July 2007
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Bolivia: 2007 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Bolivia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2007 Article IV consultation with Bolivia, the following documents have been released and are included in this package.

- The staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 15, 2007, 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 June 27, 2007. 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 supplement on external and public debt sustainability analysis.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 13, 2007 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for Bolivia.

The document listed below has been or will be separately released.

Selected Issues Paper

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

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INTERNATIONAL MONETARY FUND

BOLIVIA

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Article IV Consultation with Bolivia

Approved by Caroline Atkinson and Michael T. Hadjimichael

June 27, 2007

- **Discussions**. Article IV consultation discussions were held during April 30–May 15 with, among others: President Morales, Finance Minister Arce and other senior government officials; CBB President Raúl Garrón; opposition leaders; key embassies; representatives of the private and financial sectors; and with social movements. The mission team comprised Messrs. Furtado (head), Cerutti, Mansilla, and Vesperoni (resident representative); and Ms. Jaramillo-Mayor (all WHD); Mr. Cortavarria-Checkley (MCM); Mr. Dodzin (PDR); and Mr. Simone (FAD). Mr. Singh joined the mission during May 10–11.

- **Political setting**. Bolivia's political environment remains complex. While President Morales enjoys strong public support, the Senate and six out of nine Bolivian departments are controlled by the opposition. In addition, uncertainties related to the ongoing constituent assembly further complicate the political context. There is a possibility of early general elections in 2008.

- **Economic setting and key policy issues**. Macroeconomic developments continue to be positive. Large export windfalls in hydrocarbons and mining have been reflected in record-high international reserves, 4½ percent real GDP growth, and sizable fiscal surpluses. However, inflation has picked up in recent months, suggesting the need for combining the maintenance of a significant fiscal surplus with greater exchange rate flexibility. Moreover, the investment climate should be made more conducive to a recovery in private investment, critically needed for higher medium-term growth and increased living standards.

- **MDRI**. Since the last Article IV consultation, Bolivia has benefited from further debt reduction under the Multilateral Debt Relief Initiative. This comprised US$1.2 billion in debt relief from the Inter-American Development Bank, equivalent to 10 percent of the GDP or about one-third of the stock of debt outstanding at end-2006. The total reduction of Bolivia's debt under the MDRI thus amounted to US$2.9 billion, equivalent to about 25 percent of GDP.

- **Fund relations**. Bolivia has accepted the obligations of Article VIII, sections 2, 3, and 4. The exchange system is free of restrictions on current international payments and transfers, and there are no significant controls on capital flows. The last Article IV consultation was concluded on July 17, 2006. The latest Stand-By Arrangement expired on March 31, 2006.

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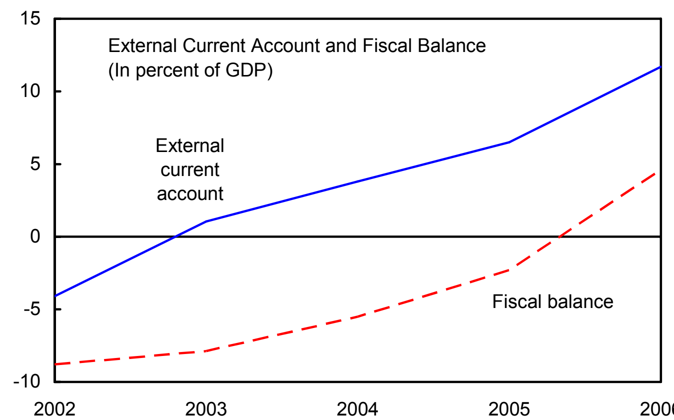
EXECUTIVE SUMMARY

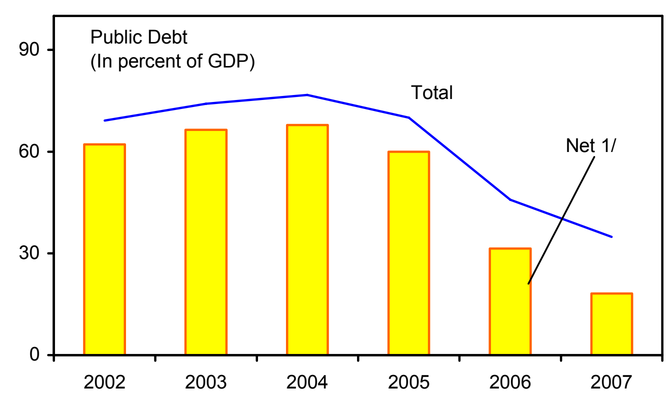
- **Over the last two years, the economy has benefited from large export windfalls in hydrocarbons and mining**. Real GDP growth has been around 4–4½ percent, the external current account has recorded large surpluses, and NIR have risen to historically high levels. The fiscal position has shifted into a substantial surplus and public debt has been substantially reduced. Financial sector stability has improved, though dollarization is still high. These trends are projected broadly to continue in the period ahead.
- **However, inflation has picked up in recent months, partly due to rapid monetary expansion**. The Central Bank has stepped up open market operations, though policy interest rates have reacted only mildly, and has appreciated the Boliviano, albeit modestly. Inflation is projected to remain in the range of 6–7 percent through the end of the year, with continued NIR accumulation contributing to inflationary pressures.
- **The high priority attached by the authorities to maintaining a fiscal surplus is welcome**. This is key for managing the inflationary pressures associated with large hydrocarbons-based external receipts. However, maintaining a surplus will demand considerable control over expenditure, including at the subnational level.
- **On the structural front, reforms are needed to make the budget a more effective developmental and poverty-reducing tool**. The authorities are encouraged to reduce the large and poorly targeted hydrocarbon product subsidies, as well as to improve the tax system, intergovernmental relations, and the budget process. The authorities felt that action on this front would have to await the outcome of the constitutional assembly.
- **Given the strength of the balance of payments, evidence of inflationary pressures, and indications that the Boliviano is undervalued, it will be important to incorporate greater exchange rate flexibility into the policy mix**. In the short run, this can be achieved under the existing exchange rate regime through a more rapid pace of nominal appreciation. The authorities were open to the possibility of transitioning to a more flexible exchange rate regime over time.
- **Efforts to address remaining financial sector vulnerabilities should be intensified**. Priority areas of reform include the adoption of prudential regulations to mitigate market risk and credit risks from dollarization; and of legislation governing corporate bankruptcy/restructuring. Exchange rate appreciation will also help reduce dollarization.
- **Even though social indicators have improved in recent years, Bolivia's levels of poverty and inequality are persistently high**. In 2005, extreme poverty amounted to 37 percent of the population, while absolute poverty reached 60 percent. Also, income inequality was among the highest in the region. As less than 2 percent of employment is in the leading hydrocarbons and mining sectors, growth in recent years has contributed only marginally to poverty reduction.
- **To underpin sustained growth, it is imperative to develop policies that lead to a recovery in private investment**. Such an increase would require improvements in the investment climate, which would benefit from greater legal/institutional stability. In particular, the government's nationalization policy should be implemented through mutually acceptable arrangements with private investors. In the key hydrocarbons sector, the authorities should seek to consolidate the recently negotiated framework and to secure early agreement on critically needed new investments.

I. Economic and Social Setting

1. **The economy has continued to benefit from rising natural gas export volumes, which has been compounded, over the last two years, by high hydrocarbons and mining export prices**. Real GDP growth has been around 4–4½ percent, mainly driven by an expansion in hydrocarbons and mining-related activities. The external current account has recorded large surpluses (12 percent of GDP in 2006), and NIR have risen to historically high levels (exceeding US$3.8 billion as of end-May 2007).

2. **The fiscal position has improved sharply and—reflecting also debt relief under the Multilateral Debt Relief Initiative (MDRI)—Bolivia's public debt has declined markedly**. Over the five-year period 2002–06, the overall fiscal position shifted from a deficit of about 9 percent of GDP to a surplus of about 4½ percent of GDP. While part of the improvement corresponds to higher hydrocarbons-based revenue (about 8 percent of GDP) other revenue has increased[1] and expenditure growth has been contained, including for wages and salaries. MDRI debt relief has helped reduce Bolivia's total public debt, from about 70 percent of GDP in 2005 to about 35 percent of GDP in 2007.

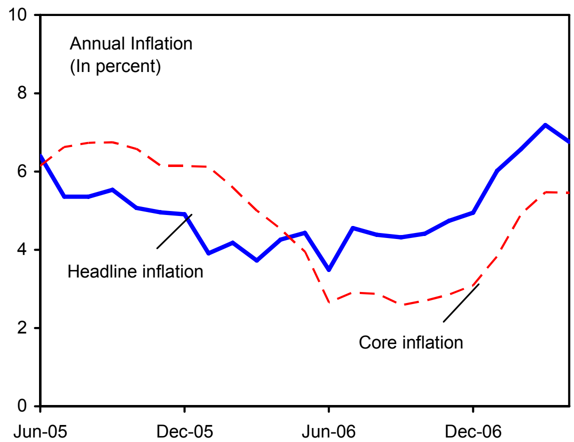


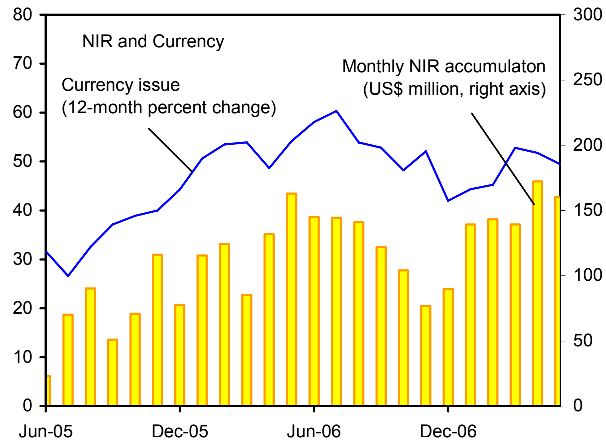


1/ Total public debt minus government's deposits in the financial system.

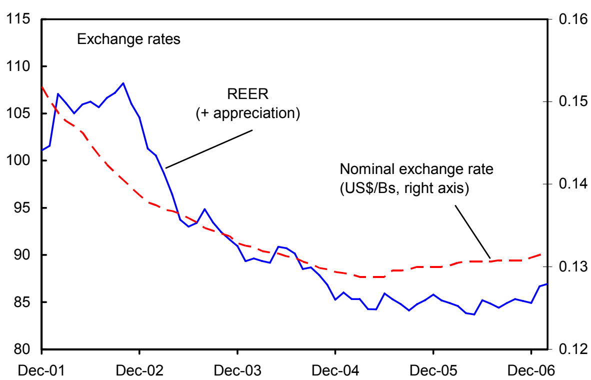
3. **However, inflation has picked up in recent months, due in part to negative supply shocks but also to rapid monetary expansion**. Twelve-month inflation rose from 4½ percent in September 2006 to 7 percent in March 2007, the highest inflation level observed since 1998, and remains at about 6 ½ percent. While part of the recent price increases has been associated with floods and one-time adjustments in some administered prices, both core and headline inflation have displayed an upward trend since the last quarter

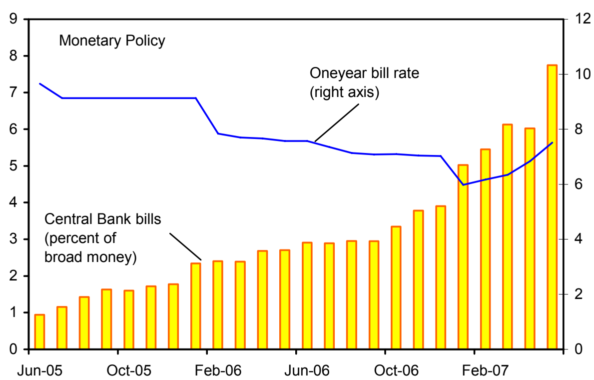
[1] The increase appears to reflect both past improvements in tax administration and, more recently, a shift in taxpayer behavior towards greater compliance.





of 2006, driven by higher prices of nontradable goods and services. Accordingly, the pick-up in inflation trends may be attributed in part to the strong and only partially sterilized NIR accumulation, which has driven the high growth in base money over the past two years. The Central Bank has responded to rising price pressures by increasing its open market operations and by appreciating the Boliviano against the U.S. dollar under the crawling peg regime. However, policy interest rates have reacted only mildly to the monetary tightening while the nominal appreciations have been very modest, leaving Bolivia's real effective exchange rate broadly flat after a substantial depreciation during 2003–04 (Box 1).[2]





4. **Financial sector stability has improved, with comfortable levels of liquidity and full NFA coverage of deposits, although vulnerabilities remain**. Credit risk is still high as restructured but performing loans (about 90 percent of capital) may deteriorate. Moreover, some banks might need to build additional provisioning over time to offset potential losses arising from the unprovisioned portion of nonperforming loans (about 9 percent of capital). Furthermore, despite some decline, dollarization still remains among the highest in the region, with the financial system considerably exposed to credit risk from unhedged borrowers.

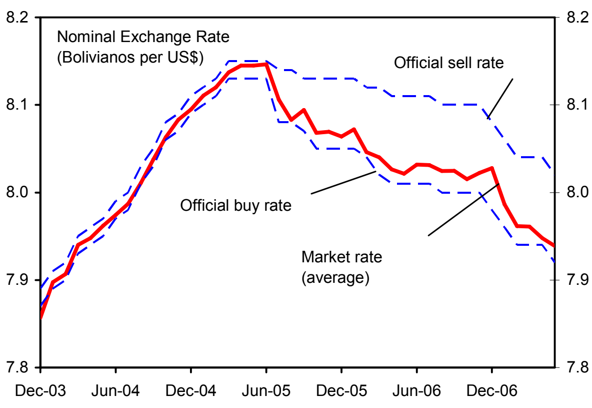
[2] For a discussion of the monetary policy transmission mechanism, see the accompanying Selected Issues Paper.

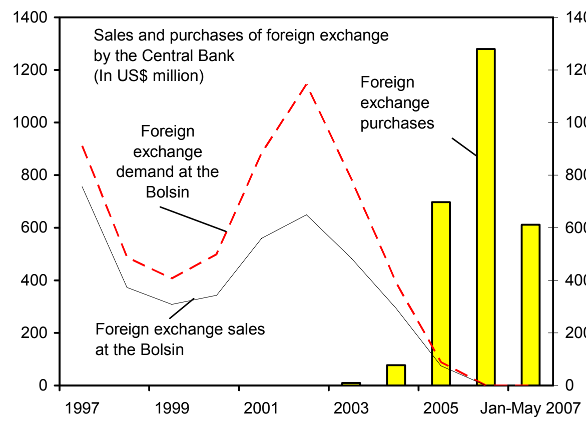
Box 1. Bolivia: Exchange Rate Regime

- **For many years, the Central Bank of Bolivia (BCB) has followed a crawling peg exchange rate regime**. Beginning in 1985, when the official and parallel exchange rates were unified, the BCB adopted a crawling peg exchange rate regime without a preannounced path. The crawling peg was a main pillar of the macroeconomic policies that, following hyperinflation in the mid-1980s, succeeded in further reducing inflation, from double digits in the late 1980s, to an average of 4½ percent in recent years. Despite numerous external shocks, political crises, and deposit runs, the crawling peg was successful in maintaining a competitive exchange rate while keeping balance sheet effects manageable in the context of the highly dollarized environment.

- **The BCB is the dominant player in the foreign exchange market**. Foreign exchange is provided to the financial system at the official exchange rate through an auction system, the *Bolsín*, with sales by the BCB of up to US$15 million per day. Meanwhile, the central bank stands ready to purchase any amount of foreign exchange offered by the financial system at the official rate. The BCB implements periodic adjustments to the official exchange rate taking into account the financial system's demand for foreign exchange in relation to the size of the *Bolsín*. With a view to stimulating the interbank market, the BCB has gradually increased its buy-sell spread, from 2 to 10 cents, with only modest results thus far.

- **Since mid-2005, in the context of a strong balance of payments, the central bank has been appreciating the Boliviano modestly under the existing exchange rate arrangement, which has become a *de facto* peg**. Demand for foreign exchange from the financial system through the *Bolsín* disappeared completely since June 2005, while central bank foreign exchange purchases surged by US$2.5 billion between June 2005 and May 2007. Against this backdrop, the BCB reversed the direction of the crawl of the exchange rate in July 2005 and has since then been appreciating the exchange rate. However, the modest pace of appreciation (only 2.7 percent against the U.S. dollar since July 2005, to Bs7.85 per U.S. dollar) has led the Fund's Monetary and Capital Markets Department to reclassify Bolivia's exchange rate regime as a *de facto* peg.





Hydrocarbons regime and investment climate

5. **Significant changes in hydrocarbons policy have been implemented over the last two years, resulting in a higher government tax take and a greater public sector role in the sector**. Following a national referendum in August 2004, a new hydrocarbons law was enacted in May 2005 and a related decree issued in May 2006. The main effects of the new legislation have been: (a) a "migration" of the contracts with the foreign companies operating in Bolivia, from risk-sharing contracts to an arrangement whereby all production is surrendered to the state energy company YPFB, which has been made the country's sole exporter of natural gas; (b) a permanent increase in natural gas royalties, from 18 percent to 50 percent of turnover;[3] and (c) a requirement that YPFB regain control over the five hydrocarbons companies that were privatized in the 1990s. While the transition to new service contracts has recently been completed, only one of the five companies targeted for nationalization (i.e., the company in charge of the country's two oil refineries, formerly owned by Brazil's Petrobras) has thus far returned to YPFB control.

6. **Following a boom in the late 1990s, which included large-scale privatization, private investment levels in Bolivia have been depressed in the past few years.** This has been associated in part with the protracted political crisis of 2003–05 and with the uncertainties arising from the changes in the hydrocarbons regime during 2005–06. While there has been significant FDI in the mining sector and public sector investment has increased, this has not been enough to overcome the fall in other private investment, notably in foreign hydrocarbons-related investment. As a result, Bolivia's overall investment-to-GDP ratio, as well as the share of private investment in total investment, are among the lowest in the region (Box 2).

Poverty and inequality

7. **Even though social indicators have improved in recent years, Bolivia's levels of poverty and inequality are persistently high**. In 2005, extreme poverty amounted to 37 percent of the population, while absolute poverty reached 60 percent. Also, income inequality was among the highest in the region. As less than 2 percent of employment is in the leading hydrocarbons and mining sectors, growth in recent years has contributed only marginally to poverty reduction. Although Bolivia will be able to meet some of the Millennium Development Goals (e.g., child mortality, maternal health, gender equality, and water and sanitation), achievement of other goals by 2015, such as those of eliminating extreme poverty and universal primary education, remains a significant challenge.

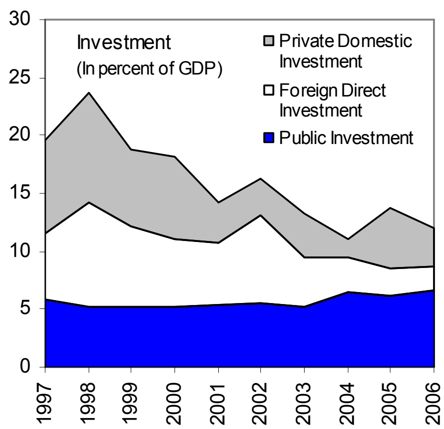
[3] The distribution of the post-royalty revenue between the service operators and YPFB is governed by an agreed contractual formula for each gas field, which takes into account, inter alia, investment-related costs and the production level.

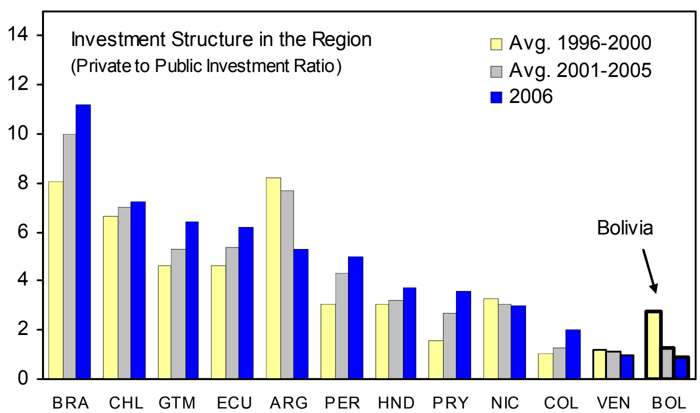
Box 2. Bolivia: Trends in Aggregate Investment

- **As a result of depressed private investment, the overall levels of investment in Bolivia have been very low in recent years, amounting to only 12 percent of GDP in 2006—the lowest ratio in the Latin American region**. This contrasts with the late 1990s, when the privatization program contributed an investment peak of about 20 percent of GDP, reflecting both strong FDI and domestic investment. In recent years, there has been an increase in public investment but this has not been enough to offset the fall in private investment.

- **Investment activity has therefore been dominated by the public sector, whose investment outlays are high by regional standards, in both relative and absolute terms**. In 2006, Bolivia's public investment was about 6½ percent of GDP, one of the highest ratios in the region. The ratio of private to public investment in Bolivia is about 90 percent. Most countries in the region exhibit higher and increasing ratios.

- **In this environment, a major recovery in private investment would appear to be a pre-condition for higher and sustainable growth over the medium term**. According to recent entrepreneurs' surveys, the main factors that would need to be addressed to promote such a recovery include: (a) political/institutional uncertainty; (b) red tape; (c) inefficiencies in the judicial system; and (d) inadequate infrastructure.





II. Report on the Discussions

8. **With the sharp turnaround in the balance of payments and fiscal position in recent years, vulnerabilities in Bolivia have shifted, and the discussions covered policies needed to manage hydrocarbons wealth so as to promote medium-term growth and intergenerational equity, while containing inflation**. In particular, discussions focused on policies to contain inflationary pressures arising from the strong external position, and to revive private investment activity to underpin higher and sustainable growth. There was agreement that, to contain inflation, the fiscal position should remain in surplus, the pace of appreciation under the crawling peg should be stepped up, and open market operations should be expanded. There was also broad agreement on the thrust of fiscal structural reforms. There was less agreement, however, on the policy adjustments to promote higher investment and growth over the medium term, with the mission emphasizing the need for improvements in the investment climate and the authorities expressing confidence that private investment

would be forthcoming and/or appropriately supplemented by state-led investments, including in association with friendly governments.

A. Short-Term Outlook

9. **The key economic trends of the past year are projected broadly to continue in the period ahead, although with a somewhat lower fiscal surplus**. In 2007, real GDP growth is projected to remain driven mainly by the boom in mining and hydrocarbons, but to slow somewhat to 4 percent as agricultural output has been reduced by floods. The fiscal surplus is projected to decline to 1 percent of GDP reflecting an increase in capital expenditure (partly payments for nationalized refineries) and a reduction in hydrocarbons revenue related to the implementation of the new contracts with hydrocarbons companies, which have recently come into effect.[4] The external current account surplus is projected at close to 9 percent of GDP, which would translate into a further rise in NIR, to US$4.3 billion. Twelve-month inflation is projected to remain in the range of 6–7 percent through the end of the year, with projected increases in government spending in the second half of the year and continued NIR growth contributing to inflationary pressures (Table 1).

B. Fiscal Policy

10. **The mission argued that an overall fiscal surplus should be maintained to protect macroeconomic stability and facilitate monetary management in light of the potential for continued high current account surpluses over the medium term**. In particular, the mission suggested that the authorities consider carefully the desirability of the sharp increases in public expenditure budgeted for 2007 and envisaged under the National Development Plan (averaging 14 percent of GDP in 2007–12, compared with 10½ percent of GDP in 2006). The mission argued that the case for a more prudent fiscal stance was also motivated by the need to entrench savings out of the windfall to guard against the risk of a weakening of hydrocarbons-based revenue (11 percent of GDP in 2007) over the medium term, as well as by long-term intergenerational equity considerations.[5] The authorities indicated their intention to maintain a prudent fiscal position, pointing out that current expenditure was being kept under control and that investment outlays would in practice be consistent with maintenance of fiscal surpluses in the range of 1–2 percent of GDP in 2007 and over the medium term (Table 2). The mission inquired about the fiscal authorities' ability to avoid expenditure increases, particularly by subnational governments, which have accumulated a large stock of deposits at the central bank. The authorities affirmed their resolve to contain the growth of central government expenditure and explained that subnational spending had to be undertaken in the context of the national budget. They noted that their ability to monitor compliance with the budget framework was being strengthened through improvements in information systems.

Structural fiscal issues

11. **The mission discussed reforms to improve the efficiency and equity of the tax system, and to raise the effectiveness of government spending, which are needed to**

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[4] Fiscal developments through May suggest that the 2007 public sector surplus could be higher.

[5] For a discussion of the long-term management of Bolivia's natural gas resources, see the accompanying Selected Issues Paper.

underpin the fiscal position over the medium term and make the budget an effective anti-poverty tool. The staff's main proposals were to reduce explicit and implicit hydrocarbons subsidies (currently estimated at 6–7 percent of GDP) gradually while compensating the poor through targeted assistance; to reform the tax system (including by introducing a personal income tax with a high exemption threshold);[6] to approve a budget framework law; and to address the weaknesses in intergovernmental fiscal relations system. In addition to strengthening the institutional environment for the conduct of fiscal policy, these reforms would release fiscal resources, which could be used to finance targeted public spending programs for the poor and/or to strengthen the fiscal surplus. The authorities agreed with the thrust of the reforms discussed but felt that action on this front would have to await the outcome of the constitutional assembly. In addition, the authorities felt that the reduction in fuel subsidies should wait until envisaged increases in natural gas production allowed for some shift in domestic consumption away from petroleum and into gas products.

12. **The mission urged caution on pension reform, emphasizing the need to analyze carefully the budgetary implications of possible changes to the pension law**. The authorities explained that discussions in this area were still at an early stage, although a reduction in the retirement age underlay most proposals. The mission noted that a reduction in the retirement age would run counter to the direction observed in pension reforms in other countries in light of demographic trends. The authorities emphasized the more general point that they attach high priority to keeping the eventual cost of pension reform within a prudent fiscal envelope.

13. **The mission welcomed the continued improvements in domestic debt management towards lengthening maturities and improving the currency composition**.[7] In this context, the authorities had recently taken a decision to reduce gradually direct issuance of bonds to pension funds, while raising (from 3 percent to 13 percent of their assets) the effective limit on their investments abroad. Such a decision will avoid an unnecessary build-up of domestic debt given the low financing needs of the government. At the same time, higher external investments by the pension funds will help diversify risk in their portfolios, as well as facilitate sterilization of foreign exchange receipts. The mission encouraged the authorities to relax those investments limits further over time.

C. Monetary, Exchange Rate, and Financial Sector Policies

14. **Greater exchange rate flexibility and a more active use of open market operations would help contain inflationary pressures**. The mission argued that an appreciation of the real exchange rate is likely to be unavoidable, given the magnitude of foreign inflows and the fact that estimates suggest the exchange rate is undervalued.[8] It

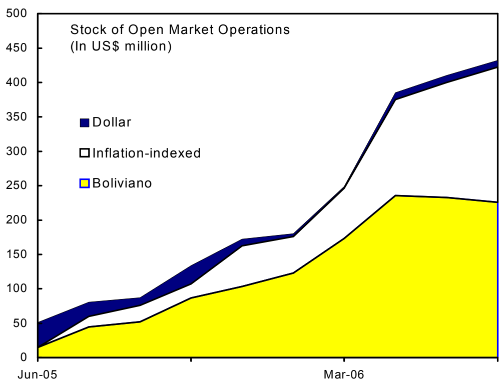
[6] For a discussion of tax policy issues, see the accompanying Selected Issues Paper.

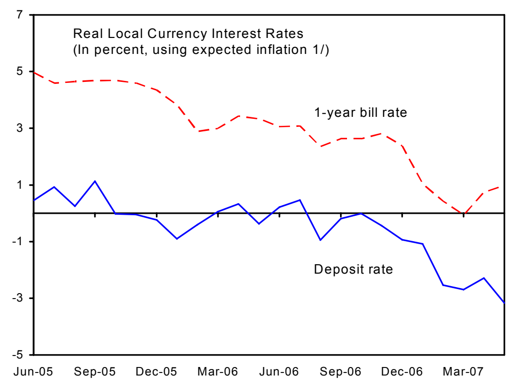
[7] Dollar-denominated Treasury bonds fell from 59 percent of total bonds in 2005 to 44 percent in May 2007, while the average maturity of auctioned bonds has increased to over four years. However, about 85 percent of the auctioned local-currency bonds continue to be inflation indexed. For a detailed discussion of recent developments in debt management, see the accompanying Selected Issues Paper, prepared jointly with the authorities.

[8] The exchange rate misalignment has arisen mainly from the permanent positive shock associated with the development of the hydrocarbons sector, combined in recent years with a major improvement in the terms of

(continued)

underscored that real exchange rate adjustments through inflation would have a regressive distributional impact, in particular for the real incomes of the poor. Furthermore, given the underlying appreciating trend, greater exchange rate flexibility would likely contribute to a reduction in dollarization. Staff therefore suggested the following: (a) for the short run, greater flexibility under the crawling peg regime—e.g., with some acceleration in the pace of nominal appreciation; and (b) for the medium term, a move to a regime that permits still greater exchange rate flexibility (e.g., a managed float). The latter would also allow more timely responses to external shocks.[9] On the monetary policy front, the mission suggested that open market operations be expanded further to manage excess liquidity in the short run, in particular as the accumulation of government deposits at the central bank is expected to subside in the second half of the year.





1/ Expected inflation as measured by the central bank's monthly economic expectations survey.

15. **The authorities' own assessment of the monetary/exchange rate policy requirements coincided with the thrust of the staff's positions but not necessarily on the magnitude of the adjustments needed**. Accordingly, the central bank has continued to appreciate the nominal exchange rate against the U.S. dollar, albeit through still very small adjustments. Also, the volume of open market operations has continued to rise, although still with only a modest impact on policy interest rates (Table 3).[10] Moreover, the authorities were open to the possibility of transitioning to a more flexible exchange rate regime over time; in this connection, they reconfirmed their request for a technical assistance mission from MCM in late June, which they hoped would provide a roadmap of the institutional adjustments that might be necessary for a transition to this type of monetary policy framework.

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trade, in the context of only small nominal exchange rate appreciations. The extent of the misalignment is uncertain, however, as alternative estimates place it within the wide range of 6–26 percent. The authorities' own estimates of the misalignment are on the lower side of this range. For a detailed discussion of these issues, see the accompanying Selected Issues Paper.

[9] While balance sheet effects from nominal exchange rate adjustments may be significant for many borrowers, they tend to be positive in this case given the underlying pressures towards appreciation of the local currency.

[10] Real interest rates on one-year instruments were about 1 percent as of end-May 2007 (based on surveys of expected inflation), compared to an average of 3 percent in 2006.

D. Financial Sector Issues

16. **While the authorities have been successful in maintaining financial sector stability, the discussions highlighted issues that still require attention (Box 3)**. The authorities remain confident that existing vulnerabilities in banks' loan portfolios have been already identified, but they concurred on the need to continue to monitor closely banks' loan provisioning and solvency; and to introduce prudential regulations to enhance banks' assessment of market risks. They did not agree on the need at this time to issue prudential measures to require banks to recognize risks from dollarization in their lending procedures, or to raise capital requirements to cover market risks. There was broad agreement that various pending structural reforms recommended by the 2003 FSAP are still relevant, including to strengthen the legislation governing corporate bankruptcy.

17. **The authorities emphasized that the recently created second-tier public development bank would be subject to standard prudential regulations, and would complement rather than compete with the existing micro-finance sector**.[11] The development bank (BDP) has replaced an existing second-tier public bank and will manage an initial resource pool of US$60 million. To prevent undue competition with microfinance institutions, beneficiaries may only be those with no outstanding credit with the financial system over the past 12 months. The authorities indicated that they do not envisage treasury financing for the BDP, which they expect would be financed instead with concessional funds from the donor community. The mission suggested that the credit procedures of the BDP should be subject to technical assessment by the Superintendency of Banks.

E. Supply-Side Policies

18. **While stressing what they viewed as major positive achievements in the hydrocarbons area, the authorities recognized the challenges ahead for the sector**. In particular, major investments (amounting to approximately US$3.5 billion) would be needed to enable the export increases committed to Argentina as well as to meet rising domestic demand. The authorities expected the current operators to submit substantial investment proposals in coming months, in line with those commitments; and were confident that any shortfalls could be covered by direct investments from YPFB, probably in association with friendly governments. They emphasized that YPFB will have to be restructured and expanded, consistent with its greater role in the new hydrocarbons framework. They will submit a bill to Congress this year to that effect, which would enable YPFB to adjust its salary structure (currently linked with that of the government) in line with industry standards.[12]

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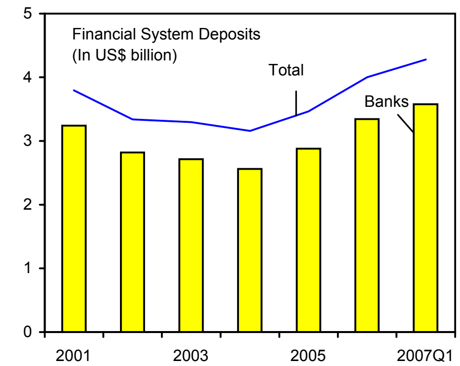
[11] Micro-finance institutions hold about 6 percent of financial system deposits and 10 percent of credit outstanding (about US$350 million).

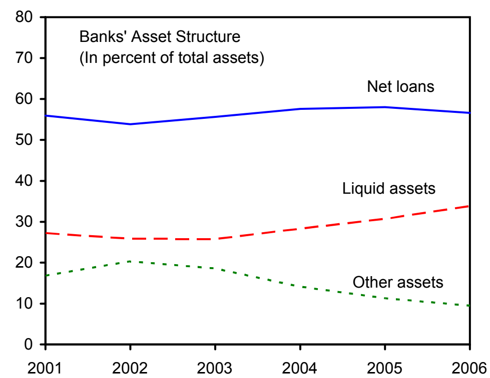
[12] In addition to restructuring YPFB as an autonomous public enterprise, this bill would reform the legal and institutional framework governing the hydrocarbons sector, including through the creation of a new regulatory agency (the National Hydrocarbons Agency).

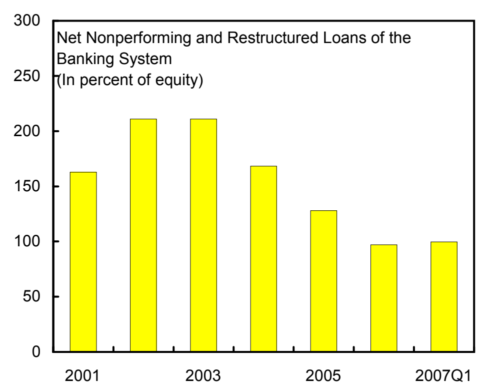
Box 3. Bolivia: State of the Banking System and Pending Reform Agenda

- **The Bolivian banking system has continued its recovery from the 2001–03 crisis**. Deposit growth has picked up, reaching 16 percent in 2006. Credit growth has also improved, although it still lags deposit growth (Table 4). Conse–quently, banks have managed to improve their liquidity position and broadly hold liquid assets of about 50 percent of total deposits. The banking system remains concentrated—the six largest banks out of 13 institutions account for almost 82 percent of banking system assets.



- **Bank profitability has improved and capitalization remains above requirements**. Return on assets and equity increased in 2006—to 1.3 percent and 13.3 percent, respectively (from 0.7 percent and 6.4 percent in 2005)—mainly due to an increase in fee income, lower loan provisioning, and a reduction in operating expenses. The banking system currently shows an aggregate capital adequacy of about 14 percent of risk weighted assets, although asset quality and loan dollarization are still a challenge (Tables 5 and 6). Despite declines, the stock of restructured and nonperforming loans could still become a source of losses as they represent—after provisioning—about 17 percent of net loans or 100 percent of equity. Moreover, foreign exchange loans account for about 80 percent of total loans, which might lead to a deterioration in the portfolio in the event of exchange rate shocks.





- **While important structural reforms have been implemented in recent years, a number of necessary reforms identified by the 2003 FSAP remain pending**. The supervisory authority's independence and regulatory role have been strengthened, and it has issued and enforced regulations on prompt corrective action, bank intervention, and liquidity risk. A large-value real time gross settlement payment system (SIPAV) has been implemented. However, recommendations remain outstanding on: (a) amending the legislation governing corporate bankruptcy/restructuring; (b) ensuring proper consolidated supervision through close coordination among financial regulators; (c) strengthening the Financial Intelligence Unit and legislation against money laundering; (d) creating a deposit insurance scheme, inter alia to reduce the potential for central bank participation in bank resolutions; (e) internalizing the risks posed by financial dollarization through prudential regulations; and (f) adopting regulations to offset market risks.

19. **The mission emphasized that improvements in the investment climate were needed to kick start domestic and foreign investment and raise economic growth**. It stressed that the investment climate would greatly benefit from a clear signal that the government's nationalization policy applies only to those enterprises privatized in the 1990s, and that it will be pursued through mutually agreeable arrangements with the concerned investors. In the same vein, the mission expressed concern over the recent decision to exit from the World Bank's investment disputes framework, which might discourage future investments. More generally, the staff noted that the investment climate would benefit from a reduction in legal/institutional uncertainties, which have been heightened by the potential for far reaching reforms in the context of the ongoing constituent assembly. While taking note of these concerns, the authorities expressed confidence that major investments would be forthcoming over the medium term—from private sources and friendly governments—in hydrocarbons, mining, and other sectors.

F. Medium-Term Outlook

20. **The medium-term outlook entails a significant narrowing of the current account surplus in the context of some improvement in the growth performance** (Tables 1 and 3)**.** The current account surplus would decline from 11½ percent of GDP in 2006 to 5 percent in 2010–12. Consistent with the WEO, the terms of trade would fall during 2008–12, driven by declines in the prices of minerals and a leveling off in natural gas export prices, contributing to lower public and private savings. As a result, and also due to higher investment, the public sector surplus would be reduced while the private sector savings-investment balances would decline, partly due to real exchange rate appreciation. However, the current account surplus would remain significant, reflecting major increases in natural gas exports to Argentina, beginning in 2010; and the large iron/ore steel project of *El Mutun,* expected to boost mining-related output starting in 2009. These projects would also contribute to some improvement in GDP growth, to an average of about 5½ percent during 2008–12.[13] The fiscal surplus would be maintained in the 1–2 percent of GDP range during 2007–12, as the impact on public sector revenue of a limited softening in natural gas export prices would be compensated for by an increase in export volumes.[14] NIR would continue to increase, although they might be allocated partly to a hydrocarbons stabilization/savings fund. Still, with greater exchange rate flexibility, inflation would fall gradually to 4.5 percent.

21. **However, this scenario is subject to a range of downside risks, including major uncertainties regarding private investment and growth**. First, substantial investments on both sides of the border will be required to undertake the major expansion in natural gas exports to the Argentine market while raising production for the domestic market in line with projected increases in consumption, as envisaged by the authorities. Second, the scenario is

[13] In the absence of these projects, real GDP growth would remain broadly around 4½ percent (i.e., same as in 2006–07), with non-hydrocarbons GDP growth at a similar level.

[14] Without the increase in exports to Argentina from the new pipeline, public sector revenue would weaken starting in 2010, and the shortfall compared to the baseline could reach 2½ percent of GDP by 2012.

sensitive to the assumption that the large mining/steel mill project at El Mutun will indeed go forward. Third, while the fiscal scenario is not predicated on any additional measures, it does assume that the authorities succeed in controlling spending, including at the subnational level, which may be challenging in an electoral environment. Finally, the projected inflation path depends importantly on the assumption that the authorities will implement a more flexible exchange rate policy, i.e., more frequent and/or greater exchange rate adjustments than observed over the last two years. Risks are also compounded by the potential for wide-ranging institutional changes in the context of the ongoing constitutional assembly, which could discourage investment and complicate macroeconomic management.

III. Staff Appraisal

22. **Over the past year, the economy continued to benefit from high and rising hydrocarbons and mining exports, which led to increased accumulation of external reserves and a large fiscal surplus**. GDP growth has continued at a satisfactory rate and inflation has remained moderate, albeit with some pick up in recent months that is partly attributable to exogenous shocks. The financial system has remained stable and dollarization, though still exceptionally high, has maintained a declining trend. Reflecting further debt relief under the MDRI, as well as the sizable fiscal surplus, the public debt has been substantially reduced.

23. **The authorities are to be commended for the strong emphasis they have continued to place on safeguarding macroeconomic stability**. In particular, the government has managed expenditure prudently over the past year, especially in the area of current spending, where wage increases have been kept within prudent limits despite the ample hydrocarbons-based resources that have become available. The fiscal gains of recent years constitute an important achievement, and the high priority attached by the authorities to protecting these gains is welcome. This achievement has been instrumental in dealing with the monetary impact—and associated inflationary pressures—of large foreign exchange receipts related to hydrocarbons, and is consistent with a prudent long-term use of the country's hydrocarbons resources. While maintaining the fiscal surplus is not predicated on new fiscal measures, it will still require considerable control over expenditure, including at the subnational level. In light of the potential fiscal impact, the authorities are urged to exercise caution in assessing the various proposals regarding possible modifications to the pension system, and craft these consistent with demographic trends.

24. **While the staff welcomes the overall medium-term fiscal stance, there is room to improve the structure of the budget to make it a more effective developmental and poverty-reducing tool**. In this context, the authorities are encouraged to consider, as soon as feasible, cuts in the large and poorly targeted hydrocarbon product subsidies, along with structural reforms to improve the tax system, intergovernmental relations, and the budget process. A gradual rise in hydrocarbon product prices towards market levels over the medium term, in tandem with the implementation of properly designed initiatives to protect the most vulnerable social groups, would release substantial fiscal resources which could be used to finance development-oriented and poverty-reducing spending, and/or to strengthen the fiscal

position. Additional elements of a structural reform agenda to enhance the effectiveness of the budget as a development/poverty reduction tool would be the elimination of distortionary taxes, concurrently with a broadening of the tax base; the removal of imbalances between the revenue sharing arrangement and expenditure assignments across levels of government; and the enactment of a budget framework law, which would contribute to strengthening the budget process and to increasing control over subnational spending. The authorities are encouraged to introduce a personal income tax with a high exemption threshold to make the tax system more equitable.

25. **Given the strength of the balance of payments, and indications from analytical work that the Boliviano is undervalued, it will be important to incorporate greater exchange rate flexibility and a more active use of open market operations into the policy mix**. Over the last two years, the slight nominal appreciations of the Boliviano under the crawling peg regime have been insufficient to address the misalignment brought about by the rapid development of Bolivia's energy exports. There is scope for greater flexibility under the current regime, which may be achieved by adjusting the frequency and/or the magnitude of exchange rate adjustments. The staff welcomes the authorities' indications that they will exercise greater exchange rate flexibility in the period ahead. Furthermore, there is scope for a more active use of open market operations to tighten monetary conditions. Despite an increase in the volume of open market operations in recent months, policy interest rates have moved only slightly in relation to end-2006 levels and base money growth remains very high. Thus far, strong base money growth has been consistent with higher real demand for the Boliviano as dollarization has declined. However, excess liquidity in the system may increase significantly if the growth in real demand for Bolivianos subsides in the period ahead. Open market operations would therefore need to be stepped up in a forward-looking manner to prevent a sustained rapid growth of the currency stock from translating into higher inflation. Over the medium term, transition to a more flexible exchange rate regime would allow more timely responses to external shocks. Furthermore, given the underlying appreciating trend, greater exchange rate flexibility would likely contribute to a reduction in dollarization. The staff therefore welcomes the authorities' request for MCM technical assistance on the technical and institutional requirements for a potential move to a more flexible exchange rate arrangement over time.

26. **The authorities have been successful in maintaining financial sector stability and efforts to address remaining vulnerabilities should continue**. Key issues include, inter alia, monitoring closely banks' loan provisioning and solvency; introducing prudential regulations to mitigate credit risks from dollarization—especially in light of the need for greater exchange rate flexibility—and market risk; amending the legislation governing corporate bankruptcy/restructuring; and strengthening of the Financial Intelligence Unit and legislation against money laundering. Creating of a deposit insurance scheme, which would provide better tools to deal with systemic crises, also merits consideration. Regarding the recent creation of a development bank, the staff welcomes the indications by the authorities that such a bank is not meant to compete with Bolivia's successful micro-finance system, and that it will be subject to standard prudential requirements.

27. **In the hydrocarbons sector, the new operating contracts with the foreign energy companies constitute an important step towards a more favorable investment climate**. However, while the new contracts have virtually ensured that current production levels will be maintained, the authorities now face the challenge of securing the major additional investments that will be needed to enable committed increases in exports to the Argentine market and forestall domestic bottlenecks in light of rising local demand. The authorities are therefore encouraged to continue to seek mutually acceptable arrangements with the foreign investors in the strategic hydrocarbons sector, especially with those investors affected by the ongoing nationalization of companies privatized in the 1990s. Given the the pivotal role of the state company YPFB in the new hydrocarbons framework, its planned restructuring as an autonomous public enterprise following international best practices is a high priority. More generally, there is a need for an efficient management of any nationalized enterprises.

28. **Regarding the overall economy, it is imperative to develop policies that lead to a recovery in private investment, which has now been depressed for several years**. Indeed, while the authorities understandably assign public investment a key role in developing the country's infrastructure and human capital, a recovery in domestic and foreign private investment will be critical to underpin sustained growth and reduce the risks to the medium term growth outlook, which is highly dependent on large projects envisaged in hydrocarbons and mining. Such an increase would require improvements in the investment climate, which would benefit from greater legal/institutional stability. Accordingly, the authorities should carefully assess the potential impact on investment and growth of possible constitutional changes, including in land tenure and any other aspect of property rights.

29. **As evidenced by the recent ROSC, Bolivia's economic statistics are of adequate quality, timeliness, and coverage to allow the conduct of Fund surveillance**. The authorities are encouraged to address expeditiously the areas identified in the ROSC for improvement in the country's statistical system.

30. It is proposed that **the next Article IV consultation with Bolivia** be held on the standard 12-month cycle.

Table 1. Bolivia: Selected Economic and Financial Indicators

	2003	2004	2005	Prel. 2006	Projections 2007	2008	2009	2010	2011	2012
	(Annual percentage changes)									
Income and prices										
Real GDP	2.7	4.2	4.0	4.6	4.0	5.5	5.3	5.7	5.9	5.3
GDP deflator	6.3	8.0	5.1	12.2	7.4	4.4	2.6	3.7	3.1	3.4
CPI inflation (period average)	3.3	4.4	5.4	4.3	6.6	5.6	5.7	5.2	4.7	4.5
CPI inflation (end-of-period)	3.9	4.6	4.9	4.9	6.5	6.0	5.5	5.0	4.5	4.5
	(In percent of GDP)									
Investment and savings										
Total investment	13.2	11.0	13.8	12.1	13.5	13.6	14.0	14.4	15.2	15.5
Public sector	5.4	6.4	6.3	6.8	7.4	7.3	6.8	6.8	7.1	7.4
Private sector	7.9	4.6	7.4	5.3	6.1	6.3	7.2	7.6	8.1	8.1
Gross domestic savings	12.5	15.8	17.2	21.9	19.1	18.2	16.5	16.4	17.0	17.7
Gross national savings	14.6	17.0	19.4	26.0	22.4	21.7	19.9	19.6	20.2	20.8
Public sector	-2.5	0.9	4.1	11.4	8.5	8.2	7.8	8.3	8.9	9.4
Private sector	17.1	16.2	15.3	14.6	14.0	13.5	12.1	11.3	11.3	11.3
Investment/saving balances 1/	1.4	6.0	5.6	14.0	8.9	8.1	5.9	5.2	5.0	5.2
Public sector	-7.9	-5.5	-2.3	4.6	1.0	1.0	1.0	1.4	1.8	2.0
Private sector	9.2	11.6	7.9	9.4	7.9	7.1	4.9	3.7	3.2	3.3
Combined public sector										
Revenues and grants	24.1	26.8	31.3	35.2	32.3	32.0	31.3	31.6	31.9	32.3
Of which:										
Royalties on hydrocarbons	2.8	3.4	6.6	9.7	9.3	9.2	8.8	9.2	9.6	10.0
Expenditure	32.0	32.3	33.6	30.6	31.3	31.1	30.2	30.1	30.1	30.3
Current	23.9	23.2	23.4	20.1	19.9	19.9	19.8	19.6	19.2	18.8
Capital	8.1	9.1	10.2	10.5	11.4	11.2	10.5	10.5	10.9	11.4
Overall balance	-7.9	-5.5	-2.3	4.6	1.0	1.0	1.0	1.4	1.8	2.0
Total gross public debt	74.1	76.7	70.0	45.8	34.8	33.5	32.4	31.1	30.2	29.6
Total net public debt 2/	66.4	67.8	60.0	31.4	18.2	15.4	13.1	10.5	7.9	5.3
External sector										
Current account 1/	1.0	3.8	6.5	11.7	8.9	8.1	5.9	5.2	5.0	5.2
Merchandise exports	19.7	24.4	29.5	34.4	32.6	32.4	29.3	29.6	30.5	32.1
Of which: natural gas	4.7	7.0	11.5	14.9	14.8	14.7	14.3	15.5	16.5	17.5
Merchandise imports	20.0	20.9	24.7	25.0	24.9	26.6	25.7	26.7	27.8	29.1
Terms of trade index (percent change)	6.1	11.9	12.5	13.9	2.7	-2.1	-6.7	-3.6	-3.8	-2.7
Gross international reserves 3/										
In millions of U.S. dollars	1,266	1,474	2,042	3,385	4,646	5,725	6,774	7,902	9,170	10,478
In percent of broad money	42.0	49.6	57.8	79.7	90.9	94.9	97.7	100.3	105.7	112.7
Exchange rates										
Bolivianos/U.S. dollar (end-of-period) 4/	7.82	8.04	8.00	7.93	...	...	...	...	...	...
REER, period average (percent change)	-10.2	-6.5	-4.2	-0.6	...	...	...	...	...	...
	(Changes in percent of broad money at the beginning of the period, unless otherwise specified)									
Money and credit										
NFA of the financial system	3.2	2.9	20.7	31.3	22.6	17.3	14.3	13.7	13.8	13.2
NDA of the financial system	-1.9	-4.3	-6.6	-12.9	-5.4	-2.0	-1.8	-0.2	-1.5	-1.7
Of which: credit to private sector (percent of GDP)	47.6	42.3	39.6	34.7	34.2	34.6	34.9	35.8	36.0	36.1
Broad money	1.3	-1.4	14.1	18.5	17.1	15.3	12.5	13.4	12.3	11.5
Interest rates (percent, end-of-period)										
Yield on treasury bills in local currency	10.9	9.6	7.9	6.4	...	...	...	...	...	...
Yield on treasury bills in U.S. dollars	6.2	5.8	7.4	4.0	...	...	...	...	...	...
Memorandum items:										
Nominal GDP (in millions of Bolivianos)	61,904	69,626	76,154	89,434	99,853	109,919	118,774	130,211	142,123	154,736
Nominal GDP (in billions of U.S. dollars)	8.09	8.81	9.47	11.24	12.80	14.38	15.86	17.38	18.60	19.46

Sources: Bolivian authorities; and Fund staff estimates and projections.

1/ For historical data, the investment-savings balance, as measured in national accounts, differs from that in the balance of payments due to adjustments in the former associated with estimations of re-exports and smuggling.
2/ Defined as total gross public debt minus government's deposit in the financial system.
3/ Excludes reserves from the Latin American Reserve Fund (FLAR) and includes Offshore Liquidity Requirements (RAL).
4/ Official (buy) exchange rate.

Table 2. Bolivia: Operations of the Combined Public Sector

(In percent of GDP)

	2003	2004	2005	Prel. 2006	Proj. 2007
Total revenue and grants	**24.1**	**26.8**	**31.3**	**35.2**	**32.3**
Current revenue	21.2	24.3	29.1	33.3	30.7
General government	21.1	23.9	28.7	31.7	25.1
Tax Revenue 1/ 2/	17.8	20.6	25.4	28.5	22.3
Of which: Excise taxes of fuel	1.7	1.6	2.5	2.2	2.1
Other	13.2	15.6	16.4	16.6	16.5
Direct taxes	2.9	3.6	4.3	4.9	4.7
Of which: Corporate income tax	1.6	2.0	3.8	3.2	2.9
Indirect taxes	9.4	12.0	12.1	11.8	11.8
Of which: VAT	5.7	6.3	6.8	7.0	7.2
FTT	...	0.5	0.8	0.5	0.3
Customs duties	0.9	1.0	1.0	1.0	1.0
Nontax revenue	3.4	3.3	3.2	3.2	2.9
Grants	2.9	2.5	3.5	1.9	1.6
Public sector enterprises operating balance	-0.1	0.1	0.1	0.8	4.6
Of which: Royalties and IDH transfers to gen. gov.	0.0	0.0	0.0	0.0	5.7
Central bank operating balance	0.2	0.3	0.3	0.7	0.9
Total expenditure	**32.0**	**32.3**	**33.6**	**30.6**	**31.3**
Current expenditure	23.9	23.2	23.4	20.1	19.9
Wages and salaries 3/	9.4	9.0	8.7	8.1	9.0
Goods and services	2.6	2.0	2.0	1.8	2.1
Interest	2.8	2.9	3.0	2.6	2.4
Domestic	1.6	1.8	1.8	1.5	1.5
Foreign	1.2	1.1	1.2	1.1	0.9
Transfers (excludes pensions)	1.5	1.9	2.3	1.6	1.7
Pensions	4.4	4.3	4.1	3.7	3.5
Other	3.2	3.1	3.3	2.4	1.2
Capital expenditure	8.1	9.1	10.2	10.5	11.4
Overall balance	**-7.9**	**-5.5**	**-2.3**	**4.6**	**1.0**
Financing	**7.9**	**5.5**	**2.3**	**-4.6**	**-1.0**
External	5.3	3.9	2.3	0.4	1.8
Disbursements	9.3	6.2	5.3	3.0	3.4
Amortizations	-4.1	-3.3	-2.9	-2.5	-1.5
Other external	0.3	1.0	-0.1	-0.1	-0.1
Domestic	2.6	1.6	0.0	-5.0	-2.8
Banking system	-0.5	-0.6	-2.4	-6.3	-3.8
Central Bank	-0.2	-0.8	-2.0	-6.4	-3.8
Commercial banks	-0.3	0.2	-0.4	0.1	0.0
Pension funds	1.6	1.5	1.5	1.3	1.1
Other domestic	1.5	0.7	1.0	0.1	-0.1
Memorandum item:					
Hydrocarbons related revenues	2.8	3.4	6.6	11.1	11.2
Royalties and IDH	2.8	3.4	6.6	9.7	9.3
YPFB participation	0.0	0.0	0.0	1.4	1.9
Non-hydrocarbons balance	-10.7	-8.9	-8.9	-6.5	-4.5

Sources: Bolivian authorities, and Fund staff estimates

1/ Since May 2007 royalties and IDH are no longer included in the definition of tax revenue of the general government as these funds are now collected and transferred by YPFB.

2/ In 2007 tax revenues include only the IDH and royalties that were paid directly by the oil companies to the general government preceding the take over of this responsibility by YPFB in May 2007.

3/ In 2007 the spending on Universities initially included in other spending was reclassified. More importantly, the wage bill now includes 1,056 million bolivianos of salaries of university personnel while other minor amounts were included in goods and services.

Table 3. Bolivia: Summary Balance of Payments

(In millions of U.S. dollars; unless otherwise indicated)

			Prel.	Projections					
	2004	2005	2006	2007	2008	2009	2010	2011	2012
Current account	**337**	**615**	**1,320**	**1,139**	**1,161**	**934**	**901**	**937**	**1,019**
Trade balance	302	457	1,055	985	823	565	509	490	574
Exports, f.o.b.	2,146	2,791	3,863	4,171	4,652	4,645	5,152	5,669	6,243
Natural gas	620	1,086	1,672	1,898	2,121	2,267	2,695	3,065	3,406
Of which: To Brazil	542	896	1,359	1,449	1,586	1,662	1,733	1,750	1,742
Volume (mmm3 p/day)	19.5	22.4	24.4	26.0	27.2	28.4	29.7	30.1	30.1
Price ($/000cf3)	2.2	3.1	4.3	4.3	4.5	4.5	4.5	4.5	4.5
To Argentina	49	162	281	397	483	554	911	1,264	1,613
Volume (mmm3 p/day)	2.2	4.8	5.1	5.6	6.7	7.7	12.7	17.7	22.7
Price ($/000cf3)	1.7	2.6	4.3	5.5	5.5	5.6	5.6	5.5	5.5
Mining	456	544	1,060	1,270	1,567	1,416	1,447	1,522	1,589
Soy - related 1/	387	264	234	250	240	237	238	241	248
Other	684	897	897	753	725	724	772	842	1,000
Imports, c.i.f.	-1,844	-2,334	-2,808	-3,186	-3,829	-4,080	-4,643	-5,179	-5,669
Services (net)	-71	-42	-194	-279	-165	-165	-163	-148	-148
Income (net)	-385	-384	-364	-325	-300	-284	-267	-244	-254
Transfers (net)	491	584	822	758	804	818	822	839	847
Capital and financial account	**-211**	**-111**	**196**	**-49**	**-107**	**82**	**185**	**286**	**244**
Capital transfers 2/	8	9	1,813	1,100	0	0	0	0	0
Direct investment (net)	63	-280	243	-120	-92	174	390	512	381
Gross investment	385	404	435	192	353	524	690	812	681
Disinvestment and investment abroad	-322	-684	-192	-312	-446	-350	-300	-300	-300
Portfolio investment (net)	-35	-153	46	-225	-168	-130	-160	-176	-188
Public sector loans	234	123	-1,543	-855	216	192	175	180	190
Disbursements	547	499	337	437	373	353	347	347	347
Amortization 2/	-313	-376	-1,880	-1,292	-156	-160	-171	-166	-156
Fin system net foreign assets, excl. liquid asset requirement	18	-97	-115	10	20	20	20	20	20
Nonbank private sector loans	65	380	-6	80	-20	-20	-20	-20	-20
Other, including errors and omissions	-563	-93	-242	-36	-59	-150	-215	-225	-266
Overall balance	**126**	**503**	**1,516**	**1,090**	**1,054**	**1,016**	**1,086**	**1,223**	**1,263**
Financing	**-125**	**-503**	**-1,516**	**-1,090**	**-1,054**	**-1,016**	**-1,086**	**-1,223**	**-1,263**
Memorandum items:									
Current account (percent of GDP)	3.8	6.5	11.7	8.9	8.1	5.9	5.2	5.0	5.2
Merchandise exports (percent of GDP)	24.4	29.5	34.4	32.6	32.4	29.3	29.6	30.5	32.1
Merchandise imports (percent of GDP)	-20.9	-24.7	-25.0	-24.9	-26.6	-25.7	-26.7	-27.8	-29.1
Gross official reserves (end-of-period)	1,212	1,674	3,054	4,265	5,319	6,335	7,420	8,643	9,906
(In months of imports of goods and services) 3/	5.1	5.8	9.3	11.4	13.4	14.3	15.1	15.1	15.1
Nominal GDP	8,809	9,466	11,235	12,800	14,378	15,858	17,385	18,603	19,464

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

1/ Excluding reexports.
2/ In 2006 includes effect of MDRI debt relief from the IMF and the World Bank equivalent to US$ 1804.3 million.
In 2007 includes effect of MDRI relief from IADB equivalent to US$ 1099 million.
3/ In months of imports of goods and services in the following year.

Table 4. Bolivia: Financial System Survey 1/ 2/

	2003	2004	2005	2006	Proj. 2007
(Flows in millions of Bolivianos, unless otherwise indicated)					
Net short-term foreign assets	860	867	6,249	10,892	9,181
(Flows in millions of U.S. dollars)	111	108	766	1,363	1,150
Net domestic assets	-509	-1,277	-1,998	-4,469	-2,204
Net credit to the public sector	35	-359	-2,134	-5,760	-3,825
Credit to the private sector	-619	-1,108	1,068	1,958	3,253
Net medium- and long-term foreign liabilities (increase -)	63	635	-390	-105	100
Other items (net)	12	-444	-543	-562	-1,733
Broad money	350	-410	4,251	6,423	6,977
Liabilities in domestic currency	807	1,544	3,441	5,578	5,738
Foreign currency deposits	-457	-1,954	810	845	1,238
(Stocks in millions of Bolivianos, unless otherwise indicated)					
Net short-term foreign assets	11,435	13,141	19,496	31,494	41,589
(Stocks in millions of U.S. dollars)	1,479	1,636	2,391	3,942	5,212
Net domestic assets	18,192	17,024	15,269	9,212	6,062
Net credit to the public sector	4,476	4,393	2,361	-4,884	-8,103
Credit to the private sector	29,283	29,287	30,778	32,171	35,390
Net medium- and long-term foreign liabilities	-3,404	-2,896	-3,326	-3,368	-3,264
Other items (net)	-12,162	-13,760	-14,544	-14,707	-17,961
Broad money	29,627	30,165	34,765	40,706	47,651
Liabilities in domestic currency	5,220	6,764	10,206	15,784	21,522
Foreign currency deposits	24,408	23,401	24,559	24,922	26,129
(Changes in percent of broad money at the beginning of the period)					
Net short-term foreign assets	3.2	2.9	20.7	31.3	22.6
Net domestic assets	-1.9	-4.3	-6.6	-12.9	-5.4
Net credit to the public sector	0.1	-1.2	-7.1	-16.6	-9.4
Credit to the private sector	-2.3	-3.7	3.5	5.6	8.0
Net medium- and long-term foreign liabilities (increase -)	0.2	2.1	-1.3	-0.3	0.2
Other items (net)	0.0	-1.5	-1.8	-1.6	-4.3
Broad money	1.3	-1.4	14.1	18.5	17.1
Liabilities in domestic currency	3.0	5.2	11.4	16.0	14.1
Foreign currency deposits	-1.7	-6.6	2.7	2.4	3.0
Memorandum items:					
Broad money (average stock in percent of GDP)	46.5	41.0	42.2	39.7	42.9
Credit to private sector (average stock in percent of GDP)	47.6	42.3	39.6	34.7	34.2
Financial system NFA coverage of deposits (percent)	43.3	50.0	66.8	96.3	113.1
Dollarization (end-period stocks)					
Foreign currency and dollar-indexed deposits	92.3	89.0	84.2	76.2	71.0
Foreign currency and dollar indexed credit	97.2	95.7	92.6	86.9	83.3

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

1/ The financial system comprises the central bank; commercial banks and nonbanks; and the National Financial Institution of Bolivia and FONDESIF, which are state-owned second-tier banks.
2/ Stocks and flows in foreign currency are valued at accounting exchange rates for 2003-05 and at the beginning of period exchange rate for 2006-07.

Table 5. Bolivia: Central Bank of Bolivia 1/

	2003	2004	2005	Proj. 2006	Proj. 2007
(Flows in millions of Bolivianos, unless otherwise indicated)					
Net international reserves	718	1,112	4,105	10,270	8,701
(Flows in millions of U.S. dollars)	93	138	503	1,285	1,090
Net domestic assets	-231	-354	-2,208	-7,676	-5,569
Net credit to the nonfinancial public sector	-103	-561	-1,543	-5,725	-3,825
Net credit to financial intermediaries	-219	-355	-604	-1,620	-1,680
Of which: Open market operations (increase -)	-18	-294	-221	-997	-2,355
Net medium- and long-term foreign liabilities (increase -)	-32	873	8	5	49
Other items (net)	124	-311	-69	-336	-113
Currency issue	487	758	1,897	2,594	3,132
(Stocks in millions of Bolivianos, unless otherwise indicated)					
Net international reserves	6,866	8,640	12,785	24,291	33,916
(Stocks in millions of U.S. dollars)	888	1,076	1,568	3,040	4,250
Net domestic assets	-3,341	-4,357	-6,605	-15,517	-22,010
Net credit to the nonfinancial public sector	2,112	1,710	236	-6,952	-10,169
Net credit to financial intermediaries	1,475	1,200	627	-1,453	-3,163
Of which: Open market operations	-95	-391	-615	-1,590	-3,970
Net medium- and long-term foreign liabilities	-1,064	-227	-220	-212	-163
Other items (net)	-5,864	-7,039	-7,248	-6,900	-8,514
Currency issue	3,525	4,283	6,180	8,774	11,906
(Changes in percent of beginning-of-period currency issue)					
Net international reserves	23.6	31.6	95.8	166.2	99.2
Net domestic assets	-7.6	-10.0	-51.6	-124.2	-63.5
Net credit to the nonfinancial public sector	-3.4	-15.9	-36.0	-92.6	-43.6
Net credit to financial intermediaries	-7.2	-10.1	-14.1	-26.2	-19.1
Of which: Open market operations (increase -)	-0.6	-8.3	-5.2	-16.1	-26.8
Net medium- and long-term foreign liabilities (increase -)	-1.1	24.8	0.2	0.1	0.6
Other items (net)	4.1	-8.8	-1.6	-5.4	-1.3
Currency issue	16.0	21.5	44.3	42.0	35.7
Memorandum items:					
Currency issue (average stock in percent of GDP)	4.4	4.6	5.7	7.3	9.1
NIR coverage of broad money (percent)	23.2	28.6	36.8	59.7	71.2

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

1/ Stocks and flows in foreign currency are valued at accounting exchange rates for 2003-05 and at the beginning of period exchange rate for 2006-07.

Table 6. Bolivia: Financial Soundness Indicators of the Banking Sector

	2001	2002	2003	2004	2005	2006	Mar. 2007
Banking sector							
Capital adequacy							
Regulatory capital as percent of risk-weighted assets	14.6	16.1	15.3	14.9	14.7	13.3	13.5
Capital as percent of assets	10.5	11.9	12.1	11.5	11.3	10.0	9.0
Asset quality							
Non-performing loans (NPL) as percent of gross loans	14.4	17.7	16.7	14.0	11.3	8.7	8.8
Provisions as percent of NPL	63.7	63.7	74.0	84.3	81.1	90.7	88.4
Provisions as percent of gross loans	9.2	11.2	12.4	11.8	9.2	7.9	7.8
Total restructured loans as percent of gross loans	21.0	31.9	33.9	33.1	25.8	19.4	18.8
Nonperforming restructured loans as percent of total restructured loans	7.3	15.8	18.6	19.4	22.7	23.7	25.3
Performing restructured loans+NPL-provisioning as percent of equity	162.9	210.9	210.9	168.1	128.1	97.0	99.7
Earnings and profitability							
Gross profits as percent of average assets (ROAA)	-0.4	0.1	0.3	-0.1	0.7	1.3	1.1
Gross profits as percent of average equity capital (ROAE)	-4.3	0.7	2.8	-1.2	6.4	13.3	12.7
assets)	6.6	6.1	5.5	5.4	6.1	6.2	6.1
Gross income as percent of average assets		8.0	7.9	8.1	8.8	8.5	7.9
Net interest income as percent of gross income	70.0	61.7	58.0	54.9	58.3	60.6	65.2
Non-interest income as percent of gross income	30.0	38.3	42.0	45.1	41.7	39.4	34.8
Non-interest expenses as percent of gross income	69.0	68.9	77.1	86.0	82.1	73.1	73.9
Personnel expenses as percent of non-interest expenses	29.3	27.0	25.7	22.5	26.3	28.3	33.1
Liquidity							
Cash & short-term investments as percent of total assets	27.2	25.9	25.8	28.3	30.7	33.9	36.8
Cash & short term investments as % of total deposits	38.8	37.4	36.3	40.0	42.4	45.2	48.1
Foreign currency loans as percent of total loans	95.2	95.8	96.3	94.3	90.2	81.8	80.8
Foreign currency deposits as percent of total deposits	90.4	91.4	90.7	86.3	84.6	74.8	74.2
Loans as percent of total assets	60.4	58.8	59.1	59.6	60.0	57.7	55.3
Deposits as percent of assets	84.8	83.4	82.7	83.8	84.6	85.9	86.8
Loans as percent of deposits and financing from other financial entities	71.2	70.5	71.5	71.1	70.9	67.2	63.7

Sources : Superintendency of Banks and Financial Institutions Bolivia and staff estimate.

Table 7. Bolivia: Financial and External Vulnerability Indicators
(In percent; end-of-period; unless otherwise indicated)

	2003	2004	2005	2006	Proj. 2007
Financial indicators 1/					
Lending rate in domestic currency	10.4	10.6	9.8	9.0	...
Lending rate in U.S. dollars	9.5	9.5	11.6	11.2	...
Velocity of money	2.1	2.3	2.2	2.2	2.1
Credit to the private sector (average stock, percent of GDP)	47.6	42.3	39.6	34.7	34.2
Share of foreign currency deposits in total deposits	92.3	89.0	84.2	76.2	71.0
Share of foreing currency loans in total credit	97.2	95.7	92.6	86.9	83.3
Nonperforming loans (percent of total loans)	16.7	14.0	11.3	8.7	...
Loan-loss provisions (percent of nonperforming loans)	74.0	84.3	81.1	90.7	...
Risk-based capital-assets ratio	15.3	14.9	14.7	13.3	...
Foreign currency deposits of the financial system (in millions of U.S. dollars)	3,121	2,911	3,070	3,143	3,359
Net short-term foreign assets of the financial system (in millions of U.S. dollars)	591	561	823	901	962
External sector					
Exports, U.S. dollars (percent change)	23.0	34.3	30.1	38.4	8.0
Imports, U.S. dollars (percent change)	-8.7	14.1	27.0	19.9	13.4
Terms of trade (percent change)	6.1	11.9	12.5	13.9	2.7
Real effective exchange rate (percent change)	0.0	0.0	0.0	0.0	0.0
Current account balance (percent of GDP)	1.0	3.8	6.5	11.7	8.9
Capital and financial account balance (percent of GDP)	-0.1	-2.4	-1.3	1.7	-0.4
Net FDI inflows (percent of GDP)	2.4	0.7	-3.0	2.2	-1.0
Total external debt (percent of GDP)	75.0	67.9	64.7	40.2	29.4
Medium- and long-term public debt (percent of GDP)	49.9	44.2	47.8	26.7	16.8
Medium- and long-term private debt (percent of GDP)	25.1	23.7	16.9	13.5	12.6
Total external debt (percent of exports of goods and services)	380	280	222	116	77
Short term external debt (original maturity, percent of total external debt)	0.20	0.23	0.25	0.36	0.48
Gross international reserves (GIR) (in millions of U.S. dollars) 2/	1,266	1,474	2,042	3,385	4,646
GIR (percent of broad money)	42.0	49.6	57.8	79.7	90.9
GIR (in months of imports of goods and services)	7	8	9	12	14
GIR (percent of short-term debt and banks' FX deposits)	40.4	50.4	66.2	107.2	137.6
Net international reserves (in millions of U.S. dollars)	888	1,076	1,568	3,040	4,250
Nonfinancial public sector					
Overall balance (percent of GDP)	-7.9	-5.5	-2.3	4.6	1.0
Primary balance (percent of GDP)	-5.1	-2.6	0.8	7.2	3.4
NFPS gross debt (percent of GDP)	74.1	76.7	70.0	45.8	34.8
Of which: in domestic currency (percent of GDP)	24.1	32.5	22.2	19.1	18.0
NFPS net debt (percent of GDP)	66.4	67.8	60.0	31.4	18.2

Source: Bolivian authorities; and Fund staff estimates.

1/ Includes commercial banks and nonbanks.

2/ Central bank gross reserves excluding reserves from the Latin American Reserve Fund (FLAR), plus offshore liquidity requirements (RAL).

Table 8. Bolivia: Millennium Development Goals

	First Observation	1998	2000	2001	2002	2003	2004	2005	Target 2015
Goal 1. Eradicate Extreme Poverty and Hunger									
Target 1: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day.									
Population below US$1 a day (in percent)	41.2 (1990)	...	45.0	39.0	...	41.3	...	38.2	24.1
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger									
Prevalence of child malnutrition (percent of children under 3)	38.3 (1990)	25.6	...	...	...	24.2	...	...	19.0
Goal 2. Achieve Universal Primary Education									
Target 3. Ensure that, by 2015, children will be able to complete a full course of primary schooling.									
Net primary enrollment ratio (percent of relevant age group)		...	96.4	97.0	97.7	94.4	94.0	94	100.0
Percentage of cohort reaching grade 5	55.4 (1992)	...	...	71.5	74.8	77.8	79.5	77.8	100.0
Goal 3. Promote Gender Equality and Empower Women									
Target 4. Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015.									
Gender disparities at completion of primary education (percent)	6.6 (1992)	...	...	3.7	2.9	3.4	...	0.3	0.0
Gender disparities at completion of secondary education (percent)	3.4 (1992)	...	...	1.1	0.9	0	...	-0.4	0.0
Goal 4. Reduce Child Mortality									
Target 5. Reduce by two-thirds, between 1990 and 2015, the under five mortality rate									
Infant mortality rate (per 1,000 live births)	89 (1990)	67	...	...	...	54	...	...	30.0
Immunization against measles (percent of children under 12-months)	68 (1994)	77	90	92	86	80	...	84.5	95.0
Goal 5. Improve Maternal Health									
Target 6. Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.									
Maternal mortality ratio (modeled estimate, per 100,000 live births)	416 (1990)	235	...	...	...	229	...	...	104.0
Proportion of births attended by skilled health personnel (percent)	27 (1995)	42.0	52.0	54.0	53.9	55.3	59.6	61.9	70.0
Goal 6. Combat HIV/AIDS, Malaria, and Other Diseases									
Target 7. Halt by 2015, and begin to reverse, the spread of HIV/AIDS									
HIV prevalence, total (per 1,000,000 people)	1.8 (1990)	5.2	5.0	9.4	6.5	11.5	13.4	19.3	13.0
Target 8. Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases									
Incidence of malaria (per 1,000 people)	7.5 (1990)	24.8	8.8	5.0	4.3	6.1	4.1	5.5	2.0
Incidence of tuberculosis cases cured (percent of diagnosed)	52.6 (1995)	55.8	71.2	78.1	81.2	...	...	78.7	95.0
Target 10. halve by 2015 proportion of people without access to safe drinking water									
Access to potable water (percent of population)	57.5 (1992)	...	...	72.0	72.0	72.0	72.3	71.7	78.5
Access to improved water source (percent of population)	28 (1992)	...	...	40.7	41.5	41.3	41.6	43.5	64.0
Goal 8. Develop a global Partnership for Development									
Target 17. Provide access to affordable essential drugs									
Proportion of households expenditure on essential drugs (percent of national health expend	17.8 (1995)	19.4	17.2	20.5	21.6	...	...	...	15.0

Source: Bolivian authorities.

APPENDIX 1. SUMMARY OF ANNEXES

The full annexes to this report may be viewed in CyberDocs on the Fund's intranet and on the secure extranet for Executive Directors and member country officials.

Fund relations

As of May 31, 2007, Bolivia's outstanding purchases and loans amounted to SDR 9.66 million (5.63 percent of quota). The latest SBA expired on March 31, 2006. In 2006, Bolivia received a SDR 160.93 million in stock of debt relief from the Fund through the MDRI. The last Article IV consultation was completed by the Executive Board on July 17, 2006 (IMF Country Report No. 06/270). Bolivia has received wide-ranging TA in recent years. An update of the safeguards assessment was completed in September, 2004, which confirmed that identified vulnerabilities had been addressed, except for those requiring a change in the central bank law. Mr. Esteban Vesperoni has been the IMF resident representative since February 2006.

Relations with the World Bank Group

The World Bank's support to Bolivia is being delivered according to the Interim Strategy Note (ISN), approved by the World Bank Board in November 2006. Bank support includes lending, analytical work, and technical assistance in the areas of governance and transparency; fostering jobs through growth; and providing better services to the poor. ISN lending includes only IDA resources, which will finance 10 investment projects, with projected disbursements of approximately US$140 million over the two-year period; and six Economic and Sector Works (EWS). The Bank's current portfolio in Bolivia comprises six projects under implementation, with total commitments of US$221 million.

Relations with the Inter-American Development Bank

As of December 31, 2006, Bolivia's outstanding debt to the IDB was US$1.28 billion. In 2006, a total of US$145 million in new concessional lending was approved for Bolivia's public sector, the most important of which was a US$120 million loan to support road rehabilitation and improve the Northern Corridor Highway from La Paz to Rurrenabaque. The IDB's portfolio in Bolivia also includes active non-reimbursable technical cooperation projects amounting to US$21.6 million. On March 16, 2007, in the context of the MDRI, the Board of Governors of the IDB approved 100% debt relief on loan balances outstanding as of December 31, 2004 from its Fund for Special Operations (FSO).

Statistical issues

The timeliness and coverage of economic statistics in Bolivia is generally adequate for surveillance purposes. A data ROSC mission in early 2007 confirmed advances in recent years, and reiterated the existence of shortcomings that might hamper the formulation of appropriate policies. Many national agencies, including the National Institute of Statistics (INE), post statistical information on the Internet. Bolivia has participated in the GDDS since November 2000 and plans to subscribe to the SDDS are at an advanced stage.

INTERNATIONAL MONETARY FUND

BOLIVIA

Staff Report for the 2007 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department

June 27, 2007

Contents Page

APPENDIX I. BOLIVIA—FUND RELATIONS
(As of May 31, 2007)

I. **Membership Status**: Joined December 27, 1945; accepted its obligations under Article VIII on June 5, 1967. The exchange system is free of restrictions on current international payments and transfers.

II.	**General Resources Account**:	**SDR Million**	**Percent of Quota**
	Quota	171.50	100.00
0	Fund holdings of currency	172.30	100.47
	Reserve position in Fund	8.87	5.17

III.	**SDR Department**:	**SDR Million**	**Percent of Allocation**
	Net cumulative allocation	26.70	100.00
	Holdings	26.62	99.68

IV.	**Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
	Stand-By Arrangements	9.66	5.63

V. **Financial Arrangements**:

Type	**Approval date**	**Expiration date**	**Amount approved (SDR million)**	**Amount drawn (SDR million)**
Stand-By	4/02/03	3/31/06	145.78	111.50
PRGF	9/18/98	6/07/02	100.96	63.86
PRGF	12/19/94	9/09/98	100.96	100.96

VI. **Projected Obligations to the Fund**: (SDR million; based on existing use of resources and present holdings of SDRs):

	Expectations Basis				
	2007	**2008**	**2009**	**2010**	**2011**
Principal	2.42	4.83	2.42		
Charges/Interest	0.38	0.29	0.05	0.00	0.00
Total	**2.79**	**5.12**	**2.46**	**0.00**	**0.00**

	Obligations Basis				
	2007	**2008**	**2009**	**2010**	**2011**
Principal		2.42	4.83	2.42	
Charges/Interest	0.40	0.51	0.29	0.05	0.00
Total	**0.40**	**2.93**	**5.12**	**2.46**	**0.00**

VII. **Implementation of HIPC Initiative:**

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

VIII. **Implementation of MDRI Assistance:**

I. Total Debt Relief (SDR Million)[3]	160.93
Of Which: MDRI	154.82
HIPC	6.11
II. Debt Relief by Facility (SDR Million)	

Eligible Debt

Delivery Date	GRA	PRGF	Total
January 2006	6.70	71.15	77.85
January 2006	83.08	N/A	83.08

IX. **Safeguards Assessment.** Under the Fund's safeguards assessment policy, the Central Bank of Bolivia (CBB) was subject to an assessment with respect to the April 2, 2003 Stand-by Arrangement (SBA). A safeguards assessment was completed June 27, 2003, and while no systemic risks with the CBB's safeguards were identified, uncertainties

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

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

[3] The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for the assistance. The debt relief covers the full stock of debt owed to the Fund as of end-2004 which remains outstanding at the time the member qualifies for such debt relief. The MDRI is financed by bilateral contributions and the Fund's own resources, as well as the resources already disbursed to the member under the HIPC Initiative (see Section VII above).

were expressed about the de facto lack of operational independence and program monetary data. An update assessment was completed September 27, 2004 in conjunction with an augmentation of the SBA. This assessment confirmed that measures had been implemented to address all previously identified vulnerabilities, except for those requiring a change in the central bank law.

X. **Exchange Arrangement.** The Bolivian currency is the boliviano and the exchange rate regime is a crawling peg. The central bank holds a daily foreign exchange auction, accepting all bids that are at least equal to the central bank's minimum price. If acceptable bids exceed the amount offered for auction, the lowest acceptable bids are prorated so as to exhaust the amount offered. The minimum price is adjusted from time to time in light of the evaluation of Bolivia's real exchange rate with respect to Bolivia's key trading partners. On March 31, 2007, the official selling rate was US$7.99 per U.S. dollar.

XI. **Article IV Consultation**. The last Article IV consultation was completed by the Executive Board on July 17, 2006 (Country Report No. 06/270). Bolivia is on a standard 12-month consultation cycle.

XII. **Technical Assistance, 2002–06**

Department	Purpose	Date
MAE	Monetary operations; monetary and exchange rate policy	May 2002
STA	National accounts statistics	August 2002
MAE	FSAP	Nov. 2002, Jan. 2003
FAD	Customs reform	December 2002
FAD	Tax administration	Dec. 2002, Aug.2004
FAD	Tax Administration	May 2003
MFD	AML/CFT training of bank supervisors	July 2003
FAD	Customs administration	Jan. 2004, Apr. 2005
FAD	Pension reform	April 2004
MFD	Banking sector	July 2004
MFD	Banking sector	August 2004
MFD/LEG	AML/CFT legal drafting/Financial intelligence unit	September 2004
FAD	PSIA	October 2004
MFD	Promote use of domestic currency	October 2004
FAD	Public expenditure management: the budget process	April 2005
FAD	Tax policy	August 2005
FAD	Decentralization and public expenditure management	October 2005
STA	Monetary statistics	March 2006
STA	ROSC Data Module	January 2007

XII. **Resident Representative**. Mr. Esteban Vesperoni took over the post of IMF resident representative in February 2006.

APPENDIX II. BOLIVIA: RELATIONS WITH THE WORLD BANK [1]

1. **The World Bank's support to Bolivia is being delivered according to the Interim Strategy Note (ISN), approved by the World Bank Board in November 2006**. The ISN has been designed to cover a two-year period (FY07–FY08) that will allow the Bank to implement a flexible work program in Bolivia while the Constitutional Assembly outcomes are defined and the National Development Plan, presented in May 2006, advances in its implementation. The Bank support include lending, analytical work and technical assistance in areas where the Bank and the Government have clear agreement: enhancing good governance and transparency; fostering jobs through growth; and providing better services to the poor. The ISN lending includes only IDA resources which will finance ten investment projects for approximately US$140 million over the two-year framework, and six Economic and Sector Works (EWS). To the extent possible, these projects and programs are being designed and implemented in a collaborative fashion with donor partners to have a greater development impact.

2. **The World Bank's portfolio in Bolivia comprises six projects under implementation for a total amount of US$221 million.** The entire portfolio is made of concessional IDA funding, of which US$129 million remain undisbursed, in the following six projects:

- The Institutional Reform Project I, for US$30 million and closing date May 2007.
- The Health Sector Reform APL II, for US$35 million and expected to close in September 2007.
- The Road Rehabilitation and Maintenance Project, for US$77 million and expected to close in December 2007.
- The Decentralized Infrastructure for Rural Transformation, for US$20 million and closing date December 2007.
- The Urban Infrastructure for the Poor Project, for US$30 million and closing date November 2010.
- The Rural Alliances Project, for US$28 million and closing date September 2011.

3. **Additionally, the World Bank program includes some trust funds**: a grant for US$300 thousand to strength the Technical Secretariat of the Constituent Assembly; and a grant amounting to US$212 thousand intended for the strengthening of the Congress Budget Commission.

4. **During 2006 the World Bank has concluded the following three studies**, which were published in both Spanish and English and presented to the Civil Society in several Bolivian cities.

[1] Prepared by World Bank staff.

- **Policy Notes** on 23 different economic and social issues, after technical discussions with major political parties – including the MAS party – which started in August 2005. The Bank presented these notes to the Government in March 2006 and to the Civil Society at the end of 2006.

- The **Country Social Analysis (CSA)** provides consideration of the options and lessons from international experience that the Constitutional Assembly faces on four critical issues: indigenous rights, land and territory, decentralization and access to justice. This document was presented to the Government and the Civil Society in March 2007.

- The **Institutional Governance Review (IGR)** analyses the second phase of the decentralization issue at the departmental level, including a thorough diagnosis of its context and current strategy, focusing on guiding principles for a successful progressive implementation. This document was also presented to the Government and the Civil Society in March 2007.

5. **The Bank is discussing with the Government the following projects for FY07**:

- The **Productivity and Job Creation Project** for US$15 million will support Government initiatives to increase productivity and job creation through both facilitating access to financial services for micro, small and medium enterprises (MSMEs) using market-friendly mechanisms, and improving the investment climate.

- The **Community-Based Land Administration Project** for US$15 million. This project aims to establish a decentralized beneficiary-driven land distribution mechanism that allows organized landless or poor farmers to acquire suitable agricultural lands and implement investment subprojects which puts them on a sustainable, higher-income, livelihood path.

- The **Participatory Rural Investment Project II**, for US$17 million, will improve the economic opportunities of poor rural producers through co-financed productive investments generated in coordinated participatory planning processes at the community, municipal, and regional level.

- The **Secondary Education Project** for US$10 million, with the objective of supporting the Municipality of La Paz education program. It will expand secondary education coverage; improve education quality; and strength infrastructure and educational management capacity.

- The **Lake Titicaca Local Sustainable Development Project**, for US$15 million. Its objective is to improve the quality of life of the basin's residents through local development opportunities such as tourism, provision of critical infrastructure services, and protection of the Lake's long term water quality and ecological vitality.

6. **Ongoing technical assistance and economic sector work includes**:

- The **Informality** study faces an in-depth analysis of the constraints to productivity as well as the productivity differentials between informal and formal firms in selected markets. Based on this analysis and international experience, the study will provide sector specific and general policy recommendations to achieve productivity gains.

- The **Social Safety Net** study will provide analytical tools for a more effective implementation of the Government's Social Protection strategy. The study will help define target populations and programs and propose institutional arrangements, including the interface with local governments and with agencies involved in the delivery of primary health and education. This study will support the FY08 Social Protection Assistance project,

- A **Public Expenditure and Financial Accountability (PEFA)** will validate the quality and performance of Public Financial Management. The study will allow the Government to assess the condition of public expenditures, procurement and accountability systems and develop a sequence of reforms based on a common baseline of information. It will also help to coordinate donor support in promoting governance and public sector efficiency. Additionally, the exercise will permit the Government to oversight future similar programs in sub-national governments.

- An Operational **Review of the *Fondo de Inversión Productiva y Social (FPS)*** will evaluate core capabilities, operational and organizational elements required for the agency to successfully fulfill its mandate. It will also identify any gaps between the current and desired best practices, determine key risks, and deliver a set of recommendations to improve the overall performance of FPS.

APPENDIX III. BOLIVIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK [1]

1. **As of December 31, 2006, the Inter-American Development Bank (IDB) had approved loans to Bolivia amounting to US$3.93 billion, with disbursements totaling US$3.25 billion**. Bolivia's outstanding debt to the IDB was US$1.28 billion. During the first half of the decade, net cash flows to the country were mostly positive, owing in large measure to the debt relief provided by the IDB under the HIPC Initiative and the extraordinary financing disbursed in 2003. In 2006, a temporary net outflow was registered. Nonetheless, a total of US$145 million in new concessional lending was approved for Bolivia's public sector, of which a US$120 million loan to support road rehabilitation and improve the Northern Corridor Highway from La Paz to Rurrenabaque was the most significant. As of March 27, 2007, undisbursed balances amounted to US$493 million. The IDB's portfolio in Bolivia also includes active non reimbursable technical cooperation projects amounting to US$21.6 million, of which US$13.8 million is undisbursed.

2. **The Board of Governors of the IDB approved March 16, 2007, 100% debt relief for Bolivia, Guyana, Haiti, Honduras and Nicaragua, on loan balances outstanding as of December 31, 2004 from its Fund for Special Operations (FSO).** In the context of the Multilateral Debt Relief Initiative, the IDB will forgive the five HIPC beneficiary countries approximately $3.4 billion in principal payments and $1.0 billion of future interest payments. This additional relief by the Bank will be retroactive to January 1, 2007 and is intended to help beneficiary countries invest more on education, health and other quality services, to improve their living conditions and reduce poverty. Under this agreement endorsed by the Bank's shareholders, which also includes new operational guidelines for the FSO, Bolivia would receive approximately US$ 1 billion in IDB debt relief (including cancelled loan balances of-US$ 736.4 million (7% of GDP) and foregone future interest - payments-of US$307.3 million (generating annual fiscal space of more than US$18 million on average).

3. **Sustainable poverty reduction remains the overarching objective of the Bank's country strategy with Bolivia**. In pursuit of this objective, the Bank is supporting government-led efforts to overcome the country's economic and social development challenges in three main areas: (a) improving the managerial capacity and transparency of the public sector, (b) supporting productivity and employment growth; (c) providing basic social services to the poorest regions. The IDB is updating its country strategy on the basis of the new priorities established by the Morales Administration since assuming office in January, 2006 and the policy framework for the medium term laid out in its National Development Program. IDB lending to Bolivia in 2007/8 contemplates new loans amounting to approximately US$ 74 million per year. These would be subject to the newly adopted operational guidelines for the FSO that feature a performance-based allocation system and a parallel lending modality, consistent with the application of the Debt Sustainability Framework. Loans to Bolivia would continue to benefit from a high concessionality element to ensure the sustainability of the debt relief and support the achievement of the Millennium Development Goals. The proposed lending program for 2007/2008 consists of six loans

[1] Prepared by IDB staff.

totaling approximately US$156 million (in support of small impoverished rural communities (Comunidades en Acción), water services, transport infrastructure, development banking and institutional strengthening in the public sector). The Bank is supporting the country in emergency clean up, impact evaluation, rehabilitation and disaster prevention and protection of public infrastructure at risk with a menu of instruments, including activation of a previous approved emergency loan in response to the damage caused by recent intense rains and flooding in the country.

4. **The backdrop for the strategy's implementation remains complex, characterized by a widespread reorientation of the reform process, need for continued fiscal consolidation, weak policy implementation and institutional capacity and an over-arching political agenda** dominated by the constituent assembly and the referendum for regional autonomy. In this context, the update of the country strategy is being conceived as a process in which the Bank, in concert with the Government and other development partners, (i) remains engaged in areas of high priority to attenuate economic risks and preserve the social gains of the last decade (pension and tax administration, microfinance), (ii) continues cooperating with the administration in improving planning, budgeting and the ongoing fiscal decentralization process, and (iii) sharpens the focus of its assistance on local/rural development (concentrating on municipalities with productive potential) and the provision of productive infrastructure. The Bank expects to conclude preparation of a new transitional strategy in the second half of 2007.

APPENDIX IV. BOLIVIA: STATISTICAL ISSUES

The timeliness and coverage of economic statistics is generally adequate for surveillance purposes. A data ROSC mission in early 2007 confirmed advances in recent years, and reiterated the existence of shortcomings that may hamper the formulation of appropriate policies. National agencies responsible for the dissemination of statistics post data on the Internet. Bolivia has participated in the GDDS since November 2000 and plans to subscribe to the SDDS are at an advanced stage.

I. REAL SECTOR

- **National accounts**. The INE has begun a thorough revision of the national accounts statistics, including the base year and intensified implementation of the *SNA 1993*. This process is expected to be completed over the next three years. Efforts to improve the quality of the real sector statistics have been hampered by an inadequate statistical law and insufficient resources to undertake censuses and surveys such as those on manufacturing, foreign direct investment, and tourism.

- **Labor market.** The quality of the household and employment surveys has deteriorated in the last few years, due mainly to financial constraints. The quarterly employment survey was discontinued in 2003, leading to a lack of quarterly information on unemployment, employment and wages.

- **Prices.** The consumer price index (CPI) covering the four largest cities has a base year of 1991. A household budget survey was conducted over a 12-month period that began in June 2, 2003 to update the CPI base year. Industrial producer price indices and external trade unit values are compiled by INE, but are in need of revision as regards their coverage, product breakdown, and base year (1990=100).

II. FISCAL SECTOR

- **The Ministry of Finance (MoF) provides timely information on revenue, current and investment spending, and financing for the consolidated general government (central government and decentralized entities), public enterprises and the central bank, with appropriate disaggregation, on a monthly basis**. The MoF also provides annual data to STA on the operations of the consolidated central government, and regional and local governments for publication in *Government Finance Statistics Yearbook*. However, these data do not cover all operations of decentralized agencies and operations channeled through special funds. The ongoing implementation of a comprehensive financial management system, with funding from the IDB, will help ensure proper monitoring of public sector financial operations including local debt and social spending.

III. External Sector

- **The Central Bank of Bolivia (BCB) provides data on balance of payments and international investment position statistics to STA for publication in the *Balance of Payments Statistics Yearbook* and the *International Financial Statistics (IFS)*.** The classification of accounts is broadly in accordance with the fifth edition of the *Balance of Payments Manual*. Although quarterly balance of payments data are available before the end of the year, these data are submitted to STA only once a year. The BCB also provides monthly trade data to the Fund, but the import data are only available with a lag. Upon request, Fund staff has access to more detailed and timely balance of payments and debt data.

- **The authorities are working on a data base on gross flows of short and medium-term private debt**. However, there is some concern about the quality of private capital flows as the foreign direct investment survey was discontinued in the third quarter of 2004. As identified by the January 2007 Data ROSC mission, the coverage of certain services and financial transactions in the balance of payments needs to be expanded.

- Although not yet an SDDS subscribing country, Bolivia is disseminating the Data Template on International Reserves and Foreign Currency Liquidity.

IV. Monetary Sector

- **Coverage, sectorization, and timeliness of monetary statistics are now broadly in line with the *Monetary and Financial Statistics Manual*.** Monetary data are based on the balance sheets of the central bank, commercial banks, credit unions, savings and loans associations, and private investment funds. The survey will be expanded to cover also the investment funds managing societies (SAFIS). A STA mission in April 2006 found weaknesses in data provided by deposit institutions, particularly regarding sectorization of the accounts, which were subsequently addressed through revisions in the report forms and the instructions issued by the Superintendency of Banks and Financial Entities.

- **The BCB has started the process to compile a monthly survey on the other financial corporations, with data from pension funds, insurance corporations, *Nacional Financiera Boliviana* (NAFIBO), and *Fondo de Desarrollo del Sistema Financiero* (FONDESIF).** This survey will help improve the quarterly flow of funds accounts currently compiled by the BCB and will be the first step in the production of a balance sheet approach matrix.

BOLIVIA: INDICATORS REQUIRED FOR SURVEILLANCE

(As of June 8, 2007)

	Date of latest observation	Date received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of publication[1]
Exchange Rates	Jun. 2007	Jun. 2007	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Jun. 2007	Jun. 2007	D	D	M
Reserve/Base Money	Apr. 2007	Apr. 2007	M	M	M
Broad Money	Apr. 2007	Apr. 2007	M	M	M
Central Bank Balance Sheet	Apr. 2007	Apr. 2007	M	M	M
Consolidated Balance Sheet of the Banking System	Apr. 2007	Apr. 2007	M	M	M
Interest Rates[3]	Jun. 2007	Jun. 2007	W	W	M
Consumer Price Index	May 2007	Jun. 2007	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] – General Government[5]	Apr. 2007	May 2007	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]– Central Government[6]	n/a	n/a	n/a	n/a	n/a
Stocks of Non Financial Public Sector-Guaranteed Debt[7]	Apr. 2007	May 2007	M	M	M
External Current Account Balance	Mar. 2007	May 2007	Q	Q	Q
Exports and Imports of Goods and Services[8]	Mar. 2007	May 2007	M	M	M
GDP/GNP	Dec. 2006	Apr. 2007	Q	Q	Q
Gross External Debt	Apr. 2007	May 2007	M	M	M

[1] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[3] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Bolivia does not compile central government fiscal data.
[7] Including currency and maturity composition.
[8] Monthly frequency for goods only.

INTERNATIONAL MONETARY FUND

BOLIVIA

External and Public Debt Sustainability Analysis

Prepared by the staff of the International Monetary Fund[1]

Approved by Caroline Atkinson and Michael T. Hadjimichael

June 27, 2007

The sustainability of Bolivia's public debt has improved substantially as a result of the MDRI—which has granted stock debt relief equivalent to about 25 percent of the GDP—and the shift into an overall fiscal surplus since 2006. Debt ratios are currently at very manageable levels, with ample margins with respect to risk thresholds, and may be expected to decline further over the long run under baseline policies. Given that the remaining stocks of both domestic and foreign debt are of long maturities, debt service is also projected to remain low. The declining path of the debt ratio displays an inflexion under standard stress tests and an alternative scenario of lower oil prices, but would still remain within sustainable bounds in the long run.

1. **Bolivia's public debt (external and domestic) decreased significantly since the last Article IV consultation thanks to lower fiscal financing needs and the delivery of the latest installment of the MDRI by the Inter American Development Bank (IADB) for US$ 1.2 billion**. The outlook for the nominal public debt-to-GDP ratio—currently at the 35 percent level, down from 70 percent in 2005—is very favorable as it is projected to decline gradually to 16 percent during the DSA's projection period. Similarly the NPV of debt-to-GDP ratio is projected to reach levels below 15 percent, compared to 33 percent at present. Moreover, with the accumulation of deposits of the public sector in the financial system—amounting to about 17 percent of GDP at present—the solvency of the public sector measured by the net public debt (i.e., gross debt minus those deposits) has improved even more significantly and could reach very low levels during the projection period.

2. **The relief granted by the MDRI has reduced significantly Bolivia's public external debt.** The relief, amounting to US$2.9 billion, is equivalent to almost 25 percent of the GDP and has cut by more than half the public external debt to about US$2.1 billion at present (19 percent of the 2006 GDP) since end-2005. The importance of multilateral debt in

[1] Since Bolivia is an IDA blend country, this DSA was not conducted jointly with the World Bank.

the public external debt has also decreased from 90 percent to about 80 percent of total, with Corporación Andina de Fomento (CAF) remaining as the main creditor with 37 percent of total external debt. The rest of the external debt comes mainly from official sources on non-commercial terms, which limits significantly the rollover risk and makes external debt service very manageable, in particular in light of the strong export earnings from hydrocarbons and mining.

Main Assumptions

The main assumptions of the baseline scenario for the period 2007–27 are:

- Average annual real GDP growth: 5 percent until 2012, on account of agriculture recovery, and mining and hydrocarbons expected project implementation, and 4 percent during 2013–27.
- Average inflation: 5 percent per year, in line with recent history and medium term expectations.
- Export growth: 8 percent until 2012 due to expected developments in the natural gas sector (notably, as specified below, increase in exports to Argentina), and 4½ percent afterwards.
- Import growth: 10 percent in the 2007–12 period as some of the expected investment projects have a significant imported content. Average of 4 percent per year in the long term.
- Natural gas price: contract prices until 2012 moving consistently with WEO projections, and for the period 2013–27 constant in real terms at US$5 dollars per thousand cubic feet.
- Natural gas volumes: growing within current capacity levels until 2010 (average of 35 million of cubic meters per day), increasing early in the next decade to reflect expected additional natural gas exports to Argentina, up to 60 million of cubic meters per day, stable after 2013.
- FDI: in line with expected investments for the hydrocarbons and mining sectors.
- The profile of the average concessionality of the public sector borrowing is projected to evolve in line with the existing official loans in the pipeline. Over the longer run, concessionality is expected to decrease gradually.
- The evolution of domestic public debt is consistent with the path for the overall fiscal balance and available domestic financing.

3. **Given Bolivia's overall macroeconomic outlook, its external debt is expected to remain sustainable throughout the projection period**. In the 20-year projections, the fiscal position shifts from overall surpluses between 1 and 2 percent of GDP in the period 2007–12 to small surpluses of about 0.5 percent of GDP in the outer years of the projection—reflecting among other things declining hydrocarbons-based revenues in relation to GDP. Nevertheless, the overall performance under baseline assumptions yields very manageable indebtedness and debt service levels. Thus, the stock of total public and private external

debt-to-GDP ratio is expected to fall to about 24 percent by 2012 and stabilize at the range of 15 percent by 2027. At the same time, while the composition of public external debt is expected to gradually shift into less concessional sources over time, the NPV of debt-to-GDP ratio would reach single digits by 2027.[2] Consequently, Bolivia's risk of debt distress is low.[3] This outcome holds even under significant stress tests.

4. **The standard stress testing shows that Bolivia's favorable external debt situation is fairly resilient to severe exogenous shocks (Table 2)**. The NPV of debt-to-GDP ratio deteriorates most under the simulation based on historical averages. Since such averages reflect the crisis period of 2002–03 (when the primary fiscal deficit reached over 6 percent of the GDP) and incorporate only partially the recent development of natural gas exports, the simulated debt ratio approaches the LIC DSA thresholds by the end of the projection period. All stress tests also lead to higher but stabilizing ratios, below levels considered risky. Flow indicators also remain manageable under most of the stress tests, except under the historical trends simulation, which results in a return to still sustainable but very high debt levels.[4]

5. **However, the outlook for public debt sustainability could be less favorable under a scenario of significantly lower energy prices**. An alternative scenario based on lower oil prices (by 30 percent compared to baseline), starting in 2008, would show a deterioration in the fiscal position throughout most of the projection period. However, since public sector deposits now stand at 17 percent of GDP, the impact should be seen mostly in the path of net public debt, as the authorities could finance the fiscal deficits by drawing from those deposits up to a point, and only then resorting to new borrowing. Such alternative scenario would diverge from the baseline net public debt-to-GDP ratio by up to about 18 percent of GDP by 2027 (Figure 1). Similar effects could also be observed under a scenario of disruption in hydrocarbons production, or in case of a delayed implementation of the new natural gas production/pipeline projects to enable increased exports to Argentina.

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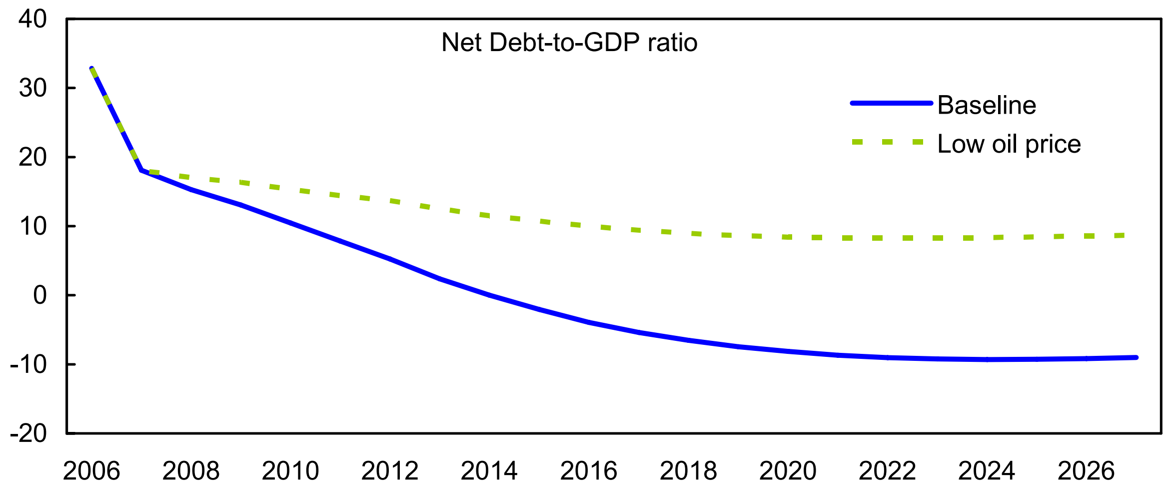
[2] Residuals shown on Table 1 are explained by the significant reserve accumulation expected during the projection period due to the strength of the balance of payments.

[3] The World Bank's 3-year average IDA Resource Allocation Index (IRAI) classifies Bolivia as a medium performer with respect to the overall quality of its macroeconomic policies and the related risk thresholds on NPV of debt-to-GDP and debt-to-exports ratios (40 and 150 percent, respectively) leave the country's current levels with significant safety margins.

[4] The historical test has been estimated on the basis of 5-year averages to leave out the extremely volatile years of the recent past. At the same time, for FDI we take only the average of the last four years to avoid an extremely positive bias due to the significant investments in hydrocarbons in the early years of this decade.

Figure 1. Bolivia: Net Public and Publicly Guaranteed Debt
under the Low Oil Price Scenario, 2006-2027
(In percent)



Source: Fund staff projections and simulations.

Table 1. Bolivia: External Debt Sustainability Framework, Baseline Scenario, 2004-27 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical	Standard	Projections									
	2004	2005	2006	Average 2/	Deviation 2/	2007	2008	2009	2010	2011	2012	Avg. Dec. 2007	2017	2027	Avg. 2013-27
External debt (nominal) 1/	**67.9**	**64.7**	**40.2**			**29.4**	**27.7**	**26.3**	**24.9**	**24.3**	**24.2**		**19.7**	**13.0**	
Of which: public and publicly guaranteed (PPG)	57.3	52.3	28.9			19.5	18.8	18.2	17.6	17.4	17.6		15.0	10.6	
Change in external debt	-7.1	-3.2	-24.5			-10.8	-1.7	-1.4	-1.3	-0.7	-0.1		-0.8	-0.6	
Identified net debt-creating flows	-10.6	-8.3	-24.1			-12.2	-8.5	-6.5	-7.4	-8.4	-9.0		-8.4	-6.5	
Non-interest current account deficit	-5.5	-8.4	-13.7	-1.3	6.7	-10.8	-9.7	-7.5	-6.7	-6.4	-6.6		-6.9	-5.7	-6.5
Deficit in balance of goods and services	-2.6	-4.4	-7.7			-5.5	-4.6	-2.5	-2.0	-1.8	-2.2		-4.2	-4.0	
Exports	29.1	34.7	38.2			36.1	35.7	32.5	32.7	33.5	35.1		32.1	26.3	
Imports	26.5	30.3	30.6			30.6	31.1	29.9	30.7	31.6	32.9		27.8	22.3	
Net current transfers (negative = inflow)	-5.6	-6.2	-7.3	-5.3	1.0	-5.9	-5.6	-5.2	-4.7	-4.5	-4.4		-2.7	-1.7	-2.5
Of which: official	-3.7	-3.2	-2.6			-1.6	-1.7	-1.5	-1.3	-1.3	-1.2		-0.2	-0.1	
Other current account flows (negative = net inflow)	2.7	2.1	1.3			0.7	0.4	0.2	0.1	-0.1	-0.1		0.0	0.0	
Net FDI (negative = inflow)	-0.7	3.0	-2.2	-5.7	5.2	-1.9	0.9	0.6	-1.0	-2.1	-2.6		-1.9	-1.0	-1.6
Endogenous debt dynamics 3/	-4.5	-2.8	-8.3			0.5	0.4	0.4	0.2	0.1	0.2		0.4	0.2	
Contribution from nominal interest rate	1.6	1.9	1.9			1.9	1.8	1.7	1.6	1.5	1.5		1.2	0.7	
Contribution from real GDP growth	-2.9	-2.6	-2.5			-1.4	-1.4	-1.3	-1.4	-1.4	-1.2		-0.8	-0.5	
Contribution from price and exchange rate changes	-3.2	-2.2	-7.7			...	...	...	...	...	...		...	...	
Residual (3-4) 4/	**3.6**	**5.0**	**-0.4**			**1.4**	**6.8**	**5.1**	**6.1**	**7.7**	**8.9**		**7.6**	**5.9**	
Of which: exceptional financing	-0.1	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 5/	...	...	32.3			25.9	24.4	23.2	22.1	21.5	21.4		18.0	12.1	
In percent of exports	...	...	84.5			71.7	68.4	71.5	67.5	64.4	60.9		56.0	46.0	
NPV of PPG external debt	**...**	**...**	**21.0**			**16.0**	**15.6**	**15.2**	**14.7**	**14.7**	**14.8**		**13.3**	**9.7**	
In percent of exports	...	...	54.9			44.2	43.6	46.8	45.1	43.9	42.3		41.4	36.7	
In percent of government revenues	...	...	63.0			52.0	50.8	50.6	48.5	47.6	47.4		44.8	37.1	
Debt service-to-exports ratio (in percent)	18.9	16.5	12.6			11.0	9.6	9.9	9.2	8.4	7.6		7.0	5.9	
PPG debt service-to-exports ratio (in percent)	14.9	11.8	7.5			6.6	5.5	5.8	5.5	5.0	4.5		4.5	4.4	
PPG debt service-to-revenue ratio (in percent)	17.8	14.0	8.7			7.7	6.4	6.2	5.9	5.4	5.1		4.9	4.4	
Total gross financing need (billions of U.S. dollars)	0.0	0.0	-1.2			-1.1	-0.8	-0.6	-0.8	-1.0	-1.2		-1.7	-2.5	
Non-interest current account deficit that stabilizes debt ratio	1.6	-5.2	10.8			0.0	-8.0	-6.0	-5.3	-5.8	-6.5		-6.2	-5.2	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.2	4.0	4.6	3.0	1.4	4.0	5.5	5.3	5.7	5.9	5.3	5.3	4.0	4.0	4.0
GDP deflator in US dollar terms (change in percent)	4.5	3.3	13.4	1.6	6.4	9.6	6.5	4.8	3.7	1.1	-0.7	4.2	2.7	2.7	2.7
Effective interest rate (percent) 6/	2.4	3.0	3.5	2.8	0.4	5.3	6.9	6.7	6.6	6.5	6.4	6.4	6.3	5.6	6.2
Growth of exports of G&S (US dollar terms, in percent)	30.6	28.0	31.0	19.1	12.6	7.7	10.9	0.3	10.3	9.6	9.7	8.1	3.9	5.1	4.8
Growth of imports of G&S (US dollar terms, in percent)	13.8	22.9	19.9	8.6	10.4	14.1	14.1	6.1	12.4	10.2	8.8	11.0	3.5	4.6	4.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	4.0	4.6	5.0	5.2	5.2	5.2	4.9	3.9	1.8	3.3
Aid flows (in billions of US dollars) 7/	0.5	0.4	0.4			0.4	0.3	0.3	0.3	0.3	0.3		0.4	0.5	
Of which: Grants	0.2	0.2	0.2			0.2	0.2	0.2	0.2	0.2	0.2		0.3	0.3	
Of which: Concessional loans	0.2	0.2	0.1			0.2	0.1	0.1	0.1	0.1	0.1		0.1	0.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.6	1.5	1.3	1.2	1.2	1.2		1.1	0.7	1.1
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			35.6	37.0	39.0	39.7	40.1	41.1		44.1	38.9	45.6
Memorandum items:															
Nominal GDP (billions of US dollars)	8.8	9.5	11.2			12.8	14.4	15.9	17.4	18.6	19.5		27.0	52.1	
(NPVt-NPVt-1)/GDPt-1 (in percent)						1.9	1.5	1.2	1.0	1.0	0.8	1.2	0.5	0.3	0.5

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
3/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
4/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
5/ Assumes that NPV of private sector debt is equivalent to its face value.
6/ Current-year interest payments divided by previous period debt stock.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the NPV of new debt).

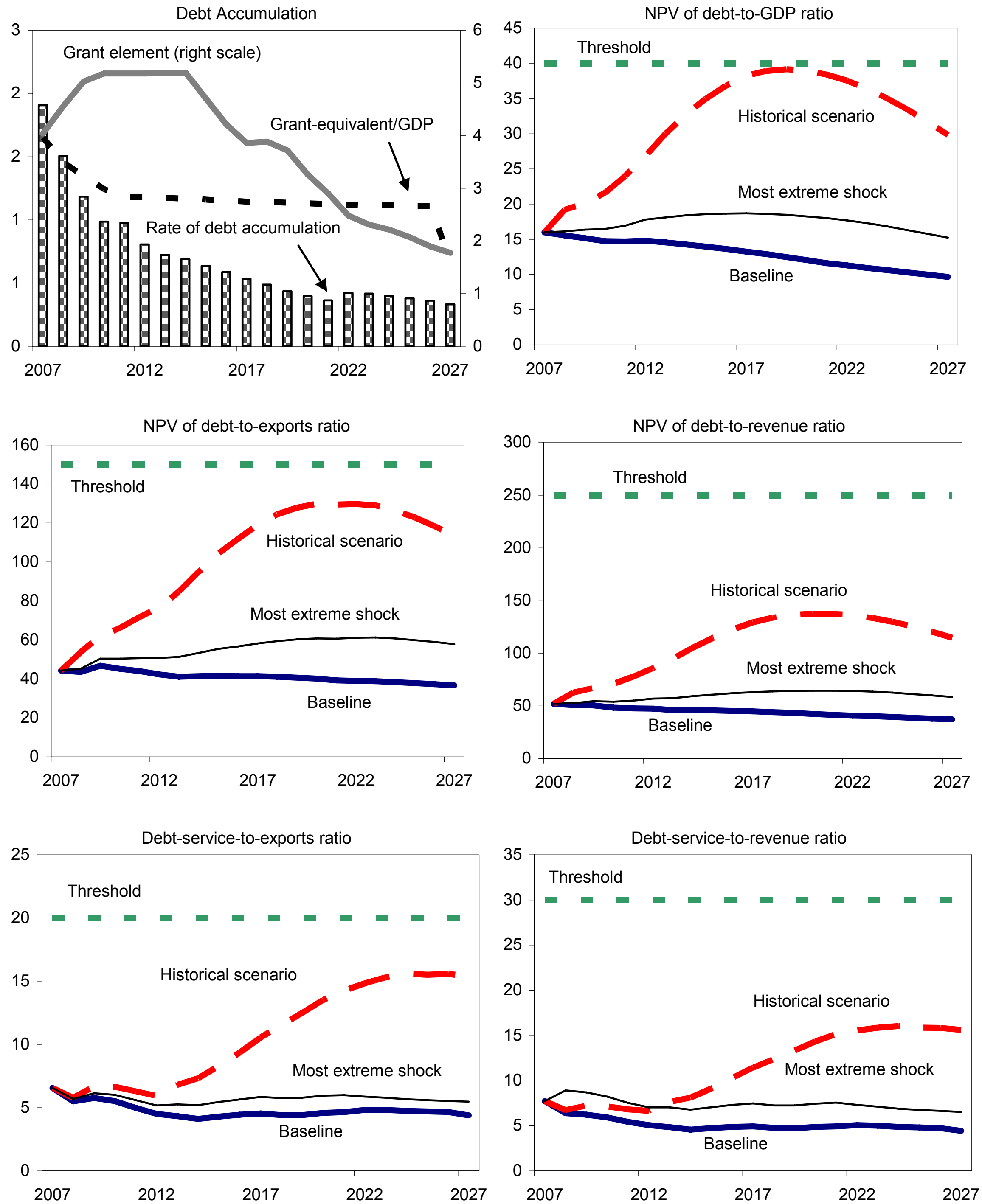
Table 2. Bolivia: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2007-27
(In percent)

	Projections							
	2007	2008	2009	2010	2011	2012	2017	2027
NPV of debt-to-GDP ratio								
Baseline	16	16	15	15	15	15	13	10
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	16	19	20	22	24	27	38	30
A2. New public sector loans on less favorable terms in 2008-27 2/	16	16	16	16	17	18	19	15
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	16	16	16	16	15	16	14	10
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	16	16	13	13	13	13	12	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	16	17	18	18	18	18	16	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	16	17	18	18	18	18	15	10
B5. Combination of B1-B4 using one-half standard deviation shocks	16	18	17	16	16	16	15	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	16	22	21	21	20	21	18	13
NPV of debt-to-exports ratio								
Baseline	44	44	47	45	44	42	41	37
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	44	54	62	66	72	77	119	113
A2. New public sector loans on less favorable terms in 2007-26 2/	44	45	50	50	51	51	58	58
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	44	44	47	45	44	42	41	37
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	44	45	38	36	35	34	35	33
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	44	44	47	45	44	42	41	37
B4. Net nondebt creating flows at historical average minus one standard deviation in 2008-09 4/	44	48	56	54	52	50	47	38
B5. Combination of B1-B4 using one-half standard deviation shocks	44	47	41	39	38	37	36	34
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	44	44	47	45	44	42	41	37
NPV of debt-to-revenue ratio								
Baseline	52	51	51	48	48	47	45	37
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	52	63	67	71	78	86	129	115
A2. New public sector loans on less favorable terms in 2007-26 2/	52	53	55	54	55	57	63	59
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	52	52	53	51	50	50	47	39
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	52	52	44	42	41	41	40	36
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	52	56	61	58	57	57	54	45
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	52	56	61	58	57	57	51	39
B5. Combination of B1-B4 using one-half standard deviation shocks	52	59	56	53	53	52	50	43
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	52	71	70	67	66	66	62	52
Debt service-to-exports ratio								
Baseline	7	5	6	6	5	5	5	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	7	6	7	7	6	6	11	15
A2. New public sector loans on less favorable terms in 2008-27 2/	7	6	6	6	6	5	6	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	7	5	6	6	5	5	5	5
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	7	6	5	5	4	4	4	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	7	5	6	6	5	5	5	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	7	5	6	6	5	5	6	5
B5. Combination of B1-B4 using one-half standard deviation shocks	7	6	5	5	5	4	4	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	7	5	6	6	5	5	5	5
Debt service-to-revenue ratio								
Baseline	8	6	6	6	5	5	5	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	8	7	7	7	7	7	11	16
A2. New public sector loans on less favorable terms in 2008-27 2/	8	7	7	6	6	6	6	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	8	7	7	6	6	5	6	5
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	8	6	6	6	5	5	5	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	8	7	8	7	7	6	6	6
B4. Net nondebt creating flows at historical average minus one standard deviation in 2008-09 4/	8	6	6	6	6	5	6	5
B5. Combination of B1-B4 using one-half standard deviation shocks	8	7	7	7	6	6	6	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	8	9	9	8	8	7	7	7
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	1	1	1	1	1	1	1	1

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 2. Bolivia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2007-2027



Source: Staff projections and simulations.

Table 3. Bolivia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2007-2027
(In percent of GDP, unless otherwise indicated)

	Actual			Historical	Standard	Projections									
	2004	2005	2006	Average 1/	Deviation 1/	2007	2008	2009	2010	2011	2012	Average 2007-12	2017	2027	Average 2013-27
Public sector debt 2/	76.7	70.0	45.8			34.7	33.4	32.4	31.0	30.1	29.6		24.7	16.3	
Of which: foreign-currency denominated	67.9	62.1	39.0			27.6	26.1	25.0	23.9	23.3	23.3		20.5	14.5	
Change in public sector debt	2.6	-6.7	-24.2			-11.1	-1.3	-1.0	-1.4	-0.9	-0.6		-1.0	-0.7	
Identified debt-creating flows	-2.9	-5.3	-15.5			-6.5	-4.6	-4.0	-4.3	-3.9	-3.5		-3.3	-1.5	
Primary deficit	2.6	-0.8	-7.2	1.7	3.7	-3.4	-3.2	-3.2	-3.6	-3.8	-3.9	-3.5	-3.1	-1.2	-2.5
Revenue and grants	26.8	31.3	35.2			32.3	32.0	31.3	31.6	31.9	32.3		30.6	27.1	
Of which: grants	2.5	2.2	1.9			1.6	1.4	1.2	1.1	1.0	1.0		1.0	1.0	
Primary (noninterest) expenditure	29.4	30.5	28.0			28.9	28.8	28.0	28.0	28.1	28.4		27.5	25.8	
Automatic debt dynamics	-4.3	-3.5	-8.3			-3.1	-1.4	-0.7	-0.7	-0.1	0.4		-0.2	-0.3	
Contribution from interest rate/growth differential	-3.0	-2.2	-2.8			-0.4	-0.2	-0.1	-0.3	-0.4	-0.3		-0.1	-0.2	
Of which: contribution from average real interest rate	-0.1	0.8	0.3			1.4	1.6	1.6	1.4	1.4	1.3		0.9	0.5	
Of which: contribution from real GDP growth	-3.0	-3.0	-3.1			-1.8	-1.8	-1.7	-1.7	-1.7	-1.5		-1.0	-0.7	
Contribution from real exchange rate depreciation	-1.3	-1.3	-5.4			-2.7	-1.2	-0.7	-0.4	0.2	0.6		...	...	
Other identified debt-creating flows	-1.3	-1.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-1.3	-1.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	5.6	-1.4	-8.7			-4.6	3.4	2.9	2.9	3.0	3.0		2.4	0.8	
NPV of public sector debt	...	44.8	40.2			33.9	32.5	31.3	29.9	28.9	28.2		22.5	14.1	
Of which: foreign-currency denominated	...	36.9	33.4			26.8	25.2	23.9	22.7	22.2	21.9		18.4	12.3	
Of which: external	...	22.3	21.0			16.0	15.6	15.2	14.7	14.7	14.8		13.3	9.7	
NPV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	14.9	12.2	0.7			2.6	2.3	3.6	2.9	2.3	1.8		1.2	1.3	
NPV of public sector debt-to-revenue and grants ratio (in percent)	...	143.1	114.1			104.9	101.5	100.2	94.7	90.8	87.4		73.6	52.2	
NPV of public sector debt-to-revenue ratio (in percent)	...	153.8	120.6			110.5	106.1	104.4	98.2	93.8	90.2		76.1	54.2	
Of which: external 4/	...	76.7	63.0			52.0	50.8	50.6	48.5	47.6	47.4		44.8	37.1	
Debt service-to-revenue and grants ratio (in percent) 5/	35.1	31.8	20.0			17.5	16.8	16.9	15.9	14.6	13.5		11.1	7.7	
Debt service-to-revenue ratio (in percent) 5/	38.7	34.2	21.1			18.4	17.5	17.6	16.4	15.1	14.0		11.5	8.0	
Primary deficit that stabilizes the debt-to-GDP ratio	0.0	5.9	17.0			7.7	-2.0	-2.2	-2.2	-2.9	-3.3		-2.1	-0.5	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.2	4.0	4.6	3.1	1.5	4.0	5.5	5.3	5.7	5.9	5.3	5.3	4.0	4.0	4.0
Average nominal interest rate on forex debt (in percent)	4.7	3.6	3.7	4.1	0.6	6.0	7.6	7.4	7.3	7.3	7.3	7.1	6.5	5.4	6.3
Average real interest rate on domestic currency debt (in percent)	-4.2	5.1	-2.2	-3.1	4.4	-2.5	1.5	4.1	2.8	2.7	1.7	1.7	-0.1	-0.7	-0.2
Real exchange rate depreciation (in percent, + indicates depreciation)	-2.5	-2.0	-9.1	1.2	5.5	-7.0	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	8.5	4.6	12.2	5.7	3.3	7.4	4.4	2.6	3.7	3.1	3.4	4.1	4.5	4.5	4.5
Growth of real primary spending (deflated by GDP deflator, in percent)	4.5	8.6	-4.0	4.5	6.5	7.4	4.9	2.4	5.7	6.3	6.4	5.5	3.5	3.4	3.3
Grant element of new external borrowing (in percent)	...	...	...	...	...	4.0	4.6	5.0	5.2	5.2	5.2	4.9	3.9	1.8	...

Sources: Bolivian authorities; and Fund staff estimates and projections.
1/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
2/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]
3/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
4/ Revenues excluding grants.
5/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

Table 4. Bolivia: Sensitivity Analysis for Key Indicators of Public Debt 2007-2027

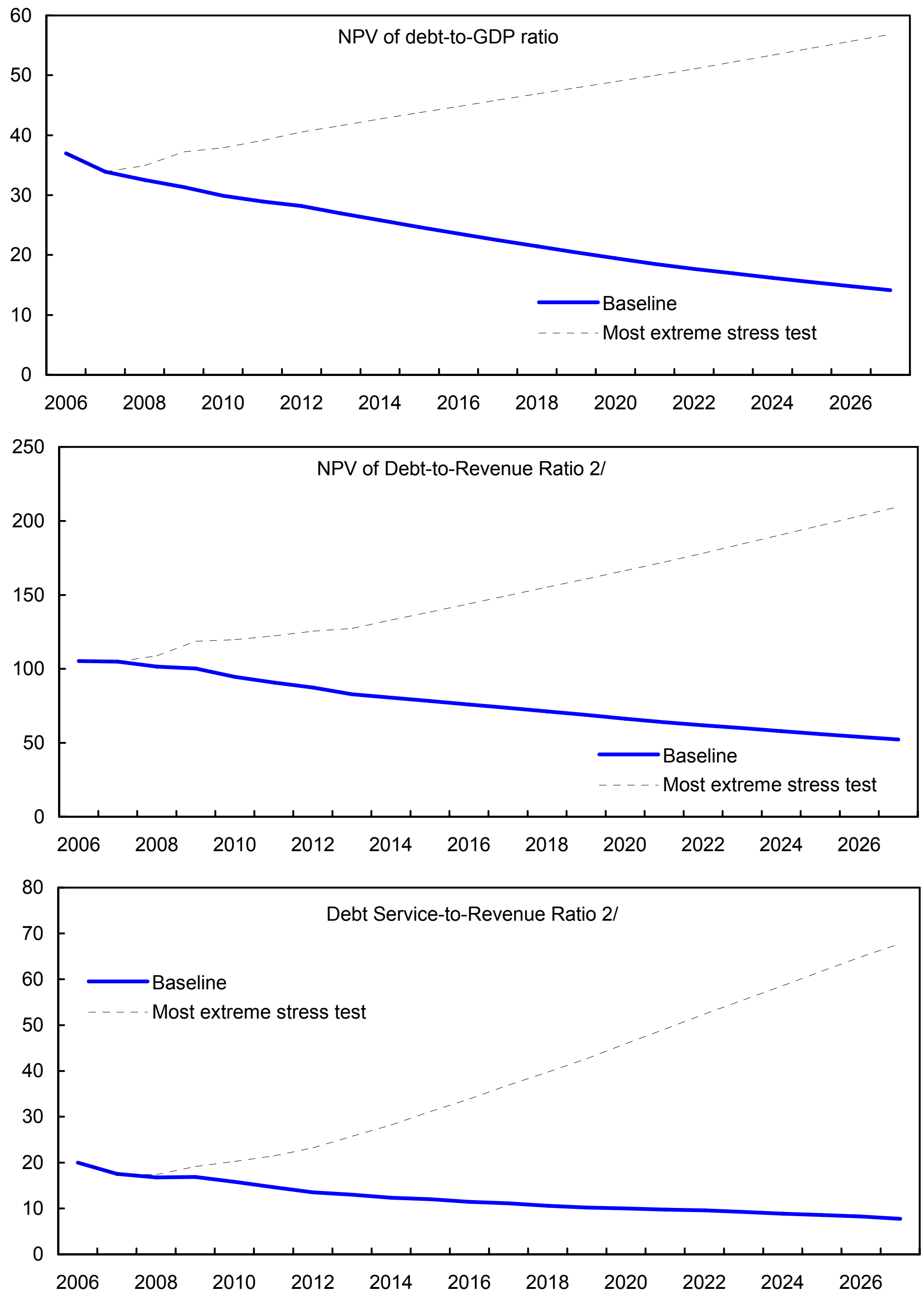
	Projections							
	2007	2008	2009	2010	2011	2012	2017	2027
NPV of Debt-to-GDP Ratio								
Baseline	34	33	31	30	29	28	23	14
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	34	38	43	48	53	59	85	122
A2. Primary balance is unchanged from 2007	34	33	32	31	31	31	29	9
A3. Permanently lower GDP growth 1/	34	33	32	31	30	30	29	35
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008-2009	34	35	37	38	39	41	46	57
B2. Primary balance is at historical average minus one standard deviations in 2008-2009	34	41	48	47	45	44	38	30
B3. Combination of B1-B2 using one half standard deviation shocks	34	40	47	46	44	44	38	29
B4. One-time 30 percent real depreciation in 2008	34	44	42	40	40	39	34	27
B5. 10 percent of GDP increase in other debt-creating flows in 2008	34	43	41	40	38	38	32	23
NPV of Debt-to-Revenue Ratio 2/								
Baseline	105	102	100	95	91	87	74	52
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	105	119	137	151	167	183	276	445
A2. Primary balance is unchanged from 2007	105	102	102	98	96	96	93	35
A3. Permanently lower GDP growth 1/	105	102	102	97	95	93	94	127
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008-2009	105	109	119	120	122	125	150	210
B2. Primary balance is at historical average minus one standard deviations in 2008-2009	105	128	155	148	142	138	126	110
B3. Combination of B1-B2 using one half standard deviation shocks	105	126	150	144	139	135	125	108
B4. One-time 30 percent real depreciation in 2008	105	136	135	128	124	121	111	99
B5. 10 percent of GDP increase in other debt-creating flows in 2008	105	133	132	125	120	116	104	85
Debt Service-to-Revenue Ratio 2/								
Baseline	18	17	17	16	15	14	11	8
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	18	17	22	27	33	40	82	160
A2. Primary balance is unchanged from 2007	18	17	17	16	16	15	19	4
A3. Permanently lower GDP growth 1/	18	17	17	16	15	15	17	34
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008-2009	18	17	19	20	21	23	37	68
B2. Primary balance is at historical average minus one standard deviations in 2008-2009	18	17	24	32	34	35	33	32
B3. Combination of B1-B2 using one half standard deviation shocks	18	17	24	30	31	32	31	30
B4. One-time 30 percent real depreciation in 2008	18	18	20	19	19	18	20	23
B5. 10 percent of GDP increase in other debt-creating flows in 2008	18	17	25	26	27	27	24	21

Sources: Bolivian authorities; and Fund staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection pe

2/ Revenues are defined inclusive of grants.

Figure 2. Bolivia: Indicators of Public Debt Under Alternative Scenarios, 2006-2027 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2017.
2/ Revenue including grants.

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IMF Executive Board Concludes 2007 Article IV Consultation with Bolivia

On July 13, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bolivia.[1]

Background

The economy has continued to benefit from rising natural gas export volumes, which has been compounded, over the last two years, by high hydrocarbons and mining export prices. Real GDP growth has been around 4–4½ percent, mainly driven by an expansion in hydrocarbons and mining-related activities. The external current account has recorded large surpluses, and net international reserves have risen to historically high levels. The fiscal position has improved sharply and—reflecting also debt relief under the Multilateral Debt Relief Initiative (MDRI)—Bolivia's public debt has declined markedly. Financial sector stability has improved, with comfortable levels of liquidity and full net foreign assets (NFA) coverage of deposits, although vulnerabilities remain. The key economic trends of the past year are projected broadly to continue in the period ahead, although with a somewhat lower fiscal surplus.

However, inflation has picked up in recent months, due in part to negative supply shocks but also to rapid monetary expansion. While part of the recent price increases has been associated with floods and one-time adjustments in some administered prices, both core and headline inflation have displayed an upward trend since the last quarter of 2006, driven by higher prices of nontradable goods and services. The Central Bank has responded to rising price pressures

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

by increasing its open market operations and by appreciating the Boliviano against the U.S. dollar under the crawling peg regime.

Significant changes in hydrocarbons policy have been implemented over the last two years, resulting in a higher government tax take and a greater public sector role in the sector. Following a national referendum in August 2004, a new hydrocarbons law was enacted in May 2005 and a related decree issued in May 2006. The main effects of the new legislation have been: (a) a "migration" of the contracts with the foreign companies operating in Bolivia, from risk-sharing contracts to an arrangement whereby all production is surrendered to the state energy company YPFB, which has been made the country's sole exporter of natural gas; (b) a permanent increase in natural gas royalties, from 18 percent to 50 percent of turnover; and (c) a requirement that YPFB regain control over the five hydrocarbons companies that were privatized in the 1990s.

Following a boom in the late 1990s, which included large-scale privatization, private investment levels in Bolivia have been depressed in the past few years. While there has been significant FDI in the mining sector and public sector investment has increased, this has not been enough to overcome the fall in other private investment, notably in foreign hydrocarbons-related investment. As a result, Bolivia's overall investment-to-GDP ratio, as well as the share of private investment in total investment, are among the lowest in the region.

Even though social indicators have improved in recent years, Bolivia's levels of poverty and inequality are persistently high. In 2005, extreme poverty amounted to 37 percent of the population, while absolute poverty reached 60 percent. Also, income inequality was among the highest in the region. Although Bolivia will be able to meet some of the Millennium Development Goals (e.g., child mortality, maternal health, gender equality, and water and sanitation), achievement of other goals by 2015, such as those of eliminating extreme poverty and universal primary education, remains a significant challenge.

Executive Board Assessment

Executive Directors welcomed the continued strong performance of Bolivia's economy, with booming hydrocarbon and mining exports contributing to rapid accumulation of external reserves and a large fiscal surplus. GDP growth has been satisfactory; inflation remains moderate, albeit with some pick-up in recent months that is partly attributable to exogenous shocks; and the public debt has declined because of debt relief and an active debt management strategy.

Directors noted, however, that poverty remains high in Bolivia, in part because of the limited employment impact of growth in the hydrocarbons and mining sectors. They stressed the importance of implementing policies conducive to a recovery of private investment from its low level and to a diversification of the economy, which they saw as critical for sustained economic growth and poverty reduction in the medium term. In particular, Directors highlighted the need to improve the investment climate, including through greater legal and institutional stability and maintaining a rules-based approach toward private investment. Some Directors encouraged the authorities to re-consider their decision to exit from the World Bank's investment dispute settlement framework.

Directors commended the authorities' strong emphasis on safeguarding macroeconomic stability. A key challenge in this respect is to manage the large revenues from hydrocarbon exports in a manner compatible with price stability and maintenance of export competitiveness. In light of this, Directors welcomed the authorities' commitment to maintain a fiscal surplus, which they also saw as consistent with a prudent long-term use of the hydrocarbon resources. They stressed that this will require considerable control over expenditure, including at the subnational level. They suggested that the authorities develop a realistic medium-term expenditure framework, taking into account the country's absorptive capacity.

Directors underscored that structural reforms should make the budget a more effective developmental and poverty-reducing tool. They encouraged the authorities to consider reducing the large and poorly targeted hydrocarbon subsidies, while introducing properly designed measures to protect the poor. Improvements of the tax system, intergovernmental relations, and the budget process should also be a priority. These reforms would release fiscal resources for financing development and poverty-reducing spending.

Directors noted the modest nominal appreciation of the Boliviano over the last two years under Bolivia's current exchange rate regime. Given the upward pressure on the equilibrium exchange rate stemming from the rapid growth of Bolivia's energy exports and indications that the currency may be undervalued, many Directors welcomed the authorities' intention to exercise greater exchange rate flexibility within the crawling peg regime in the period ahead. They believed that greater flexibility will also help reduce dollarization and forestall the adverse distributional impact that would result from allowing inflationary pressures to take hold. Over the medium term, this increased flexibility could be followed by a gradual and properly sequenced transition to a more flexible exchange rate regime, for which Fund technical assistance could help provide a roadmap. Some Directors, however, expressed concern about a move toward greater exchange rate flexibility, pointing to the impact on competitiveness of the non-hydrocarbon sectors of a currency appreciation, as well as to balance-sheet, inflation, and dollarization risks that would arise from increased volatility under a more flexible exchange rate system. Directors also encouraged the authorities to use open market operations more actively to tighten monetary conditions and reduce inflationary pressures.

Directors commended the authorities' success in maintaining financial stability, while encouraging further action to implement the 2003 Financial Sector Assessment Program recommendations in order to address remaining vulnerabilities. Key issues include closer monitoring of banks' loan provisioning and solvency; introducing prudential regulations to mitigate credit and market risks, particularly credit risks arising from dollarization; amending the legislation governing corporate bankruptcy and restructuring; strengthening the Financial Intelligence Unit and legislation against money laundering; and elimination of the financial transactions tax because of its adverse effect on financial development. Directors welcomed the authorities' intention to subject the recently created development bank to standard prudential requirements, while stressing the need to prevent undue competition with the microfinance sector.

In the hydrocarbons sector, Directors considered that the new operating contracts with the foreign energy companies constitute an important step towards a more favorable investment climate. However, they observed that the authorities now face the challenge of securing the major additional investments that will be needed to fulfill their export commitments to Argentina while satisfying rising local demand. Directors encouraged the authorities to continue to seek mutually acceptable arrangements with foreign investors.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Bolivia: Selected Economic Indicators

					Proj.
	2003	2004	2005	2006	2007
(Annual percentage changes)					
Income and prices					
Real GDP	2.7	4.2	4.0	4.6	4.0
GDP deflator	6.3	8.0	5.1	12.2	7.4
CPI inflation (period average)	3.3	4.4	5.4	4.3	6.6
CPI inflation (end-of-period)	3.9	4.6	4.9	4.9	6.5
(In percent of GDP)					
Combined public sector					
Revenues and grants	24.1	26.8	31.3	35.2	32.3
Of which:					
Royalties on hydrocarbons	2.8	3.4	6.6	9.7	9.3
Expenditure	32.0	32.3	33.6	30.6	31.3
Overall balance	-7.9	-5.5	-2.3	4.6	1.0
Total public debt	74.1	76.7	70.0	45.8	34.8
External sector					
Current account	1.0	3.8	6.5	11.7	8.9
Merchandise exports	19.7	24.4	29.5	34.4	32.6
Of which: Natural gas	4.7	7.0	11.5	14.9	14.8
Merchandise imports	20.0	20.9	24.7	25.0	24.9
Gross international reserves 1/					
In millions of U.S. dollars	1,266	1,474	2,042	3,385	4,646
In percent of broad money	42.0	49.6	57.8	79.7	90.9
(Changes in percent of broad money at the beginning of the period)					
Money and credit					
NFA of the financial system	3.2	2.9	20.7	31.3	22.6
NDA of the financial system	-1.9	-4.3	-6.6	-12.9	-5.4
Of which: Credit to the private sector (in percent of GDP)	47.6	42.3	39.6	34.7	34.2
Broad money	1.3	-1.4	14.1	18.5	17.1
Interest rates (percent, end-of-period)					
Yield on treasury bills in local currency	10.9	9.6	7.9	6.4	...
Yield on treasury bills in U.S. dollars	6.2	5.8	7.4	4.0	...

Sources: Bolivian authorities; and Fund staff estimates and projections.

1/ Excludes reserves from the Latin American Reserve Fund (FLAR) and includes Offshore Liquidity Requirements (RAL).

Statement by Javier Silva-Ruete, Executive Director for Bolivia and Victor Hugo De la Barra, Advisor to Executive Director
July 13, 2007

1. We thank the staff for their assessment of the current situation in Bolivia as well as the policies suggested as a result of their appraisal, reflecting the commendable efforts of the mission staff, which we highly appreciate.

Background and Overview

2. A number of indicators confirm that Bolivia's economy showed a satisfactory performance in 2006. In fact, the GDP growth rate was 4.5 percent, which is the highest it has been since 1998. For 2007, the GDP growth rate is projected to be lower (4 percent) due to the floods in the first quarter that affected agriculture. The balance of payments attained positive results in 2006 as exports reached $3.9 billion and the trade surplus was $1.1 billion, partly due to the positive international environment reflected in higher prices for Bolivian exports. Additionally, the balance of payment was positively boosted by foreign remittances and, as a result, international reserves reached a historic record level of $3.3 billion.

3. Projections for the current account are very positive, not only because of international prices but also due to increased exports in the coming years, as the government has reached agreements in negotiating contracts with foreign oil and mining companies. In addition, in 2006, the government negotiated an increase in the price of exports of natural gas with Argentina and has since signed a new contract for additional gas exports to that country. In 2007, Bolivia also reached an agreement to modify the price of exported gas in one of the contracts signed with Brazil. Therefore, fiscal consolidation is gaining decisive footing and it will be supported by additional income from the other economic sectors.

4. The political situation of Bolivia has reached stability as the President, Evo Morales, has a high level of acceptance and popularity, as measured by recent independent polls. While sensitive political issues remain, all political parties and the population are enjoying their civil and political rights, which reflects the fully democratic environment that the current administration is engaged in. Despite unavoidable disagreements in the political arena, the government has been reasonably successful in passing important legislation.

5. The Constitutional Assembly, formed in August 2006, is still working on the new Constitution, through an ample debate and full freedom of expression. Because of the necessity to reach consensus ?to introduce social inclusion and other important changes for a sustainable political stability? the members of the Constitutional Assembly have decided to extend their sessions until December 2007. The broad

agenda of the Constitutional Assembly includes, among other issues, the autonomy of the administrative regions and both the government and parliament have supported this decision. If the Constitutional Assembly approves the modification to the structure of the main institutions of the Executive and Legislative branches (for instance, suppression of one of the chambers of the National Congress or the presidential reelection, which is not allowed under the current Constitution), the current administration might call for an early general election.

Fiscal Policy

6. Strong fiscal consolidation is being attained, in line with the goals set in the National Development Plan, approved in May 2006. The overall fiscal surplus for 2006 was 4.5 percent of GDP, which is the highest surplus in 66 years, mainly due to hydrocarbon revenue, as a result of international prices and the 2005 Hydrocarbon Law, which allows for a greater government intake from royalties and taxes. This increased intake allows the government to expand on expenses for health, education, and infrastructure. The new contracts with foreign oil companies will allow further developments in the hydrocarbons sector and boost the economy.

7. The authorities are committed to maintaining macroeconomic stability and are aiming to keep the balance of the public sector positive, while using fiscal expenditure to enhance the capacity of the economy and reduce poverty, especially in rural areas. Revenues, expenditures, and the composition of financing are all being addressed in order to get a more efficient and sustainable public sector.

8. On the revenue side, the measures implemented this year and in late 2006, together with strong GDP and export growth (mainly in gas), are expected to maintain revenue over 30 percent of GDP, supported by the recent modifications of gas export prices to Argentina and Brazil. The authorities are planning to extend the tax base by revising taxes on the gambling sector and coca leaf production. Implementing or reforming taxation on other sectors, such as the informal commerce, is under evaluation and the authorities expect to apply it gradually over the medium term. In addition, other measures on the administrative side have been implemented to enhance efficiency in tax collection and increase revenue. Among these measures are special tax audits and on-site inspections by tax officers.

9. On the expenditure side, the wage bill for top officers was reduced in 2006, which allowed a reallocation of expenditure favoring education and health. In 2007, some items on the fiscal budget were suppressed, such as the so-called "Reserves for Expenditures", which, in the past, was used to finance spending that was neither transparent nor accountable. Capital expenditure in 2007 is greater than in 2006, in accordance with the goals of the National Development Plan, which seeks to build and improve infrastructure, as well as social spending. New and existing public

investment projects have been deemed a priority, which mainly involve building roads to link regions and cities in order to facilitate production and commerce. Since the authorities are aware of the need to continue the fiscal consolidation efforts, they have taken decisive actions to improve the quality of expenditures in the medium term ?particularly those aimed at poverty reduction? as well as to identify priorities to enable targeting a high social return.

10. Regarding the expenditure of the sub-national governments, the central government has the capacity to monitor their spending through the financial accounts, in order to avoid a negative impact on the public sector balance. Moreover, these entities are subject to the rules of public sector institutions, therefore, their projected expenditures have to be included in the national budget.

11. The authorities are concerned about the current revenue sharing and expenditure allocation system that creates structural imbalances between central government and sub-national governments and undermines the scope for fiscal management. In this regard, the authorities' objective is to reduce the earmarking problem and their intention is to deposit the receipts from the difference between the new and current prices of natural exports of gas to Argentina and Brazil in a fund that will be managed by the Ministry of Finance. Additionally, the authorities expect that the Constitution would set new spending obligations for sub-national entities and, consequently, the central government will be able to reallocate resources to prioritized national projects.

12. With regard to the temporary freeze on fuel prices, while this measure may be technically considered a backward step, it is necessary in order to avoid adverse social reactions. Price increases are expected to resume after changing the energy matrix over the medium term, in order to increase natural gas domestic consumption and gradually reduce fuel subsidies and smuggling. However, it is not prudent to move into a fully "automatic" price-adjustment mechanism.

13. The reform of the pension system is still under evaluation but the authorities are fully aware of the need to preserve macroeconomic stability while finding a means to address the demands of affiliates who were affected by the pension system reform implemented in 1996 and are facing difficulties in retiring, due the new requirements established under the 1996 Pension Law.

Monetary, Exchange Rate and Financial Policies

14. The conduct of monetary policy is carefully geared towards preserving adequate liquidity conditions and monitoring inflation developments. As foreign currency inflows grew rapidly in response to higher exports and remittances, international reserves have continued to grow strongly during 2006 and 2007 and the base money has expanded. However, additional Open Market Operations (OMO), and

accumulation of public deposits at the Central Bank of Bolivia (CBB) -reflecting the complementariness between fiscal and monetary policies- along with the exchange rate appreciation have partially offset such an expansion. The base money expansion remains high, although it has been partially matched by an increase in real demand for domestic currency, which is related to the strong growth of the economy and the reduction of financial dollarization. The CBB has absorbed liquidity, mostly in domestic currency instruments and lengthening maturities, while in the past, mostly short-term foreign currency denominated securities were available for OMO. Increased placements in local currency mitigate debt-management risks, and serve as a means to reduce financial dollarization.

15. The crawling peg regime in the past has contributed to maintaining competitiveness and the small devaluations were prudent and necessary in order to preserve the health of the highly-dollarized financial system, thus the crawling peg had mainly gone towards depreciation in line with the outcomes of the current account. In the context of increasing foreign currency flows and a positive current account, the CBB reversed the crawling peg direction to appreciation from July 2005 onwards. Thus, the exchange rate regime -still a crawling peg one- also contributed to offsetting the trend in the reserve money, although it affected the competitiveness of exports. Therefore, recommendations from the staff in this regard are already being applied, and the government will exercise more exchange rate flexibility as needed to prevent inflationary pressures, in combination with other anti-inflationary measures. Being a land-locked country, which still lacks sufficient road infrastructure, Bolivia faces high costs of transportation, which harms competitiveness of its exports. In the medium term -as the external and fiscal sectors strengthen- the authorities will consider a more flexible exchange rate regime.

16. Looking forward, the authorities are conscious that the trend of growing international reserves will remain in place, therefore, in addition to appreciating the domestic currency, they are looking for a more dynamic use of OMO, as well developing a set of measures to offset the corresponding effect on the base money, in order keep inflation under control. One of these measures would be creating a new CBB security, which would be issued directly to the public. To implement this measure, the CBB is preparing a set of necessary conditions, in order to avoid unwanted outcomes. Another measure the authorities will put in place is expanding the use of bank accounts for employees (approximately 340,000), whose salaries are not yet delivered through the banking system.

17. Moreover, the authorities have decided to allow Pension Fund Administrators to increase the share of their portfolio invested abroad from 3 percent to 13 percent. This change will help to offset partly the accumulation of international reserves. If necessary, the authorities could increase that share up to 50 percent, as stated in the Pension Law. Additionally, the Central Bank will introduce higher legal reserve

requirements and adjust the policy interest rate.

18. The financial sector stability has improved as it showed positive growth in 2006 and 2007, nonperforming loans have reduced, provisions have increased, and profitability has also improved. Despite these achievements, the authorities are aware of the remaining vulnerabilities in some of the entities of the banking system and close supervision will be applied. Credit risk regulations are serving well even for those borrowers that generate revenues in domestic currency and are affected by the depreciation of the exchange rate. Additionally, the Bank's Superintendence is preparing new prudential regulations to deal with market risk and it is working on the 2003 FSAP recommendations. Financial dollarization has significantly decreased in Bolivia from 90 percent in December 2003 to 73 percent in June 2007. This evolution is a consequence of the recent developments in the real and fiscal sectors, the trend of the exchange rate, the widening of the spread between the buying and selling exchange rate, the financial transaction tax ?which is now levied only on foreign currency denominated operations? and the settling of inflation-indexed financial instruments.

Development Policy and Structural Reforms

19. Development of the hydrocarbons sector is a key factor to Bolivia's future and to attaining a sustainable reduction in poverty levels. Being aware of this, the authorities are doing their utmost to put in place a framework for the exploitation of their vast hydrocarbons reserves, allowing room for private investment, both foreign and domestic. The authorities' ultimate goal is to arrive at a framework that promotes the development of the sector, with the proper checks and balances in place to ensure a fair share of the benefits for the Bolivian people.

20. The state oil company (YPFB) is again the main player in the sector and it will be strengthened and capitalized for conducting investments, on its own or in association with friendly governments or other foreign enterprises. The finalization of negotiations and signing of new contracts between YPFB and foreign oil companies that already were operating in Bolivia shows that the government is willing to welcome foreign investment in the hydrocarbon sector as a partnership or another type of contract. This achievement has also reduced social tensions and has empowered the executive branch with the popular backing for this new framework. Foreign investment diminished in 2006, but it will expand from 2007 onwards because of the once new contracts, which allow investors a faster investment recovery; therefore, foreign investors have incentives to additional investments and to continuing operating in Bolivia. Moreover, unlike the former ones, the Congress approved these new contracts, which confer them a real legal safety.

21. Mining is another key sector for the Bolivian economy; therefore, it was necessary to

revise the operating framework that allows a sustainable development over the medium and long term for both private and public enterprises. Thus, the government has decided to modify the royalties and tax regimes so the Ministry of Finance gets a fair share of the boom of this sector, while allowing private enterprises to continue operating under these new rules. Additionally, the authorities are about to sign a contract with an international company that will enable the exploitation and industrialization of the great deposits of iron in the east of the country. This contract will positively impact the current account from the year 2010 onwards.

22. The public policy applied in those sectors sought to correct severe biases and distortions of the privatization contracts signed between 1993 and 1996, which led to an unfair share for the Bolivian state. Such a situation was politically unsustainable, because of the emerged discontent; therefore, those contracts had to be renegotiated according to the current Bolivian legal framework. This policy has been only applied to the privatized enterprises, while in the rest of the private sector the legal framework was not -and by no means will be- modified by neither the Executive nor the Constitutional Assembly; hence, there are no disincentives for private entrepreneurs. This issue was used politically and was wrongly related to the hydrocarbons and mining policy.

23. The government has started to implement its five-year National Development Plan. This plan is based on four strategies: economic aimed to increase productivity; social-community oriented to improve the social safety net; international relationship aimed to enhance the external sector in economic, political, and cultural ambits; and social empowerment oriented to strengthen democracy through promoting social inclusion.

24. The authorities are aware that private investment is important to growth and job creation, so they emphasize that public investment in other economic sectors will be just complementary to private investment. In this vein, the government supports the enlargement of small and medium-sized companies, facilitating them credit access. These sectors are labor intensive and their expansion would help reduce unemployment, which is the major cause of poverty. To promote private investment, the government has established a second-tier public development bank (BDP) to finance micro-entrepreneurships, preserving competition within the financial system. In addition, the government is engaged in obtaining access to foreign markets for non-traditional exports and has obtained an extension of the Andean Trade Preference Drug Eradication Act (APTDEA) in the United States Congress, which enables duty-free access to United States markets for a number of nontraditional Bolivian exports.

25. Regarding the land tenure, in 2006, Congress already modified the Land Law to implement a redistribution of unproductive or illegally obtained land, to improve its use and increase employment in rural areas. Therefore, no further developments

should be expected in this regard in the Constitutional Assembly.

26. The overall performance of Bolivia's economy should not only be considered a result of the positive 2006 international environment, but also a consequence of macroeconomic policies and changes in the relationship with foreign companies operating in Bolivia, which have contributed to reduce Bolivia's vulnerabilities. As already stated, monetary and fiscal policies were sound and adequately managed in order to keep inflation under control. The change in the government's relationship with foreign oil companies led to higher fiscal revenue and a considerable fiscal surplus, which made it possible to implement new programs to address the need for helping the poor, like the incentives provided to low-income class students for encouraging school attendance. The government intends to continue on the same path of fiscal discipline and pro-poor and pro-growth development policies.