the stock of government paper in local currency increasing by 5 percentage points through 2004 to 21 percent; and (ii) the maturity on new placements lengthening from under a year at end-June, to over 1½ years by end-year.

- **While interest rates in US dollars have fallen, rates in local currency have remained steady (Figure 6).** Despite a sharp increase in mid–2004, the interbank rate and the rate on one-year treasury bills in foreign currency declined by 132 and 193 basis points, respectively, in 2004. This reflected improved liquidity conditions and low international interest rates. However, the rate on treasury bills in local currency only declined by 28 basis points, increasing the spread over one-year foreign currency bonds to over six percentage points.

Figure 6. Interest Rates



7. **Most quantitative end-September (PCs) and end-December (indicative) targets were met.** The only targets missed were: (i) the end-September PC on central bank credit to the NFPS (by less than US$2 million), owing to delays in grant disbursements; and (ii) the

indicative net domestic financing target for end-December, as the authorities opted for domestic financing to compensate for external financing shortfalls.

8. **The 2004 fiscal deficit target was met with some margin.** Revenues were higher than expected by 0.9 percent of GDP, owing mainly to the tax regularization program and taxes on hydrocarbons exports. This was partially offset by higher capital spending of around 0.6 percent of GDP, mainly on roads. Current spending was in line with the program.

9. **NIR were well above targeted levels in 2004, but have declined since.** With a recovery in deposits, favorable external conditions, and the receipt of previously delayed external disbursements, NIR at end–2004 were above programmed levels by a large margin (over US$190 million) and registered an increase of US$139 million over the year. Through February 24, 2005, NIR fell by US$79 million from end-December, partly reflecting seasonal factors.

10. **Progress has been made on structural reforms, although there have been some delays in important areas (see Table 2 of the MEFP).** The high-level expenditure commission completed its recommendations on spending (end-September PC), but the end-September PC on congressional approval of the administrative procedures to the tax code was not met. Although the procedures law has been approved by the Upper House of Congress and received a favorable opinion from the Lower House Finance Committee, Congress as a whole has not taken up the issue given the focus on hydrocarbons issues. Nevertheless, the tax code appears to have been operating correctly. All benchmarks related to the financial sector were implemented, with the exception of that on establishing the Financial Restructuring Fund as a legal entity. Finally, the key end-October benchmark on approving an appropriate hydrocarbons law was not met. The law has been subject to a protracted and contentious debate, while the government has focused on limiting the risks of Congress adopting an inappropriate framework for the sector.

III. Policy Discussions

11. **As Bolivia still needs to develop consensus on medium term policies, program discussions focused on an extension of the SBA.** Though the authorities would prefer a three-years PRGF arrangement with the Fund, significant uncertainty still surrounds medium term policies, including the hydrocarbons framework. The planned Constituent Assembly later this year may also have implications for medium-term structural economic issues. Against this background, the staff discussed a twelve-month extension of the SBA predicated on key prior actions (Box 1) and critical fiscal and financial reforms. The extension would help maintain macroeconomic stability during the coming year, as part of continued international efforts to assist Bolivia, while giving the authorities additional time to consolidate consensus on medium-term policies.

Box 1. Key Policy Measures Adopted since November 2004 1/

Fiscal Policy

- Increase in domestic prices of gasoline and diesel of 10 and 15 percent, respectively.
- Issuance of a supreme decree reducing spending limits below the 2005 budget, consistent with a deficit target of the combined public sector of 5.2 percent of GDP after grants.
- Submission to Congress of a revised budget consistent with the program deficit target and nonconcessional financing of 1.5 percent of GDP.

Financial Sector:

- Issuance of a supreme decree to eliminate regulatory powers of the Ministry of Finance over the financial system.
- Issuance of norms tightening loan classification and provision regulations, calling for gradual increases in provisions, with the first effective increase taking place by end-May 2005.
- Submission to Congress of legislation establishing the Financial Restructuring Fund (FRF) as a legal entity.

1/ Except for the fuel price increase, other measures were prior actions to issue Board documents.

12. **Discussions for completion of the fifth review and extension of the program centered on:** (i) assessing performance through end-September and end-December, 2004; (ii) monitoring progress toward securing a 2005 budget consistent with a deficit after grants of 5¼ percent of GDP and a net nonconcessional financing ceiling of 1½ percent of GDP; and (iii) assessing alternative debt sustainability scenarios, including under different assumptions for the hydrocarbons sector. The mission also discussed: (i) the recommendations of the expenditure and pension commissions; (ii) recent FAD TA on decentralization and public expenditure management; (iii) recent MFD TA on measures to promote greater exchange rate flexibility and the use of domestic currency; (iv) debt management issues; and (v) progress on preparation of a new PRSP.

A. Fiscal Policy

13. **The authorities aim to reduce the fiscal deficit to 5¼ percent of GDP after grants in 2005, and limit nonconcessional financing to 1½ percent of GDP.** The authorities have already adopted a balanced package of fiscal measures for 2005, including: (i) fuel price increases; (ii) clear spending priorities to allow for the implementation of key road projects within program ceilings; and (iii) the issuance of decrees to reduce budgeted spending by 3½ percent of GDP and thus set spending ceilings in line with the program. To receive congressional endorsement of the program spending ceilings, the executive recently submitted an amended budget in line with the program. In addition, the program aims to reduce the deficit target further by one-third of any tax revenue over-performance, thus saving revenue windfalls for which there is no sharing agreement with regions.

Table A. Fiscal accounts

	2004 est.	2005 proj
Total Revenue and grants	**27.8**	**28.1**
Tax Revenues	21.3	21.8
FTT	0.5	0.9
Hydrocarbons	5.2	6.7
Fuel Excises	1.7	2.7
Royalties	3.5	3.9
Tax amnesty	1.5	0.0
Other taxes	14.2	14.2
Expenditures	**33.5**	**33.2**
Current spending	**24.1**	**23.9**
Wages	9.0	8.7
Fuel Subsidies	0.7	0.5
Pensions	4.8	4.9
Capital Spending	**9.4**	**9.4**
Overall balance	**-5.7**	**-5.2**

Source: Bolivian authorities and staff estimates

Table B. Domestic Fuel Prices 1/
(US dollars per liter)

	Gasoline	Diesel
Bolivia		
January 2005	0.47	0.46
Before end-2004 increase	0.43	0.42
Brazil	0.84	0.60
Chile	0.81	0.53
Peru	0.81	0.73
Uruguay	1.00	0.67

1/ Brazil (December 2004); Chile (December 2004); Peru (January 2005); and Uruguay (November 2004)

14. **Despite the loss of one time tax amnesty collections (1½ percent of GDP) in 2004, revenues would increase by 0.3 percent of GDP relative to 2004 (Table A).** The staff stressed the need to compensate for the loss of temporary revenues, while incorporating appropriate safety nets to protect vulnerable groups. With the signature of agreements with Argentina on higher prices and volumes of gas exports, and programmed volume increases to Brazil, gas royalties would increase by about ½ percent of GDP. In addition, the increase in fuel excise taxes led to a fiscal yield of around 1 percent of GDP. Fuel prices still remain well below the average in Latin America (Table B). To reduce the impact on the poor, the authorities maintained LPG subsidies, despite their high costs to the budget, and strengthened their employment program (PLANE) targeted on rural and poor areas.

15. **Overall spending would decline by 0.3 percent of GDP in 2005, with cuts in nonpriority spending allowing the initiation of priority road projects.** Spending has been constrained by keeping public sector wage increases below inflation, containing fuel subsidies, and maintaining capital spending at 2004 levels as a share of GDP, through improved quality and reprioritization. The resulting savings more than offset the small increase in pension costs, which reflects the regularization of eligible pensioners under the old system. The authorities also aim to mitigate the rising pension costs by implementing measures to reduce fraud, in line with the findings of the pension commission. The mission urged the authorities to further accelerate pension reform, in cooperation with the IDB.

16. **Congressional approval of an amended budget in line with the program and the tax code procedures are PCs for end-June.** The staff pressed for these measures before completing the review. However, in light of the difficult political circumstances, the authorities preferred to focus their political capital in early 2005 on adopting an appropriate hydrocarbons framework, before switching attention to the budget and administrative procedures to the tax code. The authorities argued that the current tax code procedures issued by decree were operating well, as evidenced by tax collection in line with the program.

17. **Understandings were reached on steps to improve the tax system and implement a sustainable tax reform**. Following FAD TA recommendations, the authorities are considering introducing a personal income tax that would exempt 80–85 percent of the population, and eliminating the transactions tax (combined with an increase in the VAT rate) and the various special regimes. In this connection, the authorities would prepare a tax package for submission to Congress in September (benchmark to be converted into a PC after its specific components are identified in the context of the next review), for adoption by end-October 2005 (benchmark). The authorities are also looking to strengthen customs and tax administration.

18. **The authorities are taking actions to reduce significant vulnerabilities resulting from the weak budget and decentralization processes (Box 2).** The authorities concurred with the diagnosis of recent FAD TA, and have begun to take measures, including by preparing (i) an audit on subnational debt, to be ready by end-September (benchmark); and (ii) a draft organic budget law, with submission and approval as benchmarks for end-June and end-October 2005 respectively.

B. Monetary and Exchange Rate Policy

19. **Discussions focused on the need to continue rebuilding reserves, while gradually introducing greater flexibility to the exchange rate**. Although reserves were above programmed levels by end–2004, the authorities agreed that, given the fragility of Bolivia's highly dollarized banking system—and the NIR loss in early 2005—a further build up would be appropriate in the rest of 2005. The staff urged the authorities to follow closely the evolution of NIR and adopt prompt corrective actions should further losses compromise the agreed NIR accumulation target of US$40 million for the year as a whole. The latter would increase reserve coverage to about 46 percent by end–2005, still well below levels in comparable dollarized countries. In line with MFD TA recommendations, the staff pushed for some increased flexibility of the crawling peg regime, including by conducting foreign exchange purchases to take advantage of the positive external environment. The authorities agreed, but indicated that they would move cautiously given the risk of being misinterpreted by market participants. They intend to introduce a two-way auction—taking advantage of a new electronic platform recently introduced for open-market operations—by end-September 2005.

20. **With the staff emphasizing the significant debt roll-over risks in 2005, the authorities agreed to take steps to increase further placements of government paper in domestic currency and at longer maturities**. While commending the authorities for increasing debt placements in local currency in 2004, the staff noted that (i) nearly 80 percent of Bolivia's public sector domestic debt stock was still dollar-denominated; and (ii) some US$400 million in domestic debt was falling due in 2005, making Bolivia highly vulnerable to an exchange rate depreciation and roll over risks. To mitigate these risks, the authorities intend to further increase placements of bonds in local currency and at longer maturities, allowing interest rates to increase as necessary. In addition, the authorities have recently stablished a joint Ministry of Finance/Central Bank debt management unit to improve the

Box 2. Budget and Decentralization Processes[1]

Fiscal policy has been hampered by weak budget and decentralization processes. This has led to soft budget constraints and poor prioritization at all levels of government. Among the main weaknesses are:

- Based on over-optimistic revenue estimates and unrealistic spending ceilings, the budget and medium term fiscal framework lack credibility;
- Limitations in the government financial information system (SIGMA), including the lack of a functional budget classification, make it difficult to monitor public sector spending—particularly to adequately track pro-poor and subnational governments' operations.
- The lack of clear responsibilities for subnational governments means they have few incentives to manage spending—such as on health and education—efficiently or to raise their own revenues.
- The complex transfer system with excessive earmarking leads to the simultaneous accumulation of deposits and growing debt at the subnational level.

A strategy to address the structural weaknesses in the budget process is needed. It should focus, in the short-term, on (i) approval of an organic budget law, to have a legal framework for an improved and effective budget process; (ii) improving information systems; and (iii) the use of a proper functional classification.

Weaknesses of the decentralization process should also be addressed, particularly in the context of the forthcoming Constituent Assembly. In particular,

- Quality of the education and health sectors should be improved, while reducing costs, particularly the wage bill. In the short run, an audit of the number of teachers and health workers should be conducted, and clear salary rules established. In the long run, all responsibilities for teachers should be at one level of government.
- Subnational governments should be allowed to raise their own revenues, possibly by setting surcharge rates on central taxes and having some control over local tax rates.
- To increase equity and efficiency, a new equalization system based on revenue capacities and expenditure needs, and clearly defined tied-transfers, to meet central government policy objectives could be set up.
- An independent audit of subnational floating debt and a debt register should be established.

[1] This box relies heavily on a recent FAD TA report on budget and decentralization processes.

structure of debt, including by setting targets for reducing short-term and dollar-denominated debt, monitoring progress, and offering recommendations to correct for deviations[1].

C. Financial Sector Policy

21. **The authorities are taking a number of steps to protect the financial system and reduce liquidity, solvency, and credit risks (¶16 and 17 of the MEFP).** During the last 6 months, the authorities have intervened three savings and loans institutions that failed to comply with capital adequacy requirements in 2004, repealed supreme decrees granting forbearance on loan classification and provisioning, issued a decree eliminating regulatory powers of the Ministry of Finance over the financial system, and introduced a new norm for the gradual phase-in of the additional provisions. Looking ahead, after the staff cautioned against achieving increases in reserve requirements on foreign currency deposits through large increases in marginal rates, the authorities agreed to moderate increases in average rates. This will start in April, with an increase of 2 percentage points (benchmark). The sale process for the state's participation in banks majority-owned by NAFIBO, is also agreed as an end-December 2005 structural PC.

22. **The program incorporates steps toward a properly functioning bank resolution framework**. These would be crucial to strengthen supervision, and reduce risks and moral hazard problems in bank resolution. In this connection, the authorities recently submitted to Congress legislation to ensure that the Financial Restructuring Fund is established as a legal entity, and that the bank resolution process continues to function properly in 2005. In addition, a bill creating a deposit insurance scheme, with partial coverage and adequate financing, is expected to be submitted to Congress by end-September 2005 (benchmark).

23. **Following staff concerns, the authorities stressed that, despite pressures, they do not intend to create a development bank.** The authorities have been searching for ways to support productive activities, but they have reassured the staff that funds devoted to this would come from the reallocation of existing resources; and that activities of second-tier banks (including NAFIBO and FONDESIF) will avoid subsidies, bailouts or special treatment for specific sectors.

24. **The pace of corporate restructuring initiatives has been slow.** So far, only one firm has qualified for a pilot study, prohibiting any significant lessons from being drawn. Therefore, the end-November 2004 benchmark on submission to Congress of amendments to the corporate restructuring framework was missed. Against this background, and with World Bank advice, the authorities agreed to address known deficiencies of existing laws, including to appropriately protect creditor rights. The authorities intend to submit legislation to Congress improving the corporate restructuring and bankruptcy framework by end-September 2005 (benchmark).

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[1] The US Treasury will be providing TA in this area.

D. Hydrocarbons

25. **Given regional pressures and divisions within Bolivian society and Congress, a consensus is yet to emerge on an appropriate hydrocarbons strategy.** Oil companies are concerned that the framework under discussion in Congress will increase the role of the state, weaken property rights, and significantly increase taxation on large fields. They argue that if this occurs, it would make new large investments unviable, and have threatened international arbitration. Pulling in opposite directions, some political parties are arguing in Congress for an even greater role for the state, while oil-producing regions are calling for increased autonomy and a higher share of the tax take.

26. **The authorities acknowledged the importance of approving an appropriate hydrocarbons law consistent with increased foreign investment and medium-term debt sustainability.** The staff welcomed President Mesa's commitment to veto any inappropriate hydrocarbons law. In the Bolivian legal framework, the veto could be selective and cover only inappropriate provisions. The authorities assured staff that they were committed to working with Congress to secure an appropriate law by end-June 2005 that balances the concerns of the population for a higher tax take, while maintaining an environment conducive to increased investment (benchmark). The staff, in collaboration with the World Bank, will continue to assess progress toward the development of a viable hydrocarbons strategy, taking into the account the findings of the commission of international experts, which were reported to the authorities at end–2004.

E. PRSP and Medium-Term Agenda

27. **The National Dialogue was completed by December 2004 and a draft PRSP is under preparation.** The National Dialogue discussions concluded that any sustainable poverty reduction strategy needed to increase employment of the poor. Reflecting this, the PRSP is expected to focus on employment generation, as well as improvements in social indicators and infrastructure. The authorities assured the staff that they would not give in to pressures to include populist policies—such as greater state intervention in the economy—in the PRSP. The staff noted that the PRSP should also present sustainable sources of fiscal revenue, well-targeted social safety nets, and clear priorities for national spending, consistent with fiscal sustainability. A follow-up Consultative Group meeting could take place later in the year.

28. **Debt sustainability analysis highlights the critical need for further fiscal consolidation coupled with a viable hydrocarbons bill (Box 3)**. The baseline scenario conservatively assumes increased gas exports only to regional markets, and continued fiscal consolidation. This projection points to a debt to GDP ratio below 48 percent of GDP in net present value terms by 2015. An alternative scenario, based on gas exports remaining at their 2005 levels (Figure 7), shows that debt dynamics deteriorate significantly. Stress tests to the baseline scenario illustrate that debt sustainability is highly vulnerable to a variety of shocks and to policy inertia. In particular, a lack of fiscal consolidation and a large real exchange

Box 3. Medium Term Sustainability of Public Sector Debt

Despite Bolivia's current high level of public sector debt—around 54 percent of GDP in NPV terms—debt sustainability can be achieved provided a hydrocarbons framework conducive to further investment is adopted and further fiscal consolidation is implemented. Because of the macro-critical nature of the hydrocarbons sector and the significant uncertainty surrounding the new hydrocarbons bill, two alternative scenarios were considered, with high and low hydrocarbons exports. The low hydrocarbons export scenario demonstrates that even to keep debt stable, a high degree of fiscal adjustment is needed. Stress tests further reveal that Bolivia's debt dynamics are vulnerable to various shocks, particularly an exchange rate depreciation and lack of fiscal adjustment.

Hydrocarbons scenarios (Table 10)

- **Baseline scenario.** While Bolivia has large natural gas reserves, this scenario only assumes gas exports to regional markets. The scenario envisages an increase in gas exports to Brazil—as already contracted—and the firming up of talks to extend and augment the contract to export gas exports to Argentina, that is due to expire at end–2005. Even with the projected increase in gas exports, fiscal consolidation is essential to reduce debt. The budget deficit is assumed to decline by 5 percentage points from 2004–2015. The NPV of debt declines from 54 percent of GDP in 2003 to 47 percent of GDP by 2015.

- **High exports scenario.** With a more favorable investment climate, Bolivia's gas reserves are exploited more intensively, with further exports to Brazil or North America as possibilities. The significantly higher exports lead to higher GDP and a lower fiscal deficit, resulting in a bigger decline of NPV of debt to GDP ratio to less than 40 percent by 2015.

- **Low exports scenario.** This assumes that Bolivia adopts a hydrocarbons law that is not conducive to continued investment, with gas exports to Brazil and Argentina remaining at 2005 levels and no new projects coming on stream. A higher fiscal deficit and lower GDP lead to the NPV of debt rising to about 63 percent by 2015.

Stress tests (Table 11)

The following stress tests to the baseline were considered:

- **A lower oil prices test assumes that the crude petroleum price falls below the WEO baseline by US$15 in 2005 and US$10 each year thereafter.** The reduced revenues from oil exports and lower GDP lead to an increase in NPV of debt to GDP to about 60 percent by 2015.

- **A higher nonconcessional financing test assumes** (i) a gradual fall in grants to zero by 2010; (ii) an increase in net non concessional borrowing of 3.1 percent of GDP on average starting in 2005; and (iii) that each 1 percent fall in grants leads to only a 0.7 percent increase in the primary deficit, because the fall in grants will lead to the discontinuation of some externally financed projects. The NPV of debt to GDP reaches 65 percent by 2015.

- **A higher interest rate test assumes that interest rates on nonconcessional external and domestic borrowing increase by 3 percent points each year starting in 2005.** The NPV of debt to GDP rises to more about 52 percent by 2015. This likely provides only a lower bound of the impact on debt, as the scenario looks at the passive impact of higher debt service costs on nonconcessional debt and not the negative effect of higher interest rates on economic activity, especially on the financial sector.

- **An exchange rate devaluation test models a 30 percent devaluation in 2005, which remains permanent.** The NPV of debt to GDP rises sharply to 80 percent in the aftermath of devaluation, but subsequently gradually falls to 68 percent by 2015. Again, this is likely to be a lower bound as it does not include the potentially debilitating impact of the devaluation on the financial system and hence on economic activity.

- **A higher earmarking test assumes 100 percent earmarking of the revenues from the hydrocarbon tax envisaged under the new hydrocarbons law.** The NPV of debt to GDP rises initially until 2009, but thereafter declines to 55 percent by 2015.

- **An unchanged primary balance test assumes that the primary balance stays at the level of 2004 (a -2.7 percent primary deficit) throughout 2005–2015.** The NPV of debt to GDP rises to the highest level—83 percent—by 2015 and becomes unsustainable. This result underscores that a lack of fiscal adjustment is the most serious risk.

rate depreciation—given a highly dollarized public debt stock and financial system—would worsen debt dynamics considerably (Figure 8).

Figure 7. Alternative Gas scenarios

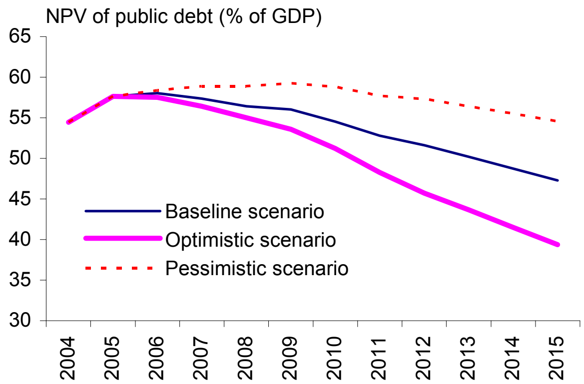
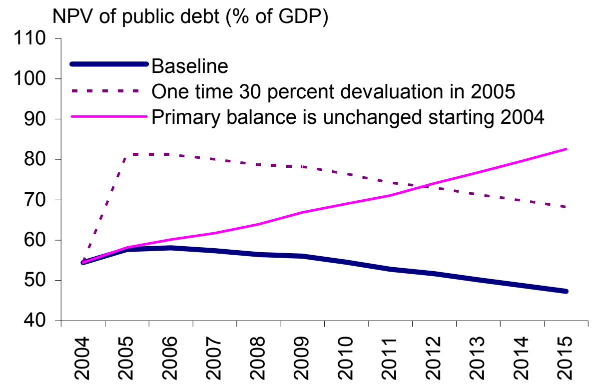


Figure 8. Stress Tests



29. **The authorities considered it essential to be actively involved in free trade negotiations with the U.S. to avoid possible harm to the export sector**. The combination of common external tariffs and free trade within the Andean region has benefited key Bolivian exports, including soybean. The staff argued that this advantage could be dismantled sooner than expected, should other Andean countries chose to abolish some of their external tariffs as part of ongoing negotiations with the U.S. over a free trade agreement. The authorities acknowledged the risks of maintaining only observer status in such negotiations, and are (i) planning to participate more actively in the free trade negotiations; and (ii) working on a comprehensive strategy to enhance Bolivian competitiveness.

F. Ex-Post Assessment (EPA) of Longer-Term Program Engagement (LTPE)[2]

30. **The ex-post assessment of the Fund's engagement with Bolivia concluded that Bolivia's past performance was hampered by an incomplete implementation of critical reforms.** Despite Bolivia undertaking some of the most extensive structural reforms in Latin America during the 1980s and 1990s, trend growth per capita did not take off because the reforms did not succeed in fundamentally altering the character of the state and improving the business environment. The report also analyzed the roots of Bolivia's continuing financial sector and fiscal fragilities, which are blamed in part on political opposition to critical structural reforms and pressures from various interest groups.

[2] The report was prepared by a team led by Jeronimo Zettelmeyer (RES), with representatives from FAD, MFD, PDR, and WHD; and is being issued as a background document.

31. **The assessment noted that continued Fund support should be conditional on the adoption of a number of key fiscal and financial reforms.** Support of the authorities' program through a new PRGF could be justified provided that it included a comprehensive reform agenda. Fundamental institutional and structural reforms would encompass improving governance, reducing and better managing public expenditure, creating a more equitable and efficient tax system, strengthening the banking system, and beginning a process of financial de-dollarization. If the authorities could start implementing key fiscal and financial reforms, but had not obtained sufficient consensus over medium-term policies, a new one-year SBA, or extension of the current program as being requested, could be considered as a bridge to a new PRGF. Nonetheless, in a situation where Fund support is urgently needed to prevent an imminent financial collapse and provide a framework for continued donor support, a Stand-By that meets adequate standards, along the lines of the 2003 Arrangement, could be justified.

32. **The authorities broadly agreed with the assessment's findings, but felt that the bar for a new PRGF was a high one.** They agreed that Bolivia needed a comprehensive reform program, but were concerned that some of the pre-conditions recommended for a PRGF—such as a "litmus test" critical reform to signal the country's readiness to undertake a new reform effort—may be difficult to meet in the near future given the current political fragmentation.

G. Program Financing

33. **The authorities agreed on a multi-year budgetary framework with bilateral donors in late October 2004.** Arising from these discussions, donors and multilaterals pledged some US$110 million, in line with estimated concessional financing requirements for 2005 under the program. This assistance was tied *inter alia* to improvements in the transparency and execution of the budget, better orientation of pro-poor spending, and implementation of a functional classification of expenditures.

H. Program Monitoring and IFIs role

34. **Extension, access, and rephasing.** It is proposed to extend the SBA to March 31, 2006, rephase the original purchases to backload disbursements, and augment access by 25 percent of quota (SDR 42.86 million). The extension is to allow time for the authorities to build consensus and adopt structural reforms that will help achieve debt sustainability and pave the way for a new three-year arrangement. The proposed augmentation reflects the strength of the program and the balance of payments needs for the period of the extension. A disbursement of SDR 9.66 million (5.63 percent of quota) would become available at completion of the fifth review (Table 7).

35. **Capacity to repay.** Debt service to the Fund constitutes a small share of Bolivia's exports of goods and services and gross official reserves (Table 9). Bolivia would therefore be expected to meet its obligations to the Fund fully and on a timely basis. Nevertheless, Fund resources would be at some risk, given sharply rising debt service costs, the fragile social and political situation, and uncertainties about medium-term prospects.

36. **Quantitative performance criteria** have been proposed for end-June 2005, end-September 2005, and end-December 2005, as shown in Table 1 of the MEFP.

37. **Structural conditionality.** In line with the recommendations of the EPA, structural conditionality focuses on fiscal reform, strengthening the financial and corporate sectors, and hydrocarbons policy (Table 3 of the MEFP).

38. **Next Review**. The sixth review will focus on assessing progress toward (i) a draft 2006 budget and tax reform package consistent with a deficit of around 4 percent of GDP, subject to available concessional financing; (ii) the adoption of an appropriate hydrocarbons framework; and (iii) reducing financial vulnerabilities.

39. **World Bank and IDB role.** As part of a concerted international effort to support Bolivia, these institutions are providing concessional loans, including balance of payment support; with credits focusing on poverty reduction, and strengthening institutions in the fiscal, financial and corporate sectors (Appendices II and III). Both have various projects on roads, health, education and the environment. The World Bank is also advising the government on hydrocarbons issues, including by providing international expertise for Bolivia on the legal framework for the sector. Structural conditionality centers on: (i) corporate sector restructuring (World Bank); (ii) civil service reform (World Bank); (iii) institutional strengthening of customs and tax administration (World Bank and IDB); (iv) land reform (World Bank); (v) social protection and provision of basic services (World Bank and IDB); and (vi) enhancing competitiveness of the private sector (IDB).

I. Program Risks

40. **Program risks remain high.** In particular:

- **Growing regional and political tensions have increased program implementation risks.** Recent events in Santa Cruz and El Alto highlighted the pressures facing the government. The upcoming election of regional governors, the announced referendum on regional autonomy, and the Constituent Assembly could increase divisions in Bolivia.

- **Despite the recent agreement between the administration and traditional political parties, there are still significant difficulties in passing key legislation.** The agreement may have strengthened the government's base in Congress, including for passing an appropriate hydrocarbons law. However, Congress' insistence on a hydrocarbons bill deemed unacceptable by President Mesa, even after the agreement with political parties, illustrates remaining risks. In addition, a key opposition party's refusal to sign the agreement and its insistence on a populist hydrocarbons law could further polarize Bolivian society.

- **Fiscal risks are high.** While curtailing current spending by decree was successful in 2004, controlling capital spending (as intended in 2005) could prove more challenging in light of regional spending pressures. Roll over risks are also high, given substantial debt falling due in 2005 (almost 5 percent of GDP) and the still large fiscal deficit.

- **The highly dollarized financial system remains vulnerable**. Despite recent progress in strengthening the financial system, large cumulative deposit losses during the last few years, low profitability, and lingering political and economic uncertainties make the system vulnerable to renewed deposit withdrawals.

- **Uncertainties surrounding approval of a viable hydrocarbons bill and the investment environment more broadly could threaten medium-term prospects**.

- **Bolivia's dependence on primary commodities makes it vulnerable to external shocks.**

41. **The proposed program has been designed to help address implementation risks.** In particular, key prior actions have been implemented and Fund disbursements have been backloaded.

IV. Staff Appraisal

42. **With the pre-conditions for a PRGF still not in place, the proposed extension of the SBA should help catalyze further financial assistance and give the authorities time to develop a medium-term policy agenda.** The recent implementation of fuel price increases, several prior actions, and the political agreement between the administration and the majority in Congress, may have improved prospects for the implementation of the authorities' program, which still needs critical fiscal and financial reforms and the building of consensus on medium-term policies.

43. **However, there are substantial risks to the program.** The continued social, regional, and political tensions; and insufficient domestic consensus pose high implementation risks. Moreover, the highly dollarized and weak financial system makes the economy particularly vulnerable to further shock.

44. **While the authorities have reduced spending limits by decree in line with the 2005 program, they should stand ready to take additional measures should deviations arise.** The fuel price increases and spending decrees have given the government a platform on which to carry out the needed fiscal consolidation. Nevertheless, the staff stressed the need to approve a new budget as soon as possible. The authorities should resist spending pressures, and be ready to take contingency measures—including further cuts in current and lower priority capital spending—should the need arise.

45. **Given Bolivia's vulnerability to a number of shocks, saving part of the windfall arising from the current favorable external conditions would be desirable.** Bolivia's

reliance on primary commodities and degree of indebtedness suggest that negative external shocks—such as higher global interest rates, or a terms of trade deterioration—would require substantial further fiscal consolidation to maintain debt sustainability. In light of this, the staff welcomed the authorities' agreement to reduce the deficit further in the event of higher revenues than assumed in the program.

46. **Achieving fiscal sustainability will require substantial fiscal consolidation during 2006 and beyond.** While the authorities have identified potential revenue and expenditure measures—including a sustainable tax reform and the implementation of the recommendations of the expenditure and pension commissions—it will be crucial to move forward and adopt these measures, and obtain congressional approval where necessary.

47. **Implementing effective public expenditure management and reforming the decentralization process are critical reforms**. The staff welcomed the authorities' plan to adopt an organic budget law to set binding budget constraints at all levels of government, and transform the budget into an effective policy tool to set spending priorities. In preparation for potentially increased regional autonomy and the Constituent Assembly, the staff urged the authorities to assess spending and revenue responsibilities across different levels of government to avoid exacerbating existing problems with the decentralization process.

48. **The authorities were able to rebuild reserves in 2004, in part owing to the favorable external conditions, but greater efforts are needed to reduce vulnerabilities.** In the context of the highly dollarized financial system and the crawling peg regime, the authorities need to further increase reserve coverage. On time, they should introduce a two-way foreign exchange auction to gradually foster greater exchange rate flexibility, better reflect market conditions and improve the ability to withstand shocks.

49. **Debt management needs to be strengthened to mitigate roll over and exchange rate risks**. Staff commended the authorities for taking steps to increase placements in domestic debt and at longer maturities, but pressed the authorities to strengthen these efforts—at higher interest rates if necessary—given the high level of dollarization and domestic debt falling due in 2005. Staff welcomed the establishment of a debt management unit with explicit targets to improve debt operations.

50. **The authorities continue to make progress in strengthening the financial sector but should press ahead in completing pending reforms, and resist pressures to create public sector development banks**. While commending the authorities for taking action to resolve various weak savings and loans institutions and tightening the regulation on loan classification and provisions, the staff noted the need to further reduce risks given remaining vulnerabilities. Steps to reduce risks include increasing reserve requirements on dollar deposits; privatizing banks where the public sector holds a majority stake; and approving the law that creates the Financial Restructuring Fund as a legal entity and provides appropriate financing for the bank resolution process.

51. **The corporate restructuring agenda needs to be reinvigorated, as it is key to reestablishing credit flows to the private sector and reducing vulnerabilities of the financial system**. Progress in this area has been slow and the authorities need to redouble their efforts in amending the relevant legislation in order to protect creditor rights. The staff welcomed the authorities' commitment to submit to Congress draft legislation strengthening creditor rights later in the year.

52. **Passage of a viable hydrocarbons bill and maintaining a general framework conducive to foreign investment are critical to attaining medium-term debt sustainability**. Staff welcomed the authorities' resolve to veto any inappropriate hydrocarbons law, and encouraged them to continue to reach out to Congress to foster greater consensus on a version, that balances the call for greater taxation on hydrocarbons and the need to increase private investment in the sector.

53. **Despite the significant risks, staff believes that program objectives can be attained through continued implementation of key reforms**. The fragile political situation and regional tensions create substantial implementation risks. However, on the basis of the important prior actions taken, including difficult fuel price increases; the authorities' commitment to work on broadening domestic support for their policy agenda; and the proposed backloading of Fund disbursements; the program can achieve its objectives. Staff therefore recommends the completion of the fifth review; granting of waivers for nonobservance of performance criteria; and extension and augmentation of the SBA through end-March 2006.

Table 1. Bolivia: Selected Economic and Financial Indicators

	2000	2001	2002	2003	2004 Country Report 04/350	2004 Prel.	2005 Proj.
	(Annual percentage change)						
Income and prices							
Real GDP	2.3	1.5	2.8	2.5	3.8	3.7	4.5
Real domestic demand	1.2	-2.5	1.6	-1.3	3.5	2.6	4.6
GDP deflator	5.3	0.7	2.7	5.1	6.9	7.6	4.0
CPI inflation (period average)	4.6	1.6	0.9	3.3	3.9	4.4	4.7
CPI inflation (end-of-period)	3.4	0.9	2.4	3.9	3.5	4.6	3.8
	(In percent of GDP)						
Investment and savings							
Gross domestic investment	18.3	14.2	14.7	11.1	13.6	12.7	13.8
Public	5.2	5.8	5.4	4.7	5.0	5.3	5.3
Private, including stockbuilding	13.1	8.5	9.4	6.4	8.6	7.4	8.5
Gross national savings	13.0	10.8	10.6	11.7	16.3	15.7	15.4
Public	2.8	1.4	-0.4	0.2	2.8	3.5	4.1
Private	10.2	9.4	11.0	11.5	13.5	12.3	11.3
Combined public sector							
Overall balance	-3.7	-6.9	-8.9	-8.1	-6.0	-5.7	-5.2
External financing	2.0	3.1	6.1	5.4	4.7	4.2	3.5
Domestic financing	1.8	3.9	2.8	2.7	1.3	1.5	1.6
Nonpension balance	0.7	-2.1	-3.9	-3.2	-1.1	-0.9	-0.2
Pension-related balance	-4.5	-4.8	-5.0	-4.9	-4.9	-4.8	-4.9
Nonfinancial public sector debt	58.8	53.7	61.6	73.0	76.3	73.8	74.6
External 2/	47.3	36.1	42.4	50.3	53.5	51.3	52.6
Domestic 2/	11.5	17.6	19.3	22.7	22.8	22.5	22.0
	(Annual percentage change, unless otherwise stated)						
Money and credit							
Broad money (in U.S. dollars at current exchange rates)	-3.3	-5.1	-11.7	-2.0	-6.6	-2.2	8.2
Credit to private sector (in U.S dollars at current exchange rates	-9.0	-14.3	-9.4	-4.8	-4.3	-6.8	7.9
Interest rates (percent, end-of-period)							
Commercial banks lending rate in U.S. dollars	15.3	13.5	11.9	9.5	...	9.5	...
Yield on treasury bills in local currency	14.7	12.9	17.2	10.9	...	10.6	...
Yield on treasury bills in U.S. dollars	9.1	5.6	4.9	6.2	...	4.3	...
External sector (US$ million)							
Current account	-446	-276	-324	46	223	257	150
(Percent of GDP)	-5.3	-3.4	-4.2	0.6	2.7	3.0	1.7
Excluding exceptional imports (in percent of GDP)	0.7	22.4	26.4	11.8	4.9	11.5	11.9
Capital and financial account	408	255	32	31	-291	-132	-113
Of which: net foreign direct investment	701	666	674	195	267	114	167
Overall balance	-39	-21	-293	77	-68	125	37
Exceptional financing	15	9	17	16	13	13	3
Merchandise export volume, percent change	13.2	6.0	7.9	8.5	10.8	16.2	11.6
Merchandise import volume, percent change	3.0	-5.4	3.3	-10.1	8.3	11.5	13.1
Terms of trade, percent change (deterioration -)	3.5	-1.4	0.5	6.1	10.6	12.3	-1.1
Gross international reserves 3/							
(Months of imports of goods and services)	8.7	8.0	6.5	6.8	6.0	6.7	6.0
(In percent of broad money)	39.7	39.2	31.2	41.3	44.0	47.2	43.4
Net International Reserves	1,075.0	1047.6	810.3	903.2	848.2	1041.2	1081.2
Disposable reserves in percent of dollar deposits 4/	...	...	34.1	39.2	...	45.1	45.5
Public sector external debt (US$ billion) 5/	4.5	3.3	3.7	4.5	4.8	4.8	5.1
Exchange rates							
Bolivianos/U.S. dollar (end-of-period) 6/	6.40	6.83	7.50	7.84	...	8.06	...
REER (percentage change during year)	-1.6	-3.2	4.4	-8.5	...	-5.2	...
REER, period average (percentage change)	-1.6	-1.8	3.0	-8.6	...	-7.3	...

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

1/ SBA (Country Report No. 04/5).

2/ External debt indicators reflect assistance under the original and enhanced HIPC Initiatives, and beyond HIPC relief. Domestic debt is the nonfinancial public sector debt, excluding bonds issued for the recapitalization of the central bank. End-2003 external debt reflects valuation changes.

3/ Equal to central bank's gross official reserves plus commercial banks' liquid asset requirement (RAL) held overseas; excludes reserves from the Latin American Reserve Fund (FLAR).

4/ Ratio of central bank gross disposable reserves (excluding gold holdings) plus commercial banks' liquid assets in foreign currency to financial system deposits.

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

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

Table 2. Bolivia: Operations of the Combined Public Sector

(In percent of GDP)

	2000	2001	2002	2003	Country Report No. 04/350 2004	Prel. 2004	Proj. 2005
Balance excluding pensions (deficit -)	**0.7**	**-2.1**	**-3.9**	**-3.2**	**-1.1**	**-0.9**	**-0.2**
Current revenue	22.8	22.9	22.5	21.7	23.6	25.0	25.0
General government	22.3	22.1	21.9	21.7	23.2	24.6	24.8
Taxes	18.7	18.1	18.0	18.3	20.3	21.3	21.8
Hydrocarbons	5.1	5.1	4.7	4.7	4.7	5.2	6.7
Other	13.6	13.0	13.4	13.6	15.6	16.1	15.1
Direct taxes	3.8	3.4	3.4	3.2	3.6	3.7	3.7
Corporate income tax	2.1	2.0	1.9	1.8	2.1	2.1	2.1
Indirect taxes	9.7	9.6	10.0	10.4	12.0	12.4	11.4
Of which:							
VAT	5.6	5.7	6.1	6.3	6.6	6.5	6.5
Financial transactions tax	...	...	...	...	0.5	0.5	0.9
Customs duties	1.3	1.1	1.1	0.9	0.9	1.0	0.9
Nontax revenue	3.6	3.9	3.8	3.4	3.0	3.2	3.1
Public enterprise operating balance	0.0	0.3	0.1	-0.1	0.1	0.1	0.0
Central bank operating balance	0.5	0.5	0.5	0.2	0.2	0.3	0.2
Current expenditure of general government	17.8	19.2	20.2	19.7	19.2	19.3	19.0
Wages	8.3	8.8	9.0	9.3	8.9	9.0	8.7
Interest	2.3	2.6	2.6	2.9	3.0	3.0	3.0
Other	7.2	7.7	8.6	7.5	7.3	7.3	7.2
Official grants	2.2	2.5	2.3	3.0	3.3	2.6	3.1
Of which: HIPC assistance from grants	0.9	1.0	0.9	0.9	1.0	1.0	0.8
Capital revenue	0.6	0.1	0.0	0.1	0.0	0.2	0.0
Capital expenditure	7.1	8.5	8.5	8.3	8.8	9.4	9.4
General government	6.9	8.3	8.4	8.2	8.8	9.4	9.3
Public enterprises	0.2	0.2	0.2	0.1	0.0	0.1	0.0
Pension-related balance (deficit -)	**-4.5**	**-4.8**	**-5.0**	**-4.9**	**-4.9**	**-4.8**	**-4.9**
Revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	4.5	4.8	5.0	4.9	4.9	4.8	4.9
Pensions	4.1	4.4	4.6	4.5	4.6	4.4	4.6
General government employer contributions	0.3	0.4	0.4	0.4	0.4	0.4	0.3
Overall balance	**-3.7**	**-6.9**	**-8.9**	**-8.1**	**-6.0**	**-5.7**	**-5.2**
without grants	**-6.0**	-9.4	-11.2	-11.1	-9.3	-8.3	-8.2
Financing	**3.7**	**6.9**	**8.9**	**8.1**	**6.0**	**5.7**	**5.2**
External	2.0	3.1	6.1	5.4	4.7	4.2	3.5
Of which: HIPC assistance from refinancing	0.2	0.1	0.2	0.2	0.2	0.1	0.0
Domestic	1.8	3.9	2.8	2.7	1.3	1.5	1.6
Central bank	0.4	-0.5	1.7	-0.2	-0.5	-0.8	0.0
Commercial banks	0.4	0.9	0.2	-0.2	0.0	0.0	0.0
Pension funds	1.7	1.7	1.7	1.6	1.6	1.6	1.5
Other	-0.7	1.8	-0.6	1.4	0.2	0.8	0.1
Memorandum items:							
Overall balance before grants (deficit -)	-6.0	-9.4	-11.2	-11.1	-9.3	-8.3	-8.2
Overall balance excluding grants and hydrocarbons (deficit -)	-11.1	-14.5	-15.9	-15.8	-14.0	-13.5	-14.9
Primary deficit (-)	-1.5	-4.3	-6.3	-5.2	-3.0	-2.7	-2.1
Poverty reducing expenditure	10.8	12.1	12.6	12.2	12.8	12.4	12.6
Total assistance under the HIPC Initiative	1.0	1.1	1.6	1.5	1.4	1.3	1.1
Original HIPC	0.9	0.7	0.5	0.5	0.4	0.4	0.2
Enhanced HIPC	0.0	0.3	1.1	1.0	1.0	1.0	0.9
HIPC assistance from stock-of-debt reduction	0.1	0.2	0.4	0.5	0.4	0.3	0.4
On interest	0.1	0.1	0.2	0.2	0.2	0.2	0.3
On amortization	0.0	0.1	0.2	0.3	0.2	0.1	0.1
GDP (in billions of bolivianos)	51.9	53.0	55.9	60.3	66.8	67.2	73.0

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

Table 3. Bolivia: Summary Balance of Payments

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

	2000	2001	2002	2003	2004	Prel. 2004	Proj. 2005
Current account	**-446**	**-276**	**-324**	**46**	**223**	**257**	**150**
Trade balance	-584	-423	-471	-36	190	266	246
Exports, f.o.b.	1,246	1,285	1,299	1,573	1,989	2,129	2,373
Of which: gas	122	234	266	381	611	620	870
Imports, c.i.f.	-1,830	-1,708	-1,770	-1,609	-1,799	-1,863	-2,128
Of which: exceptional imports	-161	-153	-235	-92	-184	-26	-110
Services (net)	-24	-36	-18	-68	-76	-69	-92
Income (net)	-226	-210	-205	-302	-343	-369	-432
Of which: interest due on external public sector debt	-130	-115	-98	-106	-107	-103	-113
Of which: investment income (net)	-146	-165	-180	-231	-279	-299	-350
Transfers (net)	387	393	369	452	452	429	428
Of which: HIPC assistance from grants	57	65	80	67	74	68	59
Capital and financial account	**408**	**255**	**32**	**31**	**-291**	**-132**	**-113**
Capital transfers	0	3	0	7	8	8	9
Direct investment (net)	701	666	674	195	267	114	167
Gross investment	...	...	999	511	660	416	530
Disinvestment and investment abroad	...	...	-325	-351	-393	-303	-363
Portfolio investment (net)	55	-23	-19	-68	-160	-122	-120
Public sector loans	112	189	321	373	331	231	321
Disbursements	292	364	577	697	644	544	631
Amortization 1/	-180	-175	-256	-370	-313	-313	-310
Banks' net foreign assets, excl. liquid asset requirement	-369	-401	16	-93	-5	17	-50
Nonbank private sector loans	-16	-50	-34	111	-49	1	-50
Other	161	-74	-826	195	-428	-381	-390
Errors and omissions	-237	-54	-100	-690	-253	-320	-310
Overall balance	**-39**	**-21**	**-293**	**77**	**-68**	**125**	**37**
Exceptional financing	**15**	**9**	**17**	**16**	**13**	**13**	**3**
Of which: HIPC assistance from rescheduling	15	9	17	16	13	13	3
GAP					0	**0**	**0**
Net international reserves (increase -)	**23**	**29**	**275**	**-93**	**55**	**-138**	**-40**
Memorandum items:							
Gross official reserves (end-of-period)	1,162	1,116	854	1,057	1,040	1,212	1,215
(In months of imports of goods and services) 2/	7.0	6.5	5.2	5.6	5.1	5.7	5.1
Gross international reserves (end-of-period) 3/	1,436	1,375	1,073	1,268	1,251	1,424	1,426
(In months of imports of goods and services) 2/	8.7	8.0	6.5	6.8	6.1	6.7	6.0
Gross Fund Financing	14.6	24.2	0.0	89.9	94.4	94.4	0.0
Total HIPC assistance and beyond HIPC relief	80	99	159	160	183	163	151
Original HIPC framework	79	59	43	39	31	30	18
Of which: assistance from debt reduction	7	8	7	10	10	10	10
Enhanced HIPC framework	1	28	84	80	87	80	82
Of which: assistance from debt reduction	1	5	22	26	21	18	28
Beyond HIPC and other debt relief	0	12	32	41	66	54	51
			(In percent)				
Export volume growth	13.2	6.0	7.9	8.5	10.8	16.2	11.6
Import volume growth	3.0	-5.4	3.3	-10.1	8.3	11.5	13.1
Nonexceptional import volume growth	0.0	0.0	0.0	0.0	3.2	0.0	0.0
Terms of trade change	3.5	-1.4	0.5	6.1	10.6	12.3	-1.1
			(In percent of GDP)				
Current account	-5.3	-3.4	-4.2	0.6	2.7	3.0	1.7
Current account, excluding exceptional imports	0.7	22.4	26.4	11.8	5.0	11.5	11.9
Current account before HIPC assistance 4/	-6.1	-4.4	-5.5	-0.6	1.5	1.9	0.6
Merchandise exports	14.9	16.0	16.7	20.0	24.3	25.1	26.5
Merchandise imports	21.8	21.3	22.7	20.4	22.0	22.0	23.8
Of which: capitalization and pipeline	1.9	1.7	3.0	1.2	0.6	0.1	0.0
Direct investment (net)	8.4	8.3	8.7	2.5	3.3	1.3	1.9
Grants and loans 5/	5.7	6.9	9.7	13.0	11.2	9.2	9.7
NPV of NFPS debt to GNFS exports (3-year backward	199.3	100.2	118.9	139.9	137.9	142.8	141.6
External debt service to GNFS exports	20.4	18.1	12.4	15.4	14.6	14.5	14.0

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

1/ Revised SBA (Country Report No. 04/5).

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/

	2001	2002 4/	2003 4/	Country Report No. 04/350 2004	Prel. 2004	Proj. 2005 5/
			I. Central Bank			
			(In percent of currency issue at beginning of period)			
Net international reserves	-7.7	-71.7	23.6	-12.6	31.6	7.6
(Flow in millions of U.S. dollars)	-28.5	-275.4	92.9	-55.1	138.5	40.3
(Flow in millions of U.S. dollars excluding reserve requirements at the BCB)			...	...	...	40.0
Net domestic assets	19.1	84.2	-7.6	19.5	-10.0	2.4
Net credit to nonfinancial public sector	-11.1	34.6	-4.5	-9.4	-15.9	0.0
Net credit to financial intermediaries	4.1	14.1	-6.1	5.9	-10.1	-2.7
Of which: open market operations	6.7	6.0	-0.6	3.7	-8.3	-13.3
Medium- and long-term net foreign liabilities	16.6	39.1	-1.1	23.7	24.8	0.2
(Flow in millions of U.S. dollars, increase -)	61.0	150.1	-4.2	104.1	-108.7	-0.9
Other	9.6	-3.6	4.1	-0.6	-8.8	4.9
Currency issue	11.4	12.5	16.0	7.0	21.5	10.0
			II. Banking System			
			(In percent of broad money at beginning of period)			
Net short-term foreign assets	9.1	-10.8	3.2	-1.9	3.6	3.0
(Flow in millions of U.S. dollars)	329.3	-379.2	99.9	-58.1	110.3	90.0
Net domestic assets	-11.1	0.7	-4.4	-3.6	-5.3	6.1
Net credit to the public sector	0.8	4.2	-1.0	-1.5	-1.4	0.0
Credit to the private sector	-15.2	-9.3	-4.9	-4.4	-6.8	7.7
Medium- and long-term net foreign liabilities	1.5	4.7	0.6	2.6	3.3	-2.7
(Flow in millions of U.S. dollars, increase -)	54.2	164.7	18.0	77.2	101.0	-80.0
Other	1.8	1.1	1.0	-0.3	-0.4	1.1
Broad money	-2.0	-10.1	-1.1	-5.6	-1.6	9.1
			(12-month percentage change)			
Broad money 2/	-2.0	-10.1	-1.1	-5.6	-1.6	9.1
Liabilities in bolivianos (M2)	11.2	0.2	18.0	11.6	28.2	19.7
Foreign currency deposits 3/	-4.7	-12.3	-5.4	-10.2	-9.7	5.1
Credit to private sector	-13.4	-9.2	-4.7	-4.2	-6.8	8.0
Credit in bolivianos	-14.6	-15.1	-12.3	-4.2	65.1	21.8
Foreign currency credit 3/	-13.4	-9.0	-4.5	-4.2	-8.3	7.5
Memorandum items:						
			(Average stock in percent of GDP)			
Currency issue	4.0	4.1	4.5	4.3	4.8	5.4
Broad money 2/	43.6	38.8	38.2	29.9	33.5	33.9
Credit to private sector	46.9	42.0	40.0	33.3	34.7	33.1
			(In percent of total deposits or credit at current exchange rates)			
Dollarization (end-period stocks)						
Foreign currency deposits 3/	92.2	91.9	90.6	89.0	86.5	84.0
Foreign currency credit 3/	97.1	97.5	97.8	97.7	96.2	95.9
			(12-month percentage change at current exchange rates)			
Broad money 2/	3.4	-3.0	2.5	-2.0	0.5	11.3
Credit to private sector	-8.0	-1.0	-0.5	0.5	-4.2	11.0
			(12-month percentage change in U.S. dollars at current exchange rates)			
Broad money 2/	-5.1	-11.7	-2.0	-6.6	-2.2	8.2
Credit to private sector	-14.3	-9.4	-4.8	-4.3	-6.8	7.9

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

1/ Flows in foreign currency are valued at the accounting exchange rate for the corresponding period. The banking system comprises the central bank, commercial banks, the National Financial Institution of Bolivia and FONDESIF, which are state-owned second-tier banks.
2/ Includes special certficates of deposits (CDDs) issued by the central bank during the liquidation of failed banks.
3/ Includes deposits and credits in bolivianos that are indexed to the U.S. dollar.
4/ Due to some changes in classification, central bank credit to the public, financial and other sectors has been revised in 2002/3.
5/ At the beginning of 2005 Banco Los Andes was reclassified as a bank.
This has led to a step increase in the levels of broad money and credit to the private sector in 2005.

Table 5. Bolivia: Medium-Term Macroeconomic Framework

	2003	Prel. 2004	Proj. 2005	Proj. 2006	Proj. 2007	Proj. 2008
	(Annual percentage change)					
Economic growth and prices						
Real GDP at market prices	2.5	3.7	4.5	3.7	5.0	4.9
Of which: Excluding hydrocarbons	2.0	2.0	2.6	3.4	3.9	3.7
Real domestic demand	-1.3	2.6	4.6	5.3	2.7	2.8
GDP deflator	5.1	7.6	4.0	3.4	2.2	1.6
CPI (period average)	3.3	4.4	4.7	3.2	3.1	3.0
CPI (end of period)	3.9	4.6	3.8	3.3	3.0	3.0
	(In percent of nominal GDP)					
Gross investment	**11.1**	**12.7**	**13.8**	**18.2**	**24.5**	**24.3**
Public investment	4.7	5.3	5.3	5.6	5.4	5.4
Private investment, including stockbuilding	6.4	7.4	8.5	12.6	19.1	18.9
Savings	**11.1**	**12.7**	**13.8**	**18.2**	**24.5**	**24.3**
Gross national savings	11.7	15.7	15.4	17.9	23.6	24.2
Public savings	0.2	3.5	4.2	5.7	6.3	7.0
Private savings	11.5	12.3	11.2	12.2	17.3	17.2
External savings	-0.6	-3.0	-1.7	0.3	0.9	0.1
Consolidated public sector						
Non-pension balance	-3.2	-0.9	-0.2	0.5	1.1	1.9
Pension-related balance	-4.9	-4.8	-4.9	-4.5	-4.3	-4.3
Overall balance	-8.1	-5.7	-5.2	-4.0	-3.3	-2.4
Net domestic financing	2.7	1.5	1.6	1.1	0.9	0.9
Net external financing	5.4	4.2	3.5	2.9	2.4	1.5
Primary deficit (-)	-5.2	-2.7	-2.1	-1.2	-0.5	0.3
External sector						
Current account balance	0.6	3.0	1.7	-0.3	-0.9	-0.1
Excluding exceptional imports	11.8	11.9	13.3	0.0	0.0	0.0
Net foreign direct investment	2.5	1.3	1.9	4.7	4.5	3.8
Memorandum items:						
Nominal GDP (millions of US dollars)	7,877	8,476	8,954	9,420	10,010	10,563

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

Table 6. Bolivia: Commercial Banks Performance Indicators

(In percent)

	2000	2001	2002	2003	2004
Profitability Ratios					
Ratios to total average assets (period average)					
Operating Income	3.5	3.7	4.1	4.4	5.3
Profits after taxes	-0.8	-0.4	0.1	0.3	-0.1
Ratios to average equity					
Profits before taxes	-4.3	-0.5	3.5	5.1	1.4
Profits after taxes	-8.6	-4.1	0.6	2.7	-1.2
Assets quality ratios					
Ratios to total loans (end-of-period)					
Nonperforming loans	11.6	16.2	17.6	16.7	14.0
Nonperforming loans (net of provisions)	5.2	7.0	6.4	4.4	2.2
Provisions (as percentage of NPL)	61.4	63.7	63.7	74.0	84.3
Liquidity ratios					
Ratios to total deposits (end-of period)					
Total loans	102.4	93.1	94.6	94.1	94.6
Total liquidity assets	27.2	30.2	30.2	30.2	33.1
of which Government papers	3.1	4.6	5.1	6.1	7.0
Capital Adequacy ratio					
Ratio of qualifying capital to total risk-adjusted assets (end-of-period)	13.5	14.3	16.1	15.3	14.9

Source : Superintendency of Banks

Table 7. Bolivia: Schedule of Purchases Under the Extension of the SBA

Date	Amount in SDR millions	In percent of quota	Conditions
2003	**64.32**	**37.50**	
April 2, 2003	42.88	25.00	Board approval of SBA (Purchase of first credit tranche)
July 7, 2003	10.72	6.25	First review, end-March 2003 performance criteria
October 6, 2003	10.72	6.25	Second review, end-June 2003 performance criteria
Total	**64.32**	**37.50**	
2004	**37.52**	**21.88**	
June 10, 2004	10.72	6.25	Third review; and end-December 2003 performance criteria
September 27, 2004	26.80	15.63	Fourth review; and end-June 2004 performance criteria
Total	**37.52**	**21.88**	
2005	**43.96**	**25.63**	
April 11, 2005	9.66	5.63	Fifth review; and end-September 2004 performance criteria
August 15, 2005	17.15	10.00	Sixth review; and end-June 2005 performance criteria
November 15, 2005	17.15	10.00	Seventh review; and end-September 2005 performance criteria
Total	**43.96**	**25.63**	
2006	**25.72**	**15.00**	
February 15, 2006	25.72	15.00	Eighth review; and end-December 2005 performance criteria
Total	**25.72**	**15.00**	
Quota	171.50	100.00	

Source: Fund staff estimates.

Table 8. Bolivia: Millenium Development Goals

Main goal	1990	1995	2001	2002
1 Eradicate extreme poverty and hunger	*2015 target = halve 1990 $1 a day poverty and malnutrition rates*			
Population below $1 a day (%)	..	..	14.4	..
Poverty gap at $1 a day (%)	..	..	5.4	..
Percentage share of income or consumption held by poorest 20%	..	..	4	..
Prevalence of child malnutrition (% of children under 5)	11.1	14.9	..	..
Population below minimum level of dietary energy consumption (%)	26	25	22	..
2 Achieve universal primary education	*2015 target = net enrollment to 100*			
Net primary enrollment ratio (% of relevant age group)	90.7	..	94.2	..
Percentage of cohort reaching grade 5 (%)	..	..	78	..
Youth literacy rate (% ages 15-24)	92.6	94.4	97.3	..
3 Promote gender equality	*2005 target = education ratio to 100*			
Ratio of girls to boys in primary and secondary education (%)	90.1	..	97.8	..
Ratio of young literate females to males (% ages 15-24)	92.5	94.3	97.5	..
Share of women employed in the nonagricultural sector (%)	35.2	35.9	36.4	..
Proportion of seats held by women in national parliament (%)	..	11	..	..
4 Reduce child mortality	*2015 target = reduce 1990 under 5 mortality by two-thirds*			
Under 5 mortality rate (per 1,000)	122	97	80	71
Infant mortality rate (per 1,000 live births)	87	73	62	56
Immunization, measles (% of children under 12 months)	53	58	79	79
5 Improve maternal health	*2015 target = reduce 1990 maternal mortality by three-fourths*			
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	420	..
Births attended by skilled health staff (% of total)	43.2	47.1	68.8	..
6 Combat HIV/AIDS, malaria and other diseases	*2015 target = halt, and begin to reverse, AIDS, etc.*			
Prevalence of HIV, female (% ages 15-24)	..	..	0.1	..
Contraceptive prevalence rate (% of women ages 15-49)	30.3	46.9	..	..
Number of children orphaned by HIV/AIDS	..	..	1,000.00	..
Incidence of tuberculosis (per 100,000 people)	..	..	216	234.1
Tuberculosis cases detected under DOTS (%)	..	39	81	75
7 Ensure environmental sustainability	*2015 target = various (see notes)*			
Forest area (% of total land area)	50.4	..	48.9	..
Nationally protected areas (% of total land area)	..	14.4	14.4	13.9
GDP per unit of energy use (PPP $ per kg oil equivalent)	4.1	4	4.9	..
CO2 emissions (metric tons per capita)	0.8	1.2	1.3	..
Access to an improved water source (% of population)	71	..	83	..
Access to improved sanitation (% of population)	52	..	70	..
Access to secure tenure (% of population)	..	..	..	..
8 Develop a Global Partnership for Development	*2015 target = various (see notes)*			
Youth unemployment rate (% of total labor force ages 15-24)	4.5	6.1	8.5	..
Fixed line and mobile telephones (per 1,000 people)	27.6	34.3	157.6	172.2
Personal computers (per 1,000 people)	2.2	3.4	20.5	22.8
General indicators				
Population (in millions)	6.6	7.5	8.6	8.8
Gross national income (US dollars, billions)	4.9	6.5	8.1	7.9
GNI per capita (US dollars)	750	860	940	900
Adult literacy rate (% of people ages 15 and over)	78.1	82.1	86.7	..
Total fertility rate (births per woman)	4.9	4.4	3.9	3.8
Life expectancy at birth (years)	58.3	60.6	62.6	63.6
Aid (% of GNI)	11.8	11.1	9.3	9
External debt (% of GNI)	92.4	81.2	59.8	64
Investment (% of GDP)	12.5	15.2	14.2	14.7
Trade (% of GDP)	46.7	49.7	45.2	48.8

Source: World Development Indicators database, April 2004

Note: In some cases the data are for earlier or later years than those stated.

Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

Goal 2 target: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

Goal 3 target: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

Goal 4 target: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

Goal 6 targets: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

Goal 8 targets: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of the Least Developed Countries. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

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

	Projections								
	2001	2002	2003	2004	2005	2006	2007	2008	2009
Outstanding Fund credit									
In millions of SDRs	164.9	143.7	187.5	197.7	217.0	208.0	150.3	91.2	39.1
In percent of quota	96.1	83.8	109.3	115.3	126.5	121.3	87.6	53.2	22.8
In percent of GDP	2.6	2.4	3.3	3.4	3.5	3.2	2.2	1.3	0.5
In percent of exports of goods and services	13.8	11.9	14.0	11.9	11.7	10.7	7.1	4.1	1.5
Debt service due to the Fund									
In millions of SDRs	23.8	21.9	23.0	28.6	28.8	40.2	62.4	62.5	54.1
In millions of U.S. dollars	30.3	28.4	32.2	42.3	44.4	62.0	96.3	96.4	83.5
In percent of quota	13.9	12.8	13.4	16.6	16.8	23.4	36.4	36.4	31.6
In percent of exports of goods and services	2.0	1.8	1.7	1.7	1.6	2.2	3.1	2.9	2.2
In percent of gross service due	10.5	8.2	7.0	10.6	11.0	15.2	25.1	25.2	20.8
In percent of gross official reserves	2.7	3.3	3.0	3.5	3.5	4.7	7.2	7.1	5.7
Gross Fund financing									
In millions of U.S. dollars	24.2	0.0	89.9	55.6	67.7	39.6	0.0	0.0	0.0
In percent of Bolivia's gross financing needs 1/	2.5	0.0	6.8	9.3	9.4	4.4	0.0	0.0	0.0
Memorandum item:									
Quota (in millions of SDRs)	171.5	171.5	171.5	171.5	171.5	171.5	171.5	171.5	171.5

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

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

Table 10a. Bolivia: Scenarios for Public Debt Sustainability Framework

(in percent of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Baseline scenario												
Nominal GDP (in millions of US dollars)	8476	8950	9420	10010	10563	11087	11800	12593	13264	14091	14952	15877
Real GDP growth (percent)	3.7	4.5	3.7	5.0	4.9	4.1	4.5	4.4	3.3	4.0	3.9	4.0
Fiscal deficit	-5.7	-5.2	-4.0	-3.3	-2.4	-2.1	-1.8	-1.5	-1.4	-1.2	-1.1	-1.0
Financing	5.7	5.2	4.0	3.3	2.4	2.1	1.8	1.5	1.4	1.2	1.1	1.0
concessional	4.2	3.4	3.0	2.5	1.8	0.8	0.8	0.4	0.3	-0.1	-0.3	-0.6
nonconcessional	1.5	1.8	1.0	0.8	0.5	1.3	1.1	1.1	1.1	1.3	1.4	1.5
NPV of non-financial public sector debt	54.5	57.6	58.0	57.4	56.4	56.0	54.5	52.8	51.6	50.2	48.8	47.3
external	32.7	35.7	36.4	36.4	35.9	35.8	34.8	33.6	32.7	31.6	30.3	29.0
internal	21.7	22.0	21.7	21.0	20.5	20.2	19.7	19.2	18.9	18.6	18.4	18.3
Exports of goods and services (in millions of US dollars)	2442.5	2702.8	2852.6	3098.5	3286.4	3762.6	3937.0	4006.5	4101.3	4199.5	4297.6	4405.7

Source: Bolivian authorities, and Fund staff estimates.

Table 10b. Bolivia: Scenarios for Public Debt Sustainability Framework

(in percent of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Optimistic scenario												
Nominal GDP (in millions of US dollars)	8476	8950	9500	10156	10789	11467	12319	13323	14200	15051	15967	16952
Real GDP growth (percent)	3.7	4.5	4.4	5.7	5.6	5.7	5.9	6.4	5.2	3.9	3.8	3.9
Fiscal deficit	-5.7	-5.2	-3.9	-3.1	-2.2	-1.7	-1.3	-0.7	-0.3	-0.2	0.0	0.1
Financing	5.7	5.2	3.9	3.1	2.2	1.7	1.3	0.7	0.3	0.2	0.0	-0.1
concessional	4.2	3.4	3.0	2.3	1.8	0.8	0.7	0.4	0.3	-0.1	-0.3	-0.5
nonconcessional	1.5	1.8	0.8	0.7	0.4	0.9	0.6	0.3	0.0	0.3	0.3	0.4
NPV of non-financial public sector debt	54.5	57.6	57.5	56.4	55.0	53.6	51.2	48.3	45.7	43.6	41.5	39.4
external	32.7	35.7	36.0	35.7	34.8	34.0	32.3	30.0	27.9	26.0	24.0	22.0
internal	21.7	22.0	21.5	20.7	20.1	19.6	18.9	18.2	17.8	17.6	17.5	17.4
Exports of goods and services (in millions of US dollars)	2443	2703	2853	3098	3286	3914	4242	4619	5022	5120	5218	5326

Source: Bolivian authorities, and Fund staff estimates.

Table 10c. Bolivia: Scenarios for Public Debt Sustainability Framework

(in percent of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Pessimistic scenario												
Nominal GDP (in millions of US dollars)	8476	8950	9372	9820	10304	10788	11412	12174	12797	13603	14437	15333
Real GDP growth (percent)	3.7	4.5	3.2	3.2	3.5	3.6	3.7	4.3	3.1	4.0	4.0	4.0
Fiscal deficit	-5.7	-5.2	-4.0	-3.7	-3.1	-2.9	-2.7	-2.4	-2.3	-2.1	-2.0	-1.9
Financing	5.7	5.2	4.0	3.7	3.1	2.9	2.7	2.4	2.3	2.1	2.0	1.9
concessional	4.2	3.4	3.1	2.4	1.9	0.9	0.8	0.4	0.3	-0.1	-0.3	-0.6
nonconcessional	1.5	1.8	0.9	1.3	1.2	2.0	1.9	2.0	2.0	2.2	2.3	2.5
NPV of non-financial public sector debt	54.5	57.6	58.4	58.9	58.9	59.2	58.8	57.7	57.3	56.4	55.5	54.6
external	32.7	35.7	36.6	37.5	37.9	38.5	38.5	38.0	37.9	37.3	36.6	35.8
internal	21.7	22.0	21.8	21.4	21.0	20.7	20.3	19.7	19.5	19.1	18.9	18.7
Exports of goods and services (in millions of US dollars)	2443	2703	2853	2870	2887	3321	3387	3456	3551	3649	3747	3856

Source: Bolivian authorities, and Fund staff estimates.

Table 11. Bolivia: Debt Sustainability Analysis - Stress Tests

			Projections										
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
NPV of Debt-to-GDP Ratio													
Baseline	53	54	58	58	57	56	56	55	53	52	50	49	47
Stress test scenarios													
A1. Lower oil prices 1/	53	54	58	58	59	60	61	61	60	60	60	60	60
A2. Higher level of non concessional financing 2/	53	54	58	58	59	60	62	62	63	64	64	65	65
A3. Higher interest rates on non-concessional borrowing 3/	53	54	58	58	58	57	57	56	55	54	53	53	52
A4. One time 30 percent devaluation in 2005 4/	53	54	81	81	80	79	78	76	74	73	71	70	68
A5. High earmarking 5/	53	54	58	58	58	58	58	57	57	56	56	56	55
A6. Primary balance is unchanged starting 2004	53	54	58	60	62	64	67	69	71	74	77	80	83
NPV of Debt-to-Revenue Ratio													
Baseline	241	216	238	222	219	212	209	202	193	191	187	183	178
Stress test scenarios													
A1. Lower oil prices 1/	241	216	238	221	236	236	239	237	233	235	235	235	235
A2. Higher level of non concessional financing 2/	241	216	238	223	226	226	230	231	229	235	239	243	247
A3. Higher interest rates on non-concessional borrowing 3/	241	216	238	223	221	215	214	208	202	201	199	197	196
A4. One time 30 percent devaluation in 2005 4/	241	216	335	311	306	295	292	283	272	269	265	261	257
A5. High earmarking 5/	241	216	238	223	222	217	217	212	207	208	208	208	208
A6. Primary balance is unchanged starting 2004	241	216	240	230	236	240	250	255	260	273	285	298	311
NPV of External Debt-to-Exports Ratio													
Baseline	126	114	118	120	118	115	105	104	106	106	106	105	104
Stress test scenarios													
A1. Lower oil prices 1/	126	114	118	120	121	123	116	120	126	131	136	141	146
A2. Higher level of non concessional financing 2/	126	114	118	121	123	127	122	128	137	145	153	162	170
A3. Higher interest rates on non-concessional borrowing 3/	126	114	118	121	119	118	109	110	113	115	117	119	121
A4. One time 30 percent devaluation in 2005 4/	126	114	118	120	117	116	106	106	109	110	112	114	115
A5. High earmarking 5/	126	114	118	121	120	120	111	113	118	122	125	129	133
A6. Primary balance is unchanged starting 2004	126	114	118	125	130	138	136	147	162	177	194	212	231
Debt Service to Revenue Ratio													
Baseline		34	31	29	26	25	24	25	24	27	29	32	34
Stress test scenarios													
A1. Lower oil prices 1/		34	31	29	28	27	26	28	27	31	34	38	41
A2. Higher level of non concessional financing 2/		34	31	29	26	26	25	27	27	31	35	39	43
A3. Higher interest rates on non-concessional borrowing 3/		34	31	31	28	27	26	27	26	29	32	36	39
A4. One time 30 percent devaluation in 2005 4/		34	45	42	33	34	29	33	29	34	36	42	43
A5. High earmarking 5/		34	31	29	26	26	24	26	25	28	31	34	37
A6. Primary balance is unchanged starting 2004		34	31	29	29	27	27	28	30	33	38	42	48

1/ US$ 15 below baseline in 2005 and US$10 below thereafter.
2/ Reduction in grants and higher share of non concessional borrowing result in an increase in net non-concessional financing by 3.1 percent on average each year starting 2006.
3/ Increase in interest rates on nonconcessional external and domestic borrowing by 3 percent each year starting 2005.
4/ Permanent 30% devaluation from 2005.
5/ Higher earmarking just to regions (100%).

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

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

II. General Resources Account:	SDR Million	Percent Quota
Quota	171.50	100.00
Fund holdings of currency	264.48	154.21
Reserve position in Fund	8.87	5.17

III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	26.70	100.00
Holdings	26.56	99.45

IV. Outstanding Purchases and Loans:	SDR Million	Percent Quota
Stand-by arrangements	101.84	59.38
ESAF/ PRGF arrangements	95.83	55.88

V. Latest Financial Arrangements:

Type of Arrangement	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	4/02/03	12/31/04	128.64	101.84
PRGF	9/18/98	6/07/02	100.96	63.86
PRGF	12/19/94	9/09/98	100.96	100.96

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

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	36.74	60.84	58.36	27.18	7.72
Charges/Interest	3.62	2.75	1.35	0.40	0.06
Total	40.36	63.59	59.71	27.58	7.79

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

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	24.68	34.71	57.69	53.31	20.45
Charges/Interest	3.69	3.53	2.65	1.27	0.34
Total	28.37	38.24	60.34	54.58	20.79

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 cannot be added.

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

VIII. **Safeguards Assessments:** Under the Fund's safeguards assessment policy, the Central Bank of Bolivia (CBB) is subject to an update assessment with respect to augmentation of the April 02, 2003 Stand-by arrangement. The assessment related to the June 10, 2004 augmentation was completed on September 27, 2004 and found no systemic risks in the safeguards of the CBB. The assessment confirmed that all previously identified vulnerabilities, except for those requiring a change in the central bank law, were eliminated. An abbreviated safeguards assessment update is currently underway.

IX. **Exchange Rate Arrangement:** The Bolivian currency is the boliviano and the exchange rate system is classified as a crawling peg. The central bank holds a daily foreign exchange auction, accepting all bids that are at least equal to the central bank's minimum price. If acceptable bids exceed the amount offered for auction, the lowest acceptable bids are prorated so as to exhaust the amount offered. The minimum price is adjusted from time to time in light of the evaluation of Bolivia's real exchange rate with respect to Bolivia's key trading partners. The administration of the system has resulted in minimal spreads between the maximum and minimum bids (generally 2 cents of boliviano). On September [xx], 2004, the official selling rate was Bs [xx] per U.S. dollar.

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

XI. **Technical Assistance:**

Dept.	Purpose	Time
FAD	Tax policy	Jan. 1999
FAD	Modernization of customs administration	June 1999
	and follow-up missions including	May 2001, Dec. 2001
FAD	Tax administration	June 1999, Feb. 2000,
		June 2001
FAD	Fiscal decentralization	Dec. 2000
MAE	Central bank operations and domestic capital markets	June 1999
MAE	Vulnerability of the banking system	Oct. 1999, Apr. 2000, Dec. 2000
STA	Money and banking statistics	Jan. 1999, Sep. 2001
STA	Balance of payments statistics	Aug. 1999
MAE	Monetary operations, monetary and exchange rate policy	May 2002
STA	National accounts statistics	Aug. 2002
MAE	FSAP	Nov. 2002, Jan. 2003
FAD	Customs reform	Dec. 2002
FAD	Tax Administration	May. 2003
FAD	Pension Reform	April 2004
MFD	Banking Sector	July 2004
MFD	Banking Sector	August 2004
FAD	Tax Policy	August 2004
FAD	Tax Administration	August 2004
FAD	PSIA	October 2004
FAD	Decentralization and Public Expenditure Management	October 2004

MFD	Promote Use of Domestic Currency	October 2004

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

Bolivia: Relations with the World Bank

The World Bank support to Bolivia is being delivered according to the strategy spelled out in the CAS covering fiscal years 2004 and 2005.[3] Bolivia is in the CAS base case, hence the annual financing resources to be provided amount to US$100 million, with 50 percent allocated to investment projects. IDA resources amount to around US$45 million a year.

Recent and Forthcoming Actions

Projects under the FY04–05 CAS. These include:

- the First Programmatic Bank and Corporate Sector Restructuring Project (US$15 million IDA and US$15 million IBRD) aimed at strengthening the banking and corporate sector. This loan was recently extended until June 2006.

- the Institutional Reform II (US$32 million, IDA) that focuses on the reform of the civil service and key agencies such as customs and other tax administration agencies. This loan will close in June 2005, but an extension could be granted if desired.

- the Land Reform Project and the Spatial Rural Development/Community-driven Development Project (US$35 million IDA) that responds directly to the problems of inequality and to the problems that the poor have in generating income. This loan is under preparation; and

- the Second Social Sector Programmatic Adjustment Credit (US$ 20 million IDA) that, like the first credit,will address issues in the basic social protection areas. This loan is also under preparation.

The Emergency Economic Recovery Credit (US$14 Million IDA) approved by the World Bank Board in December 2003 was closed due to government failure to comply with the loan requirement, i.e., to present proof of purchase of imports. Only 70 percent of the total credit was disbursed.

Technical Assistance and Economic Sector Work. The World Bank has provided technical assistance on the hydrocarbons area, including support on the design of Bolivia's new hydrocarbons law and a study on gas revenue sharing. The Bank is also providing technical assistance to strengthen the capacity of Congress.

A CAS progress report and a Country Economic Memorandum are in progress. The focus of the latter is on growth with special attention to the investment climate and trade issues. Both are expected to become available this fall.

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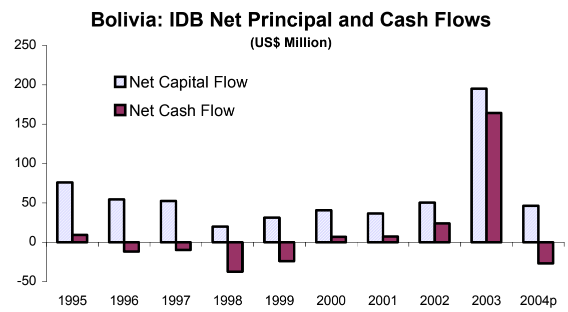
3. Bolivia-Country Assistance Strategy. Report No 26838-BO. January 8, 2004. Approved by the Board in February 2004.

BOLIVIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

Background

As of December 31, 2004, the Inter-American Development Bank (IDB) had approved loans to Bolivia amounting to US$3.7 billion, with disbursements totaling US$3.1 billion. Bolivia's outstanding debt to the IDB was US$1.8 billion. Since 2000, net cash flows to the country were positive through 2003 owing to debt relief provided by the IDB under the HIPC Initiative and other extraordinary financing disbursed that year. Looking forward, the sign of net flows from the IDB will depend on the pace of disbursements. Project and policy execution have been negatively affected by the ongoing institutional and economic crises.



Country Strategy and Lending Program

Sustainable poverty reduction is the overarching objective of the Bank's country strategy with Bolivia. In pursuit of this the Bank is supporting government-led efforts to overcome the country's economic and social development challenges in three areas: (a) improving the managerial capacity and transparency of the State, (b) supporting competitiveness and sustainable development of the private sector; (c) enhancing efficiency and equity in basic services delivery. The backdrop for the strategy's implementation is complex, characterized by a widespread rejection of the reform process, fiscal retrenchment, the need to develop a shared vision for the future and a far-reaching political agenda that includes a satisfactory hydrocarbons law following the national consultation on the use of gas reserves, and a Constitutional Assembly. In this context, the strategy has been conceived as a process in which the Bank, in concert with the Government and other partners, identify near-term high priority interventions that could attenuate economic risks and preserve the social gains of the last decade. As political and economic uncertainties diminish, Bank's actions will increasingly move towards tackling the impediments for a more equitable and sustainable social and economic progress. From the operational standpoint, the Bank's portfolio in Bolivia represents a valuable resource base from which to implement the strategy. As of December 31, undisbursed balances amounted to US$487.3 million, exceeding the expected allocation of fresh IDB concessional resources to Bolivia in the period 2005-2007, estimated at US$ 300 million.

The IDB´s lending program will continue to provide concessional resources to support fiscal sustainability, while protecting investments that are critical for achieving the Millennium Development Goals. The proposed IDB lending program for Bolivia for 2005 consists of 7 loans amounting to US$115 million.

IDB non-reimbursable technical cooperation and small projects

The IDB's portfolio in Bolivia also includes active non-reimbursable technical cooperation projects for US$22.7 million, and US$2.3 million in credits for small projects.

La Paz, Bolivia, March 24, 2005

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

Dear Mr. de Rato,

1. The macroeconomic policies and structural reforms pursued by our government continue to bear fruit despite difficult political and social conditions. Macroeconomic developments in 2004 were positive with real GDP growth of nearly 4 percent, a significant current account surplus, and increased reserve coverage of deposits.

2. Our program, supported under a Stand-By Arrangement (SBA), was broadly on track in 2004. The quantitative performance criteria (PCs) for end-September were met, except for that on central bank net credit to the nonfinancial public sector (NFPS), which was missed by a marginal amount (less than US$1.5 million). By end-December, central bank credit was back on track and the deficit target was met with a margin. Thus, we are requesting a waiver for the nonobservance of the end-September PC on central bank net credit to the NFPS. We are also requesting a waiver for the nonobservance of the end-September structural PC on congressional approval of the procedural requirements for appeals before the Tax Superintendency. While compliance with this PC was outside the control of the government, we are already working to broaden consensus for the reform agenda with congressional representatives.

3. In support of our policies described in the attached Memorandum of Economic and Financial Policies (MEFP), the Government of Bolivia requests the completion of the fifth review under the SBA, and an extension of the SBA through March 31, 2006, with an increased access level in an amount equivalent to SDR 42.86 million (25 percent of quota). We also request that the remaining amounts available under the Stand-by Arrangement, as well as the amounts corresponding to the requested increased access, be rephased over the next 12-months in four purchases linked to current and subsequent reviews. We finally ask for the establishment of the quantitative PCs for end-June, end September, and end-December 2005 specified in table 1 of the MEFP; and of the structural PCs specified in Table 3 of the MEFP. Performance under the program will be assessed at the sixth, seventh, and eight reviews to be completed by mid-August 2005, mid-November 2005 and mid-February 2006, respectively.

4. We implemented the prior actions specified in Table 3 of the MEFP before the above-requests were considered by the IMF Board.

5. The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but will take any further measures that may become appropriate for this purpose. Bolivia will consult with the Fund on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

Sincerely yours,

/s/	/s/
Luis Carlos Jemio	Juan Antonio Morales
Minister of Finance	President, Central Bank of Bolivia

Supplementary Memorandum of Economic and Financial Policies of the Government of Bolivia
Fifth Review under the Stand-By Arrangement, Request for Waiver of Nonobservance of Performance Criteria, Rephasing, Augmentation and Extension of the Stand-By Arrangement

March 24, 2005

1. Despite difficult social and political conditions, we continue to implement a solid macroeconomic program, while gradually reducing social tensions. We have observed all end-September quantitative PCs, except that on central bank net credit to the nonfinancial public sector, which was missed by a marginal amount (less than US$1.5 million). Based on preliminary data, we met all the indicative quantitative targets for end-2004, some with wide margins, except the net domestic financing target, as external disbursements were lower than expected. The recommendations of the expenditure commission were published in September (structural PC). Unfortunately, the more protracted and difficult discussions on the hydrocarbons bill have not allowed us to yet adopt a strategy on gas exports as intended (structural benchmark).

2. The program will continue to be guided by the macroeconomic and structural reform policies described in the Memorandum of March 21, 2003, and modified by the Supplementary Memoranda of June 20, 2003, September 24, 2003, June 2, 2004, September 20, 2004 and December 16, 2004.

3. The next review under the proposed extension of the SBA would focus on assessing progress toward (i) a draft 2006 budget and tax reform package, consistent with a deficit close to 4 percent of GDP, and subject to the availability of concessional financing; (ii) the adoption of a gas exports strategy, including securing Congressional approval of a hydrocarbons bill consistent with increased investment and exports; and (iii) reducing financial vulnerabilities, including those arising from high indebtedness. The test date for quantitative PCs to be assessed at the sixth review would be end-June 2005.

A. Macroeconomic Framework

4. Stronger than expected exports—particularly hydrocarbons—have driven economic activity, with real GDP growth estimated at 3¾ percent in 2004 in line with the program. 12-month inflation was 4.6 percent by end-year, exceeding the program target of 3½ percent, owing mainly to imported inflation. The external current account surplus is estimated to have been around 3 percent of GDP in 2004, with strong growth in gas, minerals, and agricultural exports.

B. Fiscal Policy

5. Preliminary estimates for 2004 point to a deficit of 5.7 percent of GDP, 0.3 percentage points of GDP below the indicative target. Tax revenues were 1.0 percent of

GDP higher than programmed, largely due to stronger than expected collection from the tax amnesty and hydrocarbons exports. With higher revenues, we were able to accelerate the implementation of high-priority road and other pro-growth projects, leading to higher than programmed investment by 0.6 percent of GDP. Pro-poor spending is estimated to have increased by 0.2 percent of GDP. Reflecting our austerity efforts, current expenditures have been contained in line with the program.

6. The 2005 budget submitted by the Executive in September 2004 acquired legal status in December, after Congress did not formally approve it within the period established by the Constitution. The budget, combined with a balanced fiscal package already adopted through supreme decrees and ministerial resolutions, is consistent with a deficit target of 5¼ percent of GDP and a maximum net use of nonconcessional financing of 1½ percent of GDP. We would aim at a lower deficit should concessional financing fall short of the assumptions under the program. Despite losing one-time revenues from the tax amnesty in 2004 (1½ percent of GDP), we expect tax revenues to increase by ½ percent of GDP, reflecting already adopted fuel price increases, higher gas export volume and prices to Brazil and Argentina, and the full year impact of the FTT. Overall spending would decline by 0.3 percent of GDP in relation to 2004, notwithstanding the initiation of new important pro-growth projects, including key roads (¾ percent of GDP). These projects have been selected based on the highest quality standards, with World Bank advice on the needs for infrastructure, and principles of transparency and accountability. Current spending would decline by 0.3 percent of GDP in relation to 2004, while cuts in lower priority investment projects would contain capital spending at the 2004 level in percent of GDP.

7. We recently submitted to Congress an amended 2005 budget with a deficit of 5¼ percent of GDP, which we expect Congress to approve before end-June 2005 (structural PC). Moreover, should actual revenues fall short of projected levels, we would reduce expenditure levels to meet the fiscal deficit target. In addition, should tax revenues exceed programmed levels, we would increase spending levels, particularly on high quality, pro-growth and poverty reducing programs drawing on the recommendations from the recent World Bank-IDBs' public expenditure review and from the independent expenditure commission, by up to 66 percent of the gross tax revenue over-performance (before coparticipation).

8. We have adopted several measures to raise revenues on a sustainable basis, including:

- In January 2005, we raised excise taxes on fuel derivatives, including gasoline and diesel, with price increases by 10 percent and 15 percent, respectively. This should increase revenues by 1.0 percent of GDP, reduce subsidies by 0.2 percent of GDP, and help contain budget costs related to smuggling and poorly targeted subsidies. Prices of gasoline and diesel remain below regional averages and a recent poverty and social impact analysis (PSIA) suggests that the increases mainly affect upper-middle and high-income segments of the population. Nevertheless, in an effort to minimize the impact on vulnerable groups, we have maintained LPG subsidies; and we are strengthening our special employment program targeted to rural and poor areas.

- With Fund technical assistance, we are preparing a comprehensive tax reform to enhance revenue collection on a sustainable basis and improve the fairness of the system. Among other measures, we are considering the introduction of a personal income tax, which will exempt 80 percent of the population, and plan to hold consensus-building meetings with different sectors of society. We expect to submit to Congress draft legislation by September 2005 (benchmark, to be converted into a PC in the context of the next review, once we have determined the specific elements of the package). Approval by October 2005 would be a structural benchmark.

- A clear priority is to strengthen the Tax and Customs administrations. In particular, regarding Customs, we are implementing a comprehensive strategy towards reducing smuggling and corruption. Fund technical assistance has been requested for the first half of the year with respect to this and other initiatives to enhance Tax and Customs performance.

9. We are adopting several recommendations of the expenditure and pensions commissions aimed at containing and improving the composition of public expenditure:

- We intend to contain the increase in public sector wages below 3 percent. Increased efficiency in both the health and education sectors, with the aim of making progress towards the Millennium Development Goals, will be combined with restraint on new hirings so that the wage bill would decline by 0.3 percent of GDP compared to 2004. This would reduce crowding out of essential goods and services, and contribute to gradually bringing the wage bill as a percent of GDP to levels close to those in neighbor countries. We will complete a comprehensive survey and setup a registry on health and education sector employment by end-September, to reduce fraud and to increase accountability (benchmark). We intend to develop an action plan to reform the civil service, building on the recommendations from the World Bank-IDBs' Public Expenditure Review (PER).

- We recently issued a supreme decree with prudential norms to stop pension fraud, such as the 15,000 ineligible pensioners identified by the pension commission's report. We are committed to implementing the report's recommendations, which over time could reduce pension costs by up to 0.5 percent of GDP on an annual basis. The program conservatively assumes no savings in 2005.

- In line with the recommendations of the high-level expenditure commission, university subsidies will be limited to increase at most with inflation for the first time in several years, given the growing spending imbalances between the university and secondary education sectors.

- Excluding local governments, capital spending and transfers to the state oil company (YPFB) and other state agencies will remain at their 2004 level. To this end, in order to accommodate key new projects, including the Santa Cruz-Puerto Suárez road, we have reduced other projects, mostly financed with nonconcessional resources.

10. Given the challenges and risks associated with decentralization and the planned Constituent Assembly, we intend to take the following steps:

With Fund technical assistance, we are preparing an Organic Budget Law, which would set hard budget constraints at all levels of government and make the budget more transparent in defining fiscal priorities. The law will be submitted to Congress by June 2005 (benchmark) and we expect its approval by end-October 2005 (benchmark).

By September 2005, we expect to conduct an audit of subnational debts, and take immediate steps to help reduce municipalities' debt and improve expenditure monitoring, including: (i) implementing sanctions for breaking debt limits; (ii) improving the fiscal accounts at the national and local level by adopting a functional classification for public expenditure; and (iii) improving financial information systems, particularly through the creation of a debt registry, which will also track floating debt.

11. While the new tax code has been useful in increasing tax collection, we believe that the approval of a law regulating the appeals process defined in the code would reinforce the ability of the Tax Superintendency to enforce legislation. We expect the approval of the law to take place by June 2005 (a structural PC).

12. With funds pledged by the international community during the budget support meeting in late October in La Paz, we expect our 2005 fiscal program to be fully financed. As part of our commitments under the Multi-Donor Budget Support Program (PMAP), we will firmly pursue a number of measures to improve fiscal transparency. Should available financing fall short of the levels under the program, we stand ready to reduce spending or adopt revenue measures, including further restraint on current expenditure and cuts in lower priority investment projects.

C. Monetary, Debt and Exchange Rate Policies

13. End-2004 NIR exceeded the program target by around US$193 million, and reserve coverage increased by 8 percentage points to 39 percent of financial sector dollar deposits. Further, monetary policy will target an increase in NIR of the central bank, excluding deposits of financial institutions, of US$40 million in 2005, raising reserve coverage to 41 percent of projected dollar deposits. Should bank deposits further recover, we will aim at maintaining the reserve coverage of deposits.

14. We intend to strengthen and institutionalize our efforts to reduce debt vulnerabilities. During the second half of 2004, we were able to significantly increase gross placements in domestic currency and to lengthen their average maturity, in part by allowing the interest rate premium for one-year domestic over foreign currency bonds to increase by 300 basis points. However, with around 80 percent of domestic debt still dollar-denominated, and US$400 million falling due in 2005, significant vulnerabilities remain. Against this background, (i) we have established a debt management unit, with senior members from the

Central Bank and the Ministry of Finance, aimed at institutionalizing efforts to improve the structure of the debt, including setting targets for reducing short-term and indexed, or dollar-denominated debt, monitoring progress towards those goals and recommending changes to correct for any deviations; and (ii) we will, in line with the recommendations of this unit, further improve the currency composition and maturity of domestic debt throughout 2005, including through further increases in interest rates, as necessary. In addition, should market conditions allow us to engage in debt management restructuring operations, we are committed, in consultation with Fund staff, to further reduce the Treasury's debt with the central bank, and increase central bank net international reserves.

15. The crawling peg exchange regime has served Bolivia well in maintaining low inflation. In addition, Bolivia's competitiveness has improved markedly, in the context of the appreciation of neighboring countries' currencies. However, the limited flexibility of the exchange rate, which restricts its ability to deal with shocks, has been a source of concern. In this context, we plan to take advantage of recently introduced technological enhancements to improve the operation of the foreign exchange auction (*"Bolsín"*) before September 2005. While this system is not expected to alter significantly the operation of the current system, it will allow the central bank to purchase foreign exchange, when appropriate, and the exchange rate to better reflect market conditions.

D. Banking and Corporate Sectors

16. Financial system policies focus on reducing liquidity and solvency risks, and fostering economic growth by improving the efficiency of the financial system:

a. Bank Supervision has been strengthened through improved early warning systems to monitor liquidity and solvency risks. New regulations for effective supervision of financial conglomerates and improved banks' liquidity management were recently issued. Further, the 2005 on-site inspections, to start in May, are aimed at taking prompt corrective actions to strengthen vulnerable institutions.

b. We recently eliminated an essential element of prudential forbearance granted by previous administrations, by repealing supreme decrees that had relaxed provisioning requirements. The SBEF issued norms tightening loan classification and provision regulations, calling for gradual increases in provisions through May 2008, with the first effective increase to take place by end-May 2005. We plan to maintain current regulations regarding repossessed assets.

c. We have submitted to Congress an amendment to the banking law to establish the Financial Restructuring Fund (FRF) as a legal entity; to ensure appropriate financing for bank resolution processes through end-2005; and to consolidate the SBEF's regulatory and budgetary autonomy. We have also clarified by decree that the regulatory powers over the financial system lie with the BCB and the SBEF only, and plan to submit by September 2005 a bill creating a deposit insurance scheme, with partial deposit coverage and adequate financing (benchmark). To this end, we plan to request World Bank technical assistance to support joint efforts by the Ministry of Finance, the BCB, and the SBEF.

d. We will sell the state's participation in banks majority-owned by Nafibo, by end-December 2005 (structural PC).

e. We will submit to Congress draft legislation to improve the corporate restructuring and bankruptcy framework by end-September 2005 (benchmark), including through enhanced protection of creditor rights.

17. To further strengthen the prudential framework and induce banks to internalize risks associated with the high level of dollarization, the Central Bank plans to gradually increase reserve requirements on dollar deposits. The first increase will be about two percentage points in April on the average requirements (benchmark) and the effective rate will be stepped up by a cumulative amount of up to 3½ percent by September. The SBEF will require by August 2005 that financial institutions assess their exposure to credit risk derived from debtors' currency mismatches.

18. Projects to broaden the public sector role in the financial sector, through expanded activities of second-tier banks (including NAFIBO and FONDESIF), will be made within the existing fiscal program limits, avoiding subsidies, bailouts or special treatment of specific sectors. Moreover, the regulatory and supervisory framework (including entry, exit, internal control, prudential rules and governance aspects) of existing or new public financial institutions will be similar to the one applicable to private financial institutions.

E. Medium-Term Issues

19. The efficient exploitation of our large gas reserves is critical to enhance growth, reduce poverty, and achieve debt sustainability over the medium term. In this connection:

- Despite recent difficulties, we still expect Congress to adopt a hydrocarbons law in the coming months, which will allow us to adopt a strategy on gas exports by end-June 2005 (benchmark). A commission of notables has started working to: (i) facilitate and enrich discussions; and (ii) help us draft the regulations to provide additional and more specific safeguards for the proposed earmarked funds and their use according to strict principles of accountability and transparency. We are also interested in joining the UK's Extractive Industries Transparency Initiative (EITI).

- We are committed to the adoption of a framework consistent with increased gas exports and investment, addressing both the wishes of the population—as mandated by the gas referendum results—and the need to maintain an environment conducive to increased private investment.

20. More generally, we are committed to maintaining a general framework friendly to private investment, including respect of signed contracts, as we see the maintenance of the rule of law as critical for Bolivia's medium-term prospects.

21. Building on the current economic recovery, the government's objective is to achieve sustained growth of 4½–5 percent (about 2 percent per capita), making a significant dent in poverty levels over the medium term. We intend to pursue further fiscal consolidation to increase the availability of financing to the private sector, while boosting and better targeting pro-poor spending. We also plan to remove structural and institutional barriers to growth, including by improving transparency and governance, and advancing negotiations on free-trade agreements with our main trading partners to ensure access to foreign markets for Bolivian products.

22. We are fully committed to broadening consensus for the reform agenda both in Congress and amongst social and private partners. This consensus will be critical to secure approval by Congress of important reforms, including an appropriate hydrocarbons law, the budgets for 2005 and 2006, a suitable organic budget law, and tax reforms.

23. Through a participatory process with civil society, the National Dialogue was concluded in December 2004 to provide input for a new PRSP, which is still under preparation. We will ensure that the PRSP encompasses fiscal issues, including sustainable sources of fiscal revenue, well-targeted social safety nets, clear priorities for national spending, and ways to increase employment and reduce poverty. We have been holding meetings with the international community to exchange views on such strategy, and intend to hold a follow-up Consultative Group meeting later in the year.

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

	2004		2005			
	Act.	Act.	Proj.	Performance Criteria		
	Sept.	Dec.	Mar.	June	Sept	Dec.
(Cumulative amounts from December 31, 2003 for the 2004 targets and December 31, 2004 for the 2005 targets; in millions of bolivianos)						
Deficit of the combined public sector 2/						
Unadjusted limit	2,556	4,032	676	1351	2123	3763
Adjusted limit	2,542	3,996				
Actual--projected	2,170	3,860				
Margin	372	136				
Net domestic financing of the combined public sector 3/						
Unadjusted limit	831	1,223	41	122	347	1174
Adjusted limit	534	926				
Actual--projected	370	1,035				
Margin	164	-109				
Central Bank Net Credit to the NPFS						
Unadjusted limit	-116	104	-166	-391	-298	137
Adjusted limit	-407	-187				
Actual--projected	-396	-360				
Margin	-11	173				
Net domestic assets of the central bank 4/						
Unadjusted limit	495	688	73	-168	-106	102
Adjusted limit	495	688				
Actual--projected 4/	10	-354				
Margin	485	1,042				
(Cumulative amounts from December 31, 2003 for the 2004 targets and December 31, 2004 for the 2005 targets; in millions of US dollars)						
Net international reserves of the central bank 5/						
Target	-104	-55	-90	-43	-21	40
Adjusted target	-104	-55				
Actual--projected 4/	-25	138				
Margin	79	193				
Net nonconcessional external debt 6/						
Limit	34	87	34.9	12.8	23.3	14.4
Adjusted limit	-28	5				
Actual--projected	-28	-4.7				
Margin	0	10				
External debt with maturities up to one year						
Limit	0	0	25	25	25	25
Actual--projected	-25	-25				
Margin	25	25				
(Cumulative amounts from December 31, 2003 for the 2004 targets and December 31, 2004 for the 2005 targets; in millions of US dollars)						
Adjuster to the nonconcessional external debt limit for financial and corporate restructuring						
WB and CAF nonconcessional financing for financial and corporate restructuring						
Program baseline	62	82	1	1	8	10
Actual--projected	0	0				
Adjuster to the net domestic financing of the NFPS						
Net external financing of the NFPS 7/						
Program baseline	172	289	70	128	188	273
Actual--projected	84	196				
Adjuster for the deficit of the SPNF						
Financing through HIPC and beyond-HIPC debt relief (program) 8/						
Program baseline	42	61	8	23	30	45
Actual--projected	41	56				
External financing for social spending						
Program baseline	0	0	0	0	0	0
Actual--projected	0	0				
Projected program grants						
Program baseline	18	45	0	3.8	3.8	45
Actual--projected	4	37				
Projected concessional program loans						
Program baseline	84	105	6.5	33.9	33.9	53.9
Actual--projected	51	88				
Tax Revenues						
Program baseline	...	...	439	966	1459	1948
Actual--projected						
(Cumulative amounts from December 31, 2003 for the 2004 targets and December 31, 2004 for the 2005 targets; in millions bolivianos)						
Maximum adjustment to limit on domestic financing of combined public sector						
Program baseline	500	500	500	500	500	500
Actual--projected	708	747				
Adjuster for NIR on currency issue						
Currency issue (program)	-338	246	-661	-518	-277	428
Maximum adjustment to NIR target	50	75	0	25	50	75

Source: Data provided by the Bolivian authorities.

1/ Definitions of the targets and adjusters as in the TMU of March 21, 2003 and the supplementary TMUs of June 2, 2004, September 23, 2004. September 2004 are PCs and December 2004 indicative targets set in Country Report No. 04/350. For the SBA extension, March 2005 are indicative targets and June, September, and December 2005 are proposed PCs.

2/ The limits on the deficit of the combined public sector will be adjusted downward by the difference between actual and projected program grants (i.e., grants not earmarked for projects). They will be adjusted downward (upward) by the amount of the shortfall (excess) between actual and projected HIPC debt relief and by the amount of the shortfall between actual and projected external financing for social spending, up to the designated ceilings. They will be revised downward by 33 percent of excess tax revenues over programmed levels.

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

4/ The limits on the NDA of the BCB will be adjusted downward by the amount of any overdue obligations to foreign official creditors. The ceiling will be adjusted for the flow flow of the Central Bank financial system foreign deposits.

5/ The ceiling on NIR will be adjusted upwards by the amount of any overdue obligations to foreign official creditors and adjusted downward by shortfalls relative to the projected currency issue, up to the designated ceiling. The ceiling will be adjusted for the flow of the Central Bank financial system foreign deposits.

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

7/ 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.

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

Table 2. Bolivia: Update of Status of Structural Conditionality For the Extension of the Stand-By Arrangement 2004[4,]

Condition	Policy Measure	Date	Comments
Public Sector Reform and Financing			
Performance Criterion	Approval by Congress of the law regulating the procedural requirements of the recursos de alzada and jerárquico before the Tax Superintendency.	September 30, 2004	Approved by the Upper House and awaiting approval of the Lower House of Congress. Now a PC for end-June, 2005.
Benchmark	Define terms of reference and appoint high-level commission of respected members of civil society	June 30, 2004	Observed. Commission appointed.
Performance Criterion	Publish high-level commission's report with specific recommendations, including measures to: (i) improve the measurement of pro-poor spending; (ii) improve the quality and efficiency of public services; (iii) prioritize spending toward growth-enhancing and pro-poor spending; and (iv) identify spending priorities to bring overall spending to a level of 32.1 percent of GDP in 2005, 31.0 percent of GDP in 2006, and 30.4 percent of GDP in 2007.	September 30, 2004	Observed. Commission published report.
Benchmark	Submission to Congress of a budget consistent with a deficit target after grants below 5½ percent of GDP, after including currently extrabudgetary funds and taking into account: (i) expenditure limits and revenue projections in the budget bill, together with the likely revenue yields of specific additional revenue measures to be proposed by the authorities; and (ii) the recommendations of the expenditure commission.	October 31, 2004	Budget submitted to Congress in September but inconsistent with program target. Approved on a lapse of time basis. Supplementary decrees were issued to make spending limits consistent with the program.
Financial and Corporate Sector			

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

Condition	Policy Measure	Date	Comments
Benchmark	On banks majority-owned by NAFIBO, complete the write-offs of the shareholders capital and approve the implementation of a business plan for the next two years, which shall include re-privatization of the banks by December 2005.	September 30, 2004	Observed. Due diligence completed June 15, and business plan is finalized.
Benchmark	Superintendency of Banks and Financial Entities (SBEF) will: (i) issue a norm to ensure the effective supervision of financial conglomerates (in compliance with Basel core principle 20); and (ii) establish procedures to strengthen early warning indicators to identify individual and systemic bank vulnerabilities and apply prompt corrective actions.	October 31, 2004	Delayed but issued in December.
Benchmark	Complete study with IMF technical assistance to recommend measures to promote the use of domestic currency.	October 31, 2004	Observed and report issued in December.
Benchmark	The Superintendency of Banks will provide a diagnostic of banks to increase provisions and develop a related action plan.	October 31, 2004	Diagnostic completed in October and action plan completed by November. Plan includes modification to loan provisioning regulation.
Benchmark	In consultation with Fund Staff, amend the laws on banks and financial institutions to ensure that the FRF is established as a legal entity and allow that its contributions to the bank resolution process be temporarily complemented by contributions of the central bank in this context for 2005 only.	November 30, 2004	Not observed.
Benchmark	Drawing upon the implementation of the informal workout law to a sample of firms and submit to Congress, draft amendments to existing legislation and draft laws, including solvency and corporate restructuring law in order to strengthen creditor's rights, taking into account the principles stated in paragraph 15 of March 24, 2003 TMU.	November 30, 2004	Not observed.
Hydrocarbons law			
Benchmark[2]	Approval by Congress of a Hydrocarbons Law that adopts a strategy on gas exports based on the national referendum including issuing the implementing regulations, regulating the taxation of hydrocarbons and providing an appropriate framework for developing the large hydrocarbon reserves.	October 31, 2004	A bill being discussed in Congress. Now a SB for end-June, 2005.

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

Table 3. Bolivia: Structural Conditionality for the Extension of the Stand-By Arrangement 2005

Conditionality

Prior Actions taken Before Issuance of Board Documents

Fiscal Policy:

- Issuance of a supreme decree reducing spending limits below the 2005 budget, consistent with a deficit target of the combined public sector of 5.2 percent of GDP after grants.
- Submission to Congress of a revised budget consistent with the program deficit target and nonconcessional financing of 1.5 percent of GDP.

Financial Sector:

- Issuance of supreme decree to eliminate regulatory powers of the Ministry of Finance over the financial system.
- Issuance of norms tightening loan classification and provision regulations, calling for gradual increases in provisions, with the first increase taking place by end-May 2005.
- Submission to Congress of legislation establishing the Financial Restructuring Fund (FRF) as a legal entity.

Condition	Policy Measures Planned	Date	Comments
	Public Sector Reform and Financing		
Performance Criterion	Passage of a revised budget law for 2005 with spending levels consistent with staff's revenue projections and the program deficit target after grants of the combined public sector of 5.2 percent of GDP.	June 30, 2005	
Performance Criterion	Approval by Congress of the law regulating the procedural requirements of the recursos de alzada and jerárquico before the Tax Superintendency.	June 30, 2005	
Benchmark	With Fund technical assistance, submit to Congress an Organic Budget Law that sets hard budget constraints on all levels of government guided by the principles of budget unity, transparency, comprehensiveness, and appropriations determined by Congress.	June 30, 2005	
Benchmark	Submission to Congress of a comprehensive tax reform, including the introduction of a personal income tax, which will exempt 80 percent of the population.[5]	September 30, 2005.	
Benchmark	Complete a comprehensive survey and setup a registry on health and education sector employment , as well as an audit on sub-national debt, including floating debt, based on FAD TA.	September 30, 2005	

[5] It is proposed to be converted to a performance criterion in the next review once more specificity can be determined.

Condition	Policy Measures Planned	Date	Comments
Benchmark	Submission to Congress of a 2006 budget with spending levels consistent with staff's revenue projections and a deficit target after grants for the combined public sector of 4.1 percent of GDP.	October 31, 2005	
Benchmark	Approval by Congress of an Organic Budget Law that sets hard budget constraints on all levels of government guided by the principles of budget unity, transparency, comprehensiveness, and appropriations determined by Congress.	October 31, 2005	
Benchmark	Approval by Congress of a comprehensive tax reform including the introduction of a personal income tax, which will exempt 80 percent of the population.	October 31, 2005	
Performance Criterion	Passage of the 2006 budget law with spending levels consistent with staff's revenue projections and a deficit target after grants for the combined public sector of 4.1 percent of GDP.	December 31, 2005	
Financial and Corporate Sector			
Benchmark	Increase average reserve requirements on dollar deposits of financial institutions by 2 percent.	April 30, 2005	
Benchmark	Submit a draft law creating a deposit insurance scheme with partial deposit coverage and establishing its proper functioning.	September 30, 2005	
Benchmark	Submit to Congress draft legislation to improve the corporate restructuring and bankruptcy framework, including through enhanced protection of creditor rights.	September 30, 2005	
Performance Criterion	Sale and transfer on final basis of the ownership of the state's participation in banks majority-owned by Nafibo.	December 31, 2005	
Hydrocarbons law			
Benchmark	Approval by Congress of a Hydrocarbons Law and its regulations, which should provide an appropriate framework for developing the large hydrocarbon reserves.	June 30, 2005.	

BOLIVIA—SUPPLEMENTARY TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This technical memorandum supplements the technical memorandum of understanding of March 21, 2003 and the supplementary technical memoranda of understanding of June 2, and September 20, 2004. It outlines the quantitative targets and limits described below for 2005, which will be measured as cumulative flows from December 31, 2004 (Table 1). It refines definitions for existing quantitative targets for (performance criteria for June, September, and December) net domestic financing of the combined public sector. It also includes new adjusters on the deficit of the combined public sector and the net international reserves of the central bank (BCB).

Quantitative performance criteria

2. The definition of net domestic financing of the combined public sector in Table 2 of the technical memorandum of understanding of March 21, 2003 will be replaced by the following:

a) ***Net domestic financing of the combined*** **p*ublic sector (CPS), sum of:***

(i) Increase in the net claims of the domestic financial system on the NFPS (excluding deposits in the BCB related to foreign loans administered as trust funds;

(ii) Cash operating results before distribution to the treasury's account of the BCB;

(iii) Change in the NFPS liabilities to the private sector in the form of fiscal certificates;

(iv) Increase in the domestic floating debt of the NFPS (liabilities incurred for goods and services received but not yet paid for, excluding claims on and liabilities to other entities within the NFPS); and

(v) All borrowing by the NFPS; including net disbursements to the NFPS related to any new domestic debt instruments issued by the government and held outside the NFPS.

Valuation changes (due to changes in inflation) in the stock of domestic debt denominated in inflation-indexed units (UFVs) would be excluded from the computation of net domestic financing of the CPS.

Adjusters to the program

3. **New adjuster to the deficit of the combined public sector (CPS):** Should tax revenues of the CPS be higher than programmed (see adjuster for tax revenue in the PC Table), the quantitative performance criterion of the deficit of the CPS will be revised downward by 33 percent of the difference between actual and program outturns.

4. **New adjuster to the net international reserves of the central bank:** The quantitative performance criterion on net international reserves of the BCB will be adjusted

upward/downward by the net increase/decrease of the legally required and excess reserves denominated in foreign currency by financial institutions held with the BCB.

Information requirements

5. The treasury will remit to the Central Bank, on a weekly basis, information on all placements of treasury bonds other than open market operations, necessary to monitor the deficit of the combined public sector and net domestic financing of the CPS targets.

Statement by the IMF Staff Representative
April 8, 2005

This statement provides an update on recent developments since the staff report was issued on March 28. This information does not change the thrust of the staff assessment or appraisal.

1. **Recent Economic and Financial Developments**

Inflation. 12-month inflation increased from 4.6 percent at end-2004 to 5.7 percent in March 2005, reflecting largely the fuel price increases that took place at the beginning of 2005. The authorities remain confident that the target for end-2005 of 3.8 percent can be met with appropriate policies of the central bank.

Fiscal performance. Based on preliminary information through end-February 2005, the end-March fiscal deficit is expected to have been within the indicative ceilings. The deficit through February (⅓ percent of annual GDP) was lower than programmed (½ percent of annual GDP), reflecting high tax revenues and current expenditure restraint.

Other targets. Based on preliminary data, the end-March indicative targets for central bank credit to the nonfinancial public sector, NIR of the central bank, and NDA of the central bank also have been met.

Financial system. Following a drop of around 2 percent during the first part of March reflecting heightened political tensions, deposits have partially recovered, and as of end-March are about 1 percent below their level at end-2004.

2. **Policy Developments and Discussions with the Authorities**

Recent discussions with the authorities have centered on the newly submitted revised budget. Staff raised two questions: first, whether spending limits on transfers may be difficult to implement because they were not detailed by region; and second, whether some spending cuts implemented through freezing certain spending items may be easily undone. The authorities clarified that having overall ceilings on transfers should facilitate the implementation of the program by permitting some fungibility on the regional allocation of resources, depending on execution rates. Despite protests in Cochabamba, Santa Cruz and Tarija, against cuts in transfers, earlier this week, the authorities have assured the staff that they will maintain the program spending limits unchanged. They also explained that unfreezing spending items would require a decision by Congress in the form of a new budget.

The Senate initiated discussions on the hydrocarbons bill on March 29, 2005. After the Chamber of Deputies approved a hydrocarbons bill in mid-March, the Senate has started discussions within its own Economic Development Commission. In providing input solicited by the commission, oil companies have expressed strong opposition to the version approved by the Lower House, warning that if approved it could prompt recourse to international arbitration. It remains unclear if the Executive and Congress will reach a consensus over an acceptable bill. Against this background, the President has reiterated his commitment to veto an unviable bill if approved by Congress.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 05/78
FOR IMMEDIATE RELEASE
April 8, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth Review Under Bolivia's Stand-By Arrangement, Approves US$14.5 million Disbursement, a US$64.5 Augmentation and an Extension of The Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the fifth review of Bolivia's performance under a 12-month, SDR 85.75 million (about US$129.1 million) Stand-By Arrangement that was originally approved on April 2, 2003 (see Press Release No. 03/46) and later augmented and extended (see Press Release No. 04/113).

This decision enables the release of SDR 9.66 million (about US$14.5 million) to Bolivia, bringing total disbursements under the arrangement to SDR 111.5 million (about US$167.9 million).

In completing the review, the Executive Board approved Bolivia's request for waivers for the nonobservance of two performance criteria, related to the central bank net credit to the nonfinancial public sector; and to the law on the tax code procedures. In addition, the Executive Board approved an extension of the Stand-By Arrangement by about 12 months to March 31, 2006, and augmented access to Fund resources by SDR 42.86 million (about US$64.5 million) to support the government's 2005 economic policies.

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

"Macroeconomic developments have been positive in 2004, in part reflecting the favorable global environment. Led by exports, economic activity has picked up and the current account surplus has been high. Inflation has increased, but remains well in single digits. Following deposit losses in the context of the introduction of the financial transactions tax, the financial situation has stabilized, and high levels of liquidity have allowed the authorities to place more securities in local currency and at longer maturities.

"The authorities aim to reduce the fiscal deficit after grants, and to limit nonconcessional financing. This will be achieved by already-adopted fuel price increases, higher revenues related to gas exports, and the full year impact of the financial transactions tax. Cuts in nonpriority spending will allow the initiation of high priority road projects. The government has expressed its willingness to take contingency measures, should the need arise, to ensure that 2005 fiscal targets are met.

"Monetary policy will aim to strengthen the international reserve position further, while gradually introducing greater flexibility to the exchange rate over the medium term. The program targets enhancement of debt management practices and the introduction of a two-way foreign exchange auction in 2005.

"Measures are being taken to reduce risks in the still-fragile and highly dollarized financial system. These include the gradual phase-in of additional loan provisioning; increases in reserve requirements on foreign currency deposits; and the preparation of a law on a deposit insurance scheme, which will be submitted to Congress later in the year.

"Maintaining a general framework conducive to foreign investment, and in particular the passage of a viable hydrocarbons bill, will be critical to attaining medium-term debt sustainability. The authorities are encouraged to continue to reach out to Congress to foster greater consensus on a hydrocarbons law that balances the call for greater taxation on hydrocarbons against the need to increase private investment in the sector.

"Looking forward, reaching a broad political and social consensus on policies to support growth and poverty reduction, including through the efficient development of Bolivia's rich hydrocarbons resources, is urgently needed to facilitate the development of a medium-term program that could form the basis for a revised Poverty Reduction Strategy Paper and a new three-year arrangement with the Fund as soon as possible," Ms. Krueger stated.

Statement by Javier Silva-Ruete, Alternate Executive Director for Bolivia and Javier Cuevas, Advisor to Executive Director
April 8, 2005

1. On behalf of our Bolivian authorities, we would like to thank the Executive Directors, Management, and the staff for their continuous support. The Bolivian authorities confirm their strong commitment to preserving macroeconomic stability and promoting structural reforms to achieve higher and sustainable growth, create employment opportunities, reduce poverty, and enhance social equity. They are particularly committed to creating a business environment aimed at protecting investors and enforcing contracts.

I. Background and Overview

2. Despite difficult political and social conditions, the Bolivian authorities continue to implement a solid economic program. During 2004 the program remained on track. All quantitative performance criteria were observed, with the exception of the end-September target on central bank credit to the non-financial public sector, which was marginally missed. The end-September structural performance criterion on administrative modifications to the tax code was also missed, as congressional deliberations centered on the hydrocarbons bill.

3. Macroeconomic developments were positive, reflecting a favorable global environment. Preliminary estimates for 2004 point to real GDP growth of 3¾ percent, in line with the program; 12-month inflation was 4.6 percent by end-year, exceeding the program target of 3½ percent, mainly due to imported inflation; and the current account surplus was around 3 percent of GDP, with strong growth in gas, mining, and agricultural exports.

4. Preliminary data for 2004 point to a fiscal deficit of 5.7 percent of GDP, 0.3 percent of GDP below the indicative target. Revenues were higher than programmed, as well as public investment, while current spending was in line with the program. It is important to underscore the enormous effort displayed by the Bolivian authorities to reduce the deficit to 5.7 percent of GDP in 2004, from 8.1 percent of GDP in 2003, despite mounting political pressure and social demands.

5. In 2004, net international reserves exceeded the program target by about US$193 million and reserve coverage increased to 39 percent of financial sector dollar deposits, from 31 percent in 2003. In order to reduce debt vulnerabilities, the authorities considerably increased gross placements in domestic currency and lengthened the average maturity of the debt. Nevertheless, important vulnerabilities remain, since 80 percent of the domestic debt is still dollar-dominated and US$400 million is due in 2005.

6. Even though the government does not have representation in Congress, it has been able to strengthen its political standing over the past months and recently it obtained the support of 30 representatives. While this figure is low in relation to the total number of representatives (157), the authorities are confident that this will help them to press forward with the approval of crucial reforms. In this regard, the government will attempt to pass a hydrocarbons law geared to support a substantial increase in gas exports. A bill was approved by the Lower Chamber on March 24, 2005 and is currently being discussed by the Development Commission of the Senate. Quite importantly, the government is attempting to amend the law approved by the Lower Chamber, in fact, disagreement on the approved bill was one of the main reasons for the President's move to submit his resignation and call for early elections in March.

II. Economic Policy

7. The main challenges facing the Bolivian authorities are high unemployment, an elevated fiscal deficit, and a vulnerable financial system. In this regard, the economic program supported by a Stand-By Arrangement over the next 12-months will focus on policies aimed at reducing fiscal and financial risks. Moreover, the authorities are fully aware that the lack of job opportunities is the source of serious social conflict. A significant decrease in unemployment depends on higher and sustainable growth. In this respect, it is necessary to change the role of the state and improve the business environment. The latter is hindered by governance problems, poor infrastructure, and high costs of operating in the formal sector. These problems will need to be tackled in the context of a comprehensive medium-term program.

Fiscal Policy

8. The 2005 deficit target is 5¼ percent of GDP, consistent with a maximum net use of non-concessional financing of 1½ percent of GDP. The authorities will aim at a lower deficit, should concessional financing fall short of the assumptions under the program. To meet the deficit target, the government has taken the following steps: (i) an increase in excise taxes on fuel in January 2005, with resulting increases of 10 and 15 percent in gasoline and diesel prices, respectively; (ii) issuance of legislation to establish spending limits in the 2005 budget; and (iii) submission to Congress an amended 2005 budget with a deficit of 5¼ percent of GDP, which the authorities expect Congress to approve before the end of June 2005.

9. On the structural side, the authorities are preparing a comprehensive tax reform to enhance revenue collections and improve the fairness of the system. Among other measures contemplated is the introduction of a progressive personal income tax that will exempt 80 percent of the population. They expect to submit a bill to Congress by September, which could be approved by October. In addition, one of the authorities' priorities is to strengthen tax and customs administrations. Regarding the latter, a comprehensive strategy towards reducing smuggling and corruption is being implemented. We thank the staff for technical assistance in the design of both reforms.

10. The authorities are adopting the recommendations made by the expenditure and pensions commissions to contain and improve the composition of public spending. In this regard, the government: (i) issued legislation to establish prudential norms for stopping pension fraud and is committed to implementing the recommendations of the pensions commission, which over time could reduce pension costs by up to 0.5 percent of GDP on an annual basis; (ii) intends to limit the increase in public sector wages below 3 percent and develop an action plan to reform the civil service, building on the recommendations by the World Bank-IDB Public Expenditure Review; (iii) will complete a comprehensive employment survey in the health and education sectors and set up a registry to help reduce fraud and increase accountability in this field; (iv) will limit the increase in public university subsidies to inflation in line with the recommendations by the high-level expenditure commission, given the growing spending imbalances between university and secondary education; and (v) will keep capital spending and transfers to the state oil company (YPFB) and other state agencies at their 2004 levels.

11. Due to the challenges and risks associated with decentralization and the Constituent Assembly, the authorities intend to prepare an Organic Budget Law with Fund technical assistance and to conduct an audit at the sub-national level with the purpose of taking immediate steps in reducing municipalities' debt and improving monitoring of spending.

Monetary, Debt, and Financial Policies

12. In 2005, monetary policy will target an increase in net international reserves of the central bank, excluding deposits of financial institutions of US$40 million, thus raising reserve coverage to 41 percent of projected dollar deposits. Moreover, the authorities intend to increase their efforts to reduce debt vulnerabilities through the following actions: (i) they have established a debt management unit to improve the structure of the debt, including setting targets for reducing short-term, indexed, and dollar denominated debt, closely following up on progress towards these goals, and recommending changes to correct any deviations; and (ii) they will improve the currency composition and maturity structure of domestic debt, including through further increases in interest rates, if necessary. In addition, market conditions permitting, the authorities will reduce the Treasury's debt with the central bank and increase central bank net international reserves.

13. Financial system policies focus on reducing liquidity and solvency risks. Specifically, (i) the Superintendence of Banks and Financial Institution (SBEF) improved its early warning systems to monitor liquidity and solvency risks; (ii) the government eliminated legislation that relaxed provisioning requirements, and the SBEF issued tight norms on loan classification and provision regulations for a gradual increases in provisions through May 2008, with the first increase to take place by end-May 2005; (iii) the government submitted to Congress an amendment to the banking law for the creation of the Financial Restructuring Fund as a legal entity, to ensure appropriate financing for bank resolution processes through end-2005 and to reinforce the SBEF's regulatory and budgetary autonomy; and (iv) the authorities clarified that regulatory powers over the financial system lie only with the central bank and the SBEF.

14. The authorities intend to submit by September 2005 a bill creating a deposit insurance scheme, with partial deposit coverage and adequate financing; and will sell the state's stake in NAFIBO[1] bank by December 2005. Moreover, the Bolivian authorities will submit to Congress a draft legislation to improve the legal framework for corporate restructuring and bankruptcy by end-September 2005.

15. To strengthen the prudential framework and induce banks to internalize risks associated with the high level of dollarization, the central bank plans to gradually increase reserve requirements on dollar deposits. In addition, by August 2005 the SBEF will require financial institutions to assess their exposure to credit risks derived from debtors' currency mismatches.

III. Next Steps

16. Bolivia has large gas reserves. Efficient exploitation is critical to ensure that this resource enhances growth, reduces poverty, and contributes to debt sustainability over the medium term. Despite difficulties, by end-June 2005 the authorities are expecting Congress to approve a hydrocarbons law that can facilitate the adoption of a gas export strategy. The authorities have emphasized that Bolivia needs a framework to attract investment and generate increasing revenues by eliminating tax loopholes and improving administration.

17. Finally, the participatory process with civil society to provide input for a new PRSP, embodied in the National Dialogue, was concluded in December 2004. Building on this, and after the hydrocarbons law is approved, the Bolivian authorities plan to request Fund support for the policies formulated in the PRSP through a new three-year arrangement. The authorities have been holding meetings with the international community to exchange views on a PRSP strategy, and plan to hold a follow-up Consultative Group meeting later in the year.

[1] *Nacional Financiera Boliviana* (NAFIBO) is a second floor financial institution. The state and the Andean Development Corporation own 80 and 20 percent of shares, respectively.