January 2009
IMF Country Report No. 09/27

Bolivia: 2008 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 2008 Article IV consultation with Bolivia, the following documents have been released and are included in this package:

- The staff report for the 2008 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 5, 2008, 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 December 11, 2008. 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 the joint IMF/World Bank debt sustainability analysis.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 14, 2009 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for Bolivia.

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 2008 Article IV Consultation

Prepared by the Staff Representatives for the 2008 Article IV Consultation with Bolivia

Approved by José Fajgenbaum and Alan MacArthur

December 11, 2008

- **Discussions.** Article IV consultation discussions were held in La Paz during September 16–26 and November 3–5 with, among others: finance minister Arce, planning minister Villegas, central bank presidents Garrón (in September) and Loza (in November), and representatives of the financial sector. The mission teams comprised Messrs. Furtado (head), Sosa, Valencia, and Vesperoni (resident representative) (all WHD); Cortavarria-Checkley (MCM); and Tolosa (SPR).
- **Political setting**. Following a protracted period of political tensions, agreement was reached on holding a national referendum on a new constitution, to be held on January 25, 2009. However, the political environment remains very complex in light of entrenched regional and social polarization. If the new constitution is approved as expected, early presidential elections will be held in December 2009; President Evo Morales will be allowed to run for a new full term through 2014.
- **Economic setting.** The current global crisis will affect Bolivia mainly through declines in commodity prices given its very limited integration with international capital markets. While macroeconomic performance has been supported by booming hydrocarbons and mining exports in recent years, real GDP growth is projected to decline to 4 percent in 2009 and the fiscal and external current accounts to shift into small deficits as export earnings decline.
- **Key policy recommendations**. As inflation remains in the double digits despite a recent deceleration in food prices, there is a need for a more active monetary policy. To guard against a further deterioration in the external environment and ensure intergenerational sharing of hydrocarbons wealth beyond its depletion point, the authorities need to restore a fiscal surplus of at least 3 percent of GDP over the medium-term. To underpin medium-term growth, steps are needed to reduce remaining financial sector vulnerabilities and to improve the investment climate.
- **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 13, 2007. The latest Fund arrangement expired on March 31, 2006.

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EXECUTIVE SUMMARY

- **In recent years, Bolivia experienced an export boom led by hydrocarbons and mining**. The positive external shock supported an improvement in the growth performance and a strengthening of the external and fiscal positions, but inflation has accelerated and investment—despite a recent pickup—has remained low in the context of persistent political tensions.

- **The current global crisis affects Bolivia mainly through declines in commodity prices and remittances**. Given the adverse external environment, GDP growth will slow markedly in 2009 while the fiscal and external current accounts would shift into deficits. At the same time, further reductions in food prices would help lower inflation.

- **The overall fiscal position is projected to shift from a surplus of 3.5 percent of GDP in 2008 to a deficit of 0.5 percent in 2009**. In the event of a further deterioration in exports and related fiscal revenue, the authorities would implement cuts in government capital expenditure—where they see scope for streamlining while preserving critical investments and social spending.

- **A more active monetary policy would help speed up the decline in inflation to the single digits**. The central bank is encouraged to conduct open market operations in a manner consistent with bringing about higher interest rates on non-indexed bonds, which are negative in real terms. This would also help eliminate incentives for indexation.

- **While the financial sector appears to be stable and highly liquid, efforts to reduce vulnerabilities should continue.** The staff welcomes plans to fully adopt international accounting standards and the ongoing efforts to improve risk management practices in banks. The authorities are encouraged to introduce prudential regulations to mitigate credit risks from dollarization and market risk.

- **The exchange rate of the Boliviano is broadly appropriate**. While standard estimates suggest a mild overvaluation, and indeed the current account deficit could be significant in 2009, the outlook points to a subsequent improvement in the external current account. Looking forward, greater exchange rate flexibility would help absorb possible external shocks, such as those stemming from adverse movements in commodity prices.

- **For the medium term, the authorities need to target a reduction in the non-hydrocarbons deficit by about 3½ percentage points of GDP**. This would reduce dependency on volatile export-based revenue and lead to greater inter-generational equity in the use of hydrocarbons wealth. The authorities could consider, in this context, a gradual reduction of explicit and implicit hydrocarbons subsidies while using part of the resulting fiscal savings to protect vulnerable groups. In addition, there is scope to further strengthen Bolivia's fiscal position through well-designed structural reforms.

- **Improving the investment climate remains a top priority for Bolivia**, as its private investment rate remains significantly below the levels observed in the past decade and well below the regional average.

I. Economic and Political Setting

1. **In recent years, Bolivia experienced an export boom led by the hydrocarbons and mining sectors, which supported an improvement in the growth performance and a strengthening of the external and fiscal positions, but inflation accelerated and investment remained low in the context of persistent political tensions**. The rise in export prices through mid-2008 led to exceptionally high external current account surpluses and reserve accumulation. Changes in the hydrocarbons taxation regime in 2005-06 further boosted fiscal revenue, shifting the public sector accounts from deficits into substantial surpluses. External surpluses fueled demand pressures, which—combined with increases in food prices—caused inflation to rise to double digits in 2007-08. As part of its policy response, the central bank gradually allowed the Boliviano to appreciate, which contributed to a significant reduction in deposit dollarization. However, despite the predominantly positive trends, the adverse investment climate resulting from political tensions and lingering uncertainty about property rights has contributed to keep private investment rates among the lowest in the region.

2. **As Bolivia's integration with international capital markets is very limited, the current global crisis affects Bolivia mainly through declines in commodity prices and remittances**. Capital inflows have been negligible for many years, except for FDI in hydrocarbons and mining, thereby largely insulating Bolivia's financial system from the external turmoil. However, current trends in commodity prices will have a major impact on export receipts and related fiscal revenue—starting in 2009, because of the lagged response of contractual gas export prices.

3. **Following a protracted period of rising political polarization, tensions have eased significantly in recent weeks.** The tensions revolved around constitutional reform, and in particular around presidential re-election rules, regional autonomy, and proposed constraints to the size of private land holdings. The draft constitution passed by the national assembly in December 2007 was strongly resisted by opposition forces, which until recently impeded congressional approval of the referendum that is required for the new constitution to take effect. Following an agreement between the government and the opposition on critical issues—notably, that the president can be re-elected only once, and that the cap on land size does not affect existing holdings—such a referendum was finally approved by Congress, and is now scheduled for January 25, 2009. If the new constitution is approved, early general elections would be held in December 2009.

4. **While the authorities' macroeconomic policy actions have been broadly in line in with past Fund advice, the complex political environment has posed challenges on other fronts.** Regarding macroeconomic policies, a fiscal surplus has been maintained and greater flexibility has been exercised in exchange rate policy in the face of strong appreciating pressures. On the structural front, however, a number of past Fund recommendations remain pending (as discussed in Section II).

II. REPORT ON THE DISCUSSIONS

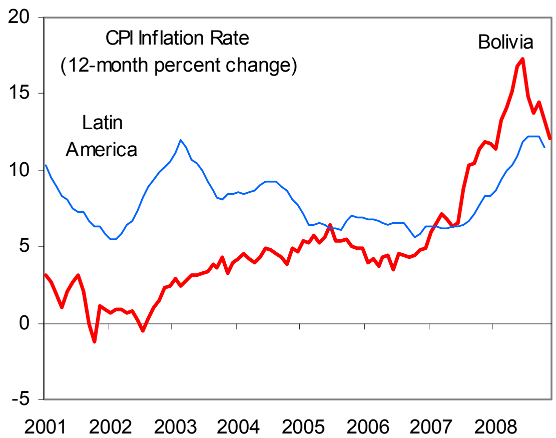
5. **As the discussions took place in the context of a major slowdown of the global economy and turnaround in commodity prices, they focused on key developments in 2008 and on the policies needed to buttress the fiscal position and reduce financial sector vulnerabilities**. Regarding developments in 2008, there was consensus that high rates of monetary growth had compounded the impact of food price inflation, although the authorities also emphasized exogenous factors (speculative and political) as contributors to Bolivia's inflation developments. Regarding the outlook, sharp changes are likely to occur in the fiscal and external current accounts, both of which—according to staff projections—would shift into deficits in 2009, for the first time in several years. The discussions covered, in addition to the baseline scenario (reflecting then available WEO projections), a more adverse alternative scenario, consistent with a 25 percent lower path for oil prices relative to the baseline (somewhat more pessimistic than the current WEO projections). In the period ahead, macroeconomic policy management will benefit from Bolivia's high level of reserves, which provides a buffer against disorderly adjustments. Moreover, fiscal measures and financial sector reforms would reduce the downside risks to the baseline medium-term scenario and enhance the economy's resilience to adverse external shocks.

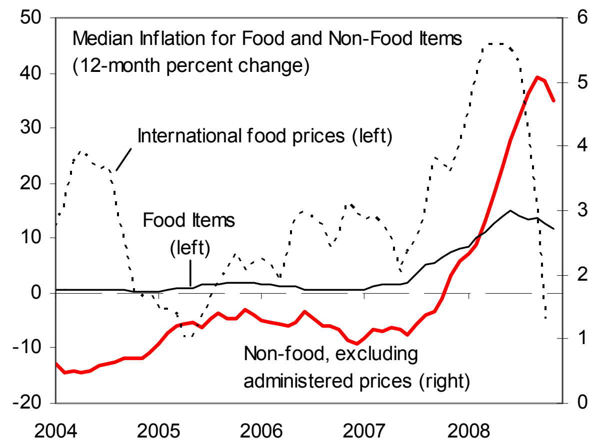
A. Developments in 2008

6. **In 2008, strong hydrocarbons and mining exports has continued to support Bolivia's growth performance as well as its fiscal and external positions**. Real GDP growth has picked up to an estimated 5.9 percent (from an average of 4.7 percent in 2006-07), boosted in part by the start of production at a large mining project (Table 1). The external current account has recorded a surplus of 11 percent of GDP, and central bank reserves have risen to historical highs. The combined public sector[1] has also remained in surplus, benefiting from continued high export-based revenues.

7. **The external developments and associated partial monetization of the increase in reserves have contributed to double-digit inflation, which peaked in mid-year and has since eased somewhat**. Following an increase to 17 percent in the first half of 2008, twelve-month inflation has declined and is now projected at 12 percent for the year. While the earlier increase was driven partly by food inflation, external developments generated significant demand pressures, compounding the effects of the supply shock (Box 1). The role of excess aggregate demand in the inflationary process is evidenced by increases in non-food inflation. The deceleration in recent months reflects moderation in food prices, slower monetary expansion, as reserves stabilized, a modest appreciation of Boliviano, and substantial depreciations of trading partners' currencies.

[1] The combined public sector comprises the general government, the public enterprises, and the central bank's operating balance.





Box 1. Main Inflation Drivers

Preliminary empirical evidence confirms that, while supply shocks have been critical, domestic factors have been important drivers of inflation in Bolivia.

- **A first empirical approach involved estimating a general equilibrium model with forward-looking features**. Using quarterly Bolivian data for 1995Q1-2008Q1, the model incorporates an interest rate-based monetary policy rule, takes into account expectations about the future of the economy, and imposes exchange rate flexibility. Preliminary simulations suggest that about half of the variability in inflation is explained by food price shocks, and about a third is explained by domestic demand shocks (7.2 percent) and the interest rate on open market operations (26.4 percent)—a proxy for monetary policy instrument.

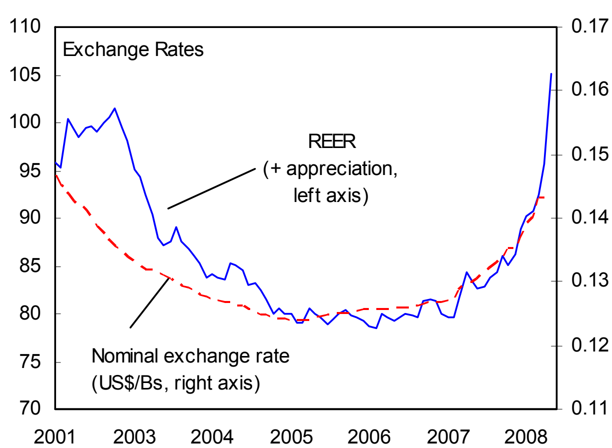
Variance Decomposition of Inflation	
Food prices	53.5
Interest rates on open market operations	26.4
Other	8.2
Domestic demand	7.2
Foreign interest rates	3.8
Exchange rate	0.6
Foreign growth (Brazil)	0.2
Total	**100.0**

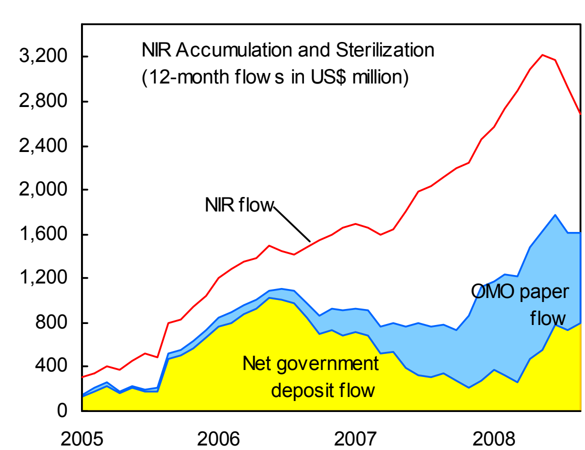
- **A second approach addressed the analysis of inflation using VAR's.** Under this alternative, a Bayesian VAR was estimated with the same sample, but assumed a money-based monetary policy framework—closer to Bolivia's actual monetary regime—and used the stock of currency as the measure of money supply. Similarly, preliminary simulations yield that 22 percent of the variability in inflation is explained by changes in the currency stock, whereas domestic demand shocks contribute 7 percent. Both approaches thus suggest that domestic factors account for an important fraction of the variability of inflation.

8. **Bolivia's overall fiscal position has improved in 2008, benefiting from high hydrocarbons-based revenue (Tables 2 and 3).** The overall fiscal surplus is estimated to rise to 3.5 percent of GDP (from 2.6 percent of GDP in 2007), reflecting in part a strong increase in the surplus of the state energy company YPFB, which benefited from high natural gas export prices and the incorporation of activities such as refining and distribution,

previously carried out by private sector enterprises.[2] However, the non-hydrocarbon deficit[3] has risen to an estimated 8.5 percent of GDP—reflecting, inter alia, outlays on new social programs and higher fuel subsidies. Net public debt has continued to fall, with the overall fiscal surplus reflected in rising public sector deposits at the central bank.

9. **Booming hydrocarbon and mining exports, together with high remittance inflows, led to a record-high current account surplus and large reserve accumulation, with major pressures on monetary/exchange rate policy during the first three quarters of 2008**. In the period through September, the central bank stepped up open market operations, mainly through greater placement of indexed instruments. However, foreign exchange inflows were only partially sterilized, so that monetary expansion remained strong. Meanwhile, the authorities continued to implement small nominal upward adjustments to the exchange rate under the crawling peg regime. Since September, central bank reserves have declined somewhat, in part as a result of lower foreign exchange inflows and greater demand for foreign assets, resulting in a significant slowdown of monetary expansion. As a result, the growth rates of broad money and currency in circulation declined somewhat to, respectively, 24 percent and 35 percent for the year as a whole (Tables 4 and 5). During the last three months, the exchange rate has been stable, following about three years of gradual nominal increases. In real effective terms, the Boliviano has appreciated markedly over the past year, reflecting mainly the high inflation in Bolivia and significant currency depreciations in trading partners.





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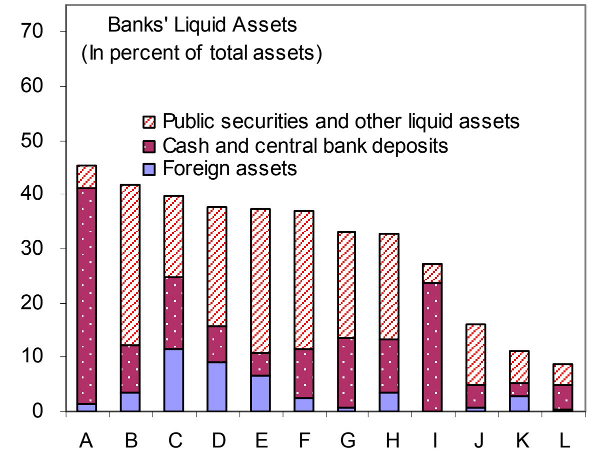
[2] A one-off deferred receipt from 2007 sales also contributed to the increase in the surplus.

[3] The non-hydrocarbons balance excludes natural gas royalties and the *Impuesto Directo a los Hidrocarburos* (IDH), as well as the operating balance of YPFB.

10. **The banking system appears to be stable and liquid, although some vulnerable areas require special attention.** Mainly reflecting sluggish demand in the context of political uncertainties, credit to the private sector has continued to expand at a very low pace, contributing to high levels of bank liquidity. Bank capitalization stands at 14 percent, and nonperforming loans have fallen to 5 percent of total loans. However, the level of restructured loans (about 9 percent of total loans or 40 percent of equity) still raises concerns.[4] In addition, the system remains exposed to exchange-rate-induced credit risk, as loan dollarization remains high.



B. Outlook for 2009

11. **The baseline staff projections[5] suggest that the negative terms of trade shock from lower energy and mining prices, as well as an expected decline in remittances, will slow GDP growth markedly in 2009—to 4 percent (from 6 percent in 2008)—while the fiscal and external current accounts would shift into small deficits**. At the same time, further reductions in food prices would contribute to a decline in the twelve-month inflation rate to about 8 percent by end-2009. While the baseline scenario suggests that current fiscal/monetary policies, as well as the exchange rate level, are sustainable, Bolivia's outlook is highly sensitive to developments in export prices, and their further weakening could give rise to significant financing needs and undermine external and fiscal sustainability. The authorities envisaged somewhat higher export prices and real GDP growth than suggested by the staff's baseline projections, and expected that fiscal and external current account deficits could be averted.

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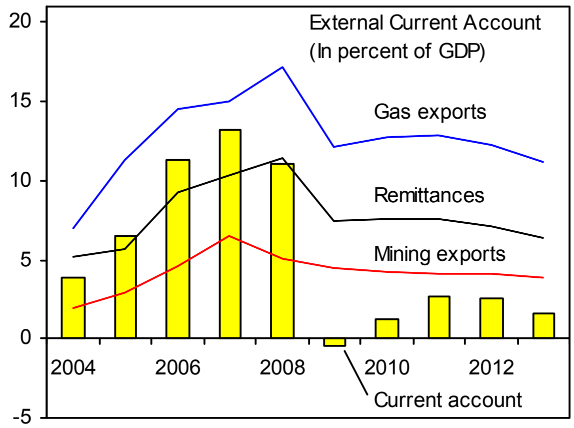
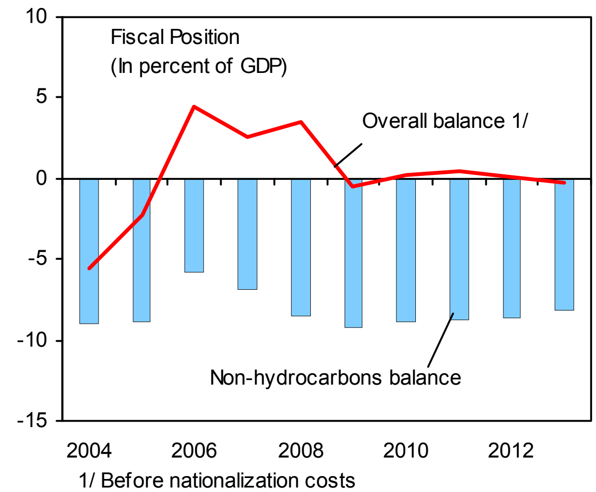
[4] The delinquency indicator for restructured loans is about 30 percent and the repayment schedule of some of them reportedly includes larger installments toward their maturity.

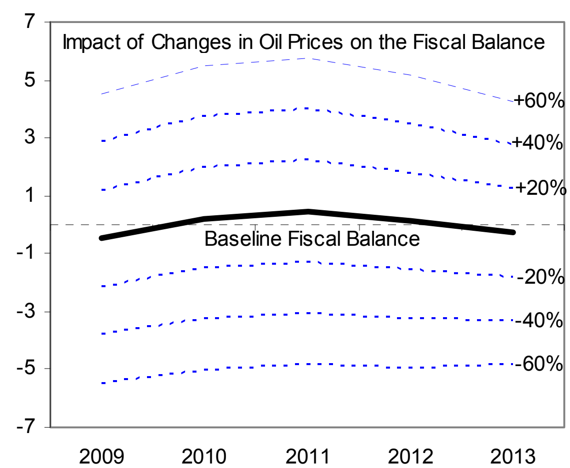
[5] The baseline projections are consistent with the October 2008 WEO vintage.





Fiscal policy

12. **Staff projects that the overall fiscal position would shift from a surplus of 3.5 percent of GDP in 2008 to a deficit of 0.5 percent in 2009**. This would reflect a reduction in hydrocarbons-based tax revenue, a lower operating surplus of the state energy company, and higher current spending—the latter due to a catch-up increase in wages and pensions. The mission took the view that, while financing a small deficit is manageable and does not impair debt sustainability, the authorities need to target a reduction in the non-hydrocarbons deficit by about 3½ percentage points of GDP over the medium term (to about 5 percent). Under the baseline assumptions, this would imply an overall surplus in the order of 3 percent of GDP (somewhat lower than the average of the last three years). Such an adjustment would reduce dependency on volatile export-based revenue[6] and lead to greater inter-generational equity in the use of hydrocarbons wealth.



[6] As shown in the chart, a further large drop in oil prices could push the fiscal deficit to as high as around 6 percent of GDP, which would give rise to serious financing difficulties and undermine fiscal sustainability.

13. **To strengthen the fiscal position, the authorities may need to consider a reduction of explicit and implicit hydrocarbons subsidies[7]—projected at about 1 percent and 4 percent of GDP, respectively, in 2009—while using part of the substantial resulting fiscal savings to protect vulnerable groups**.[8] This is particularly relevant since there is consensus that these subsidies are inefficient, give rise to smuggling, and discourage investment and energy conservation. The authorities are keenly aware of these distortions and of their fiscal cost, and are considering policies to address them. The mission also recommended wage and pension restraint[9] and a rigorous prioritization of investment projects.

Box 2. Structural Fiscal Issues

The authorities concurred with the thrust of the mission's recommendations on fiscal reform. However, they indicated that progress was likely to be limited until the ongoing constitutional reform process is completed.

- ***Tax reform***. There is a need for measures aimed at simplifying the tax system and improving its efficiency and equity. In line with previous IMF technical assistance, the mission recommended eliminating the transactions tax and the complementary tax to the VAT (RC-IVA). The associated revenue loss (about 2½ percent of GDP) could be more than offset by an increase in the VAT rate (currently 13 percent), the closing of loopholes in the corporate income tax, and the transfer of special regime (such as simplified regimes for small taxpayers and free trade zone regimes) taxpayers to the regular tax regime. Appropriate turnover thresholds would need to be added to the VAT and the corporate income tax, below which taxpayers would be exempt from the VAT and liable to presumptive taxation only under the corporate income tax.

- ***Intergovernmental relations***. Also in line with previous Fund technical assistance recommendations, the mission emphasized the need to better balance expenditure allocations and resources available at each level of government, rationalize the transfer system, and strengthen controls over sub national borrowing.

- ***Budget process***. Adoption of the draft Budget Framework Law prepared in 2005 would contribute importantly to strengthening the budget process.

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[7] Implicit subsidies are associated with the longstanding freeze on domestically produced crude oil price at US$27 per barrel, which provides the basis for maintaining very low administered prices for petroleum products in the domestic market. These policies depress the base for the corporate profit tax and for excise taxes.

[8] For example, through targeted food and urban transportation subsidies, as highlighted in FAD's 2004 PSIA report.

[9] A pension reform proposal has been submitted by the government, and is currently with the relevant committee in Congress, which would include a fully-funded minimum pension benefit. Such a minimum pension would be paid in addition to the transfer scheme for persons over age 60 created in 2007, the *Renta Dignidad*.

Monetary and exchange rate policy

14. **The mission argued for a more active monetary policy to reinforce the downward trend in inflation**. While lower food prices will facilitate progress towards price stability, inflation is still high, and real interest rates remain negative on non-indexed central bank instruments. The mission recommended conducting open market operations in a way consistent with bringing about higher interest rates on non-indexed bonds, which would not only have an impact on inflation but also reduce the incentives for dollarization and indexation.[10] While accepting the thrust of the staff's views, the authorities argued that supply-side factors (such as speculation and road blockades) had played a key role in fueling inflation, and that their reversal would also contribute to the disinflation process.

15. **The external current account, which has recorded large surpluses over the last three years, is projected to move into a deficit of 0.5 percent of GDP in 2009 (Table 6)**. The value of exports is projected to decline by 23 percent in 2009, to US$4.7 billion, reflecting mainly lower export prices. In addition, manufactured exports to the United States will be affected by the recent suspension of trade preferences under the Andean Trade Promotion and Drug Eradication Act (ATPDEA), and remittances are projected to decline by about 10 percent, reflecting recessionary conditions in developed countries. Nonetheless, the overall balance of payments will remain in surplus as continued FDI would more than cover the current account deficit.

16. **Against this background, the mission discussed with the authorities the appropriateness of Bolivia's exchange rate level and degree of flexibility of its exchange rate regime.**[11] While the Boliviano is mildly overvalued according to CGER estimates (Box 3), it would appear to be broadly appropriate given the high degree of uncertainty associated with such estimates. Regarding the exchange rate regime, the mission noted that the inflationary pressures associated with large reserve accumulation prior to the decline in export prices had underscored the need for greater exchange rate flexibility, which could be in the form of greater and/or more frequent adjustments under the exiting crawling peg. Looking forward, such flexibility would help absorb negative external shocks, like further declines in commodity prices, while intervention in the foreign exchange market could be used to forestall disruptive exchange rate adjustments.

[10] Academic work—for example, "*Addicted to Dollars*" (NBER Working Paper 10015, 2003) by Reinhart C. and K. Rogoff—supports the view that a high degree of dollarization does not pose an insurmountable obstacle to monetary control or to disinflation.

[11] Central bank staff conducts significant analytical work on equilibrium exchange rate issues.

Alternative scenario

17. **In anticipation of downward revisions to the WEO oil baseline, the mission developed an alternative scenario in which oil prices are 25 percent lower than in the baseline (Table 7)**. In such a scenario—which has become more relevant given downward revisions to the WEO baseline since the discussions—, both the external current account and the overall fiscal balance would record significant deficits in 2009 (respectively, 4.3 percent and 2.8 percent of GDP). There was consensus that, in the event of a further deterioration in exports and related fiscal revenue, the first line of defense in the policy adjustment would be on the fiscal front. Specifically, the authorities indicated that, if oil prices were to display a sustained gap vis-à-vis the baseline path, they would compensate for lower revenue through cuts in government capital expenditure—where they see scope for streamlining while preserving critical investments and social spending. Staff concurred with such an approach.

Medium-Term Oil Price Assumptions 1/
(In U.S. dollars per barrel)

	2009	2010	2011	2012	2013
Baseline 2/	68.0	75.0	79.3	82.0	83.0
Alternative 3/	51.0	56.3	59.4	61.5	62.3
Memorandum item					
WEO (November vintage)	54.3	64.8	71.3	75.0	77.5

1/ For each US$ 10 dollar/barrel reduction in oil prices, the overall fiscal balance and external current account deteriorate by 1½ percent and 2½ percent of GDP, respectively.

2/ Based on WEO's October vintage.

3/ Reflects a 25 percent reduction relative to the baseline.

Box 3. Exchange Rate Assessment

Staff estimates based on CGER methodologies suggest that the Boliviano could be mildly overvalued following the recent sharp changes in commodity prices and in trading partners' currencies.

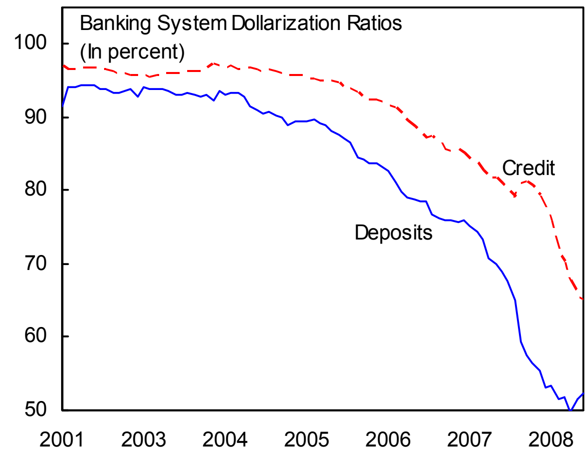
- **The macroeconomic balance approach (MB) suggests an overvaluation of 8 percent.** The underlying current account balance—i.e., that which would prevail under current real exchange rates once temporary factors have dissipated—is estimated to be a surplus of 1.8 percent of GDP, much lower than in 2008 because of the recent reduction in the terms of trade. Meanwhile, an estimation of the current account norm for Bolivia yielded 3.4 percent, using the same parameters as those in the CGER exercise.

- **The equilibrium exchange rate approach (ERER) suggests the Boliviano could be overvalued by 7 percent.** Econometric evidence points to a long-run relationship between the real exchange rate and terms of trade, public consumption, productivity, FDI, and the net foreign assets of the banking system (NFA). Until recently, the Boliviano was undervalued, but the observed real effective exchange rate has rapidly risen, while the equilibrium real exchange rate has fallen because the effect of declining terms of trade more than offset that of the prior increase in NFA.

- **The external sustainability also suggests an overvaluation of 10 percent.** Bolivia would need a current account surplus of 4 percent of GDP to stabilize its net foreign asset position, compared with the estimated underlying current account surplus of 1.8 percent of GDP. The exchange rate adjustment required to close the gap would be about 10 percent.

C. Financial Sector Issues

18. **The financial system in Bolivia continues to be broadly unaffected by the ongoing global financial turmoil**. While deposits fell in September by about US$160 million (2.5 percent of the total), this could be attributed to political tensions as deposits have since stabilized. Furthermore, there are no signs that the small existing international credit lines are being curtailed or cancelled. The recent drawdown in central bank reserves appears to reflect a portfolio shift on the part of the financial and nonfinancial private sectors to rebuild their dollar positions—which had been reduced in response to previous currency appreciation trends. Nonetheless, NIR still represent 120 percent of financial system deposits.



19. **While dollarization declined markedly in recent years, the slight increase in the share of dollar deposits in recent months suggests that a reversal of that process could be taking place**. A full-blown re-dollarization is not expected, but the risk of such a development would be particularly high in the event of a sharp depreciation of the currency.

20. **The authorities concurred with the thrust of the mission's recommendations to enhance on financial sector soundness.** Specifically:

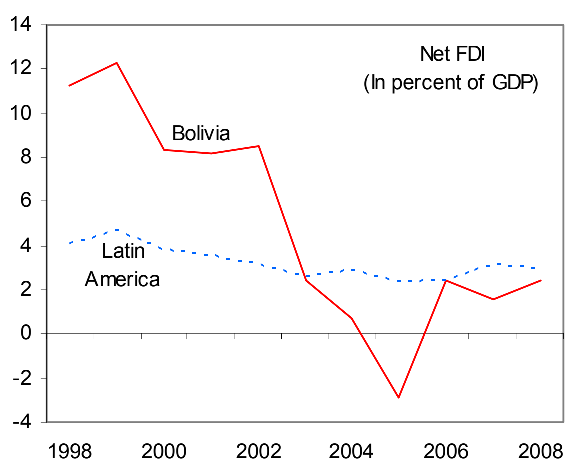
- **Efforts to reduce vulnerabilities need to continue, even if the financial sector appears to be stable and highly liquid.** The mission welcomed plans to fully adopt IAS by January 2010 and the ongoing efforts to improve risk management practices in banks, including countercyclical loan-loss provisioning. The mission recommended ensuring that new regulations on subordinated debt, foreign exchange exposures, and the use of general provisions as tier II capital do not depart from international best practices. It also stressed the need for prudential regulations to mitigate credit risks from dollarization and market risk, as dollar-denominated loans represent about 70 percent of bank credit. In addition, there is scope to improve further the assessment of risk management procedures on household lending. The supervisory agency was encouraged to continue assessing, in the field, the sufficiency of all financial institutions' loan provisioning and solvency.

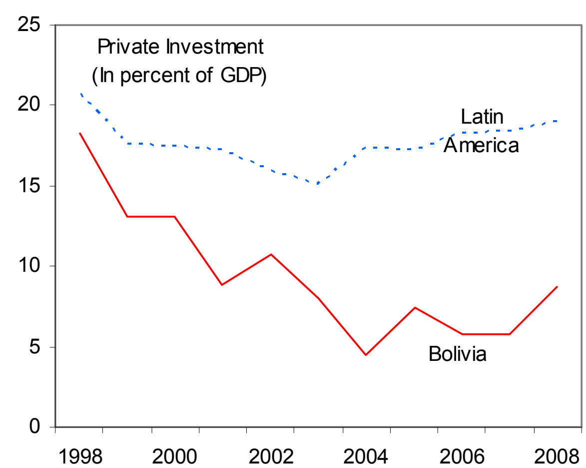
- **Addressing some pending legal, prudential, and institutional issues would contribute to reducing potential vulnerabilities**. This would include: (a) the creation, in due course, of a deposit insurance scheme; (b) amendments to the legislation governing corporate bankruptcy/restructuring; and (c) strengthening further the Financial Intelligence Unit (in particular staffing) and anti-money laundering legislation.[12]

- The authorities are considering the possibility of conducting an **FSAP update** in early 2010.

D. Supply Side and Social Issues

21. **The mission suggested that improving the investment climate was a top priority for Bolivia, as private investment remains significantly below the levels displayed in the past decade, which has contributed to growth rates below the regional average**. Investment picked up in 2008, but the increase was concentrated on residential investment and the completion of a large mining project. In May 2008, the government expropriated the shares needed to regain control over five companies in the hydrocarbons sector, and intervened the telecommunications company ENTEL, which have triggered demands for international arbitration from the affected investors. More recently, the government announced plans to recover control over the three electricity generation companies. The mission suggested the importance of pursuing actions on the nationalization front through mutually agreeable arrangements with the concerned private parties.





22. **While acknowledging the desirability of higher rates of private investment, the authorities emphasized that their development strategy ascribes a leading role to public sector investment**. In their view, the private sector will, in due course, take advantage of investment opportunities that are expected to arise from major infrastructure improvements.

[12] Bolivia's progress in implementing the FATF 40+9 Recommendations against money laundering and the financing of terrorism was recently discussed at the last Plenary meetings of GAFISUD (the FATF-style regional body for South America). The related progress report noted a recent progress in Bolivia's political commitment to fight these crimes. As a result, no counter-measures or sanctions were applied.

23. **The authorities emphasized the importance of ongoing efforts to reduce poverty.** These include, most notably, transfer schemes targeted at youth and the elderly. The mission welcomed these initiatives and underscored the need for more timely data to better assess progress in poverty reduction.[13]

E. Medium-Term Outlook

24. The key elements of the **baseline medium-term macroeconomic scenario** are:

- ***Growth***. Real GDP growth is projected to slow to around 3½ percent toward the end of the projection period (2012-13) as mining output stabilizes following the completion of a large project. The authorities noted that growth could be sustained in the vicinity of 6 percent if account were taken of envisioned investments and production increases in the hydrocarbons sector, which would enable a substantial boost to natural gas exports to Argentina in the context of the 2006 bilateral agreement. While recognizing their potential effects, staff has not been incorporated these elements in the projections because the related investment plans and financing arrangements have not yet been fleshed out. Moreover, the envisaged increase in natural gas exports to Argentina is contingent on the construction of a pipeline in that country.

- ***Investment***. The assumed growth rate is consistent with private investment picking up from the 2008 level, reflecting mainly the start of a new large mining project (*El Mutun*), which is projected to add on average about 1 percent of GDP a year to private investment levels over the five-year period beginning in 2009.

- ***External current account***. The current account balance would return to surplus in 2010, benefiting from a projected recovery in hydrocarbon prices and higher export volumes to Argentina (based on greater utilization of the already existing pipeline capacity).

- ***Fiscal position***. The overall fiscal position would shift to small surpluses in 2010-11 but subsequently move back to small deficits, as hydrocarbons-based revenue declines in relation to GDP due to stable export volumes.

- ***Inflation***. Inflation, which is projected to drop to single digits in 2009, in line with projected declines in food prices, would decline further over the medium term as the external sector is not expected to be a source of liquidity pressures.

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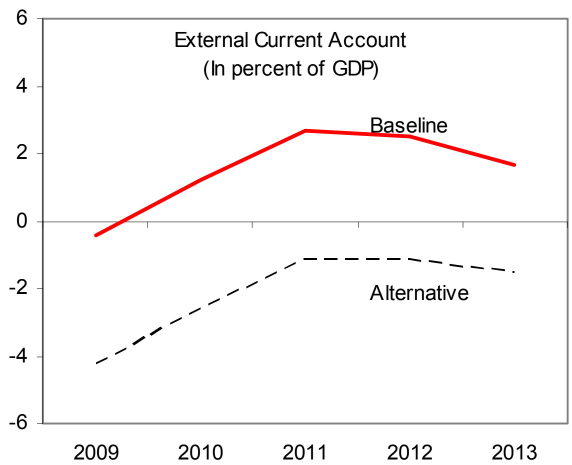
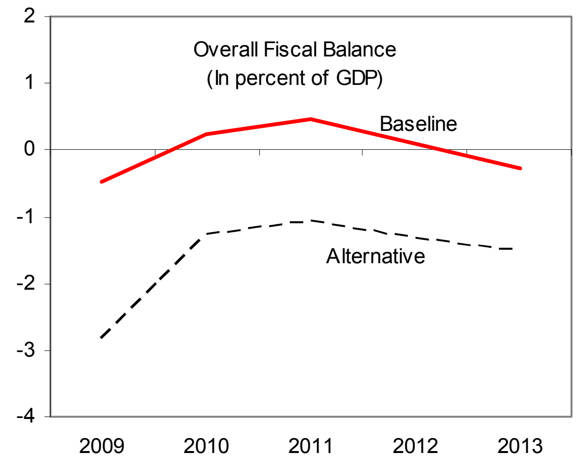
[13] The latest poverty indicators date from 2006 and show stable poverty levels at 60 percent.

25. In the **alternative medium-term scenario,** the external current account and the overall fiscal deficits would narrow somewhat in 2010, reflecting mainly the assumed higher natural gas export volumes to Argentina. Following a small decline in 2009, central bank reserves would rise gradually, to US$8.8 billion by 2013 (compared with US$12.5 billion in the baseline scenario).





Debt sustainability

26. **Longer-term projections beyond the baseline medium-term scenario suggest that Bolivia's public and external debts are likely to remain sustainable**. However, standard stress tests suggest that the debt ratio would rise in the event of severe exogenous shocks.[14]

III. Staff Appraisal

27. **Strong hydrocarbons and mining exports continued to support Bolivia's growth performance as well as its fiscal and external positions**. In 2008, real GDP growth picked up, the external current account surplus remained very large, and international reserves reached record levels. The combined public sector balance remained in surplus, benefiting from continued high export-based revenues. The currency strengthened, which contributed to a further significant reduction in deposit dollarization.

28. **The high rates of monetary expansion prevailing until recently have contributed importantly to double-digit inflation**. While food inflation has also been an important factor, the role of domestic demand in the inflationary process that peaked in mid-2008 was evidenced by increases in non-food inflation. The decline in inflation in recent months is a welcome development that reflects not only moderation in food prices but also slower monetary growth and the effect of a substantial real appreciation of the currency.

[14] See accompanying external and public debt sustainability analysis.

29. **In view of the major changes in the external environment and outlook, the key policy challenge has shifted from containing inflation to maintaining a sound fiscal position and external stability**. While Bolivia's financial system continues to be broadly unaffected by the global financial turmoil, the major decline in the terms of trade from lower energy and mining prices, as well as an expected decline in remittances, are projected to slow GDP growth markedly in 2009, and to push both the fiscal and external current accounts into deficits. The staff's baseline scenario suggests that current fiscal and monetary policies are still appropriate while the exchange rate remains competitive. However, Bolivia's outlook is highly sensitive to developments in export prices, and their further weakening could give rise to significant financing needs and call for a strengthening of policies to ensure external and fiscal sustainability.

30. **In the event of a deterioration in exports and related fiscal revenue,** the first line of defense in **the policy adjustment should be on the fiscal front**. Staff welcomes the authorities' approach, which includes cuts in government capital expenditure—where there is scope for streamlining—while preserving social spending. Moreover, given the need to reduce dependency on volatile export-based revenue and ensure intergenerational sharing of hydrocarbon wealth, the authorities need to target a reduction in the non-hydrocarbons fiscal deficit over the medium term—in the order of 3½ percent of GDP. To this end, the authorities could consider a gradual reduction of explicit and implicit hydrocarbons subsidies while using part of the resulting fiscal savings to protect vulnerable groups. This is particularly relevant since there is consensus that these subsidies are inefficient, give rise to smuggling, and discourage investment and energy conservation. Meanwhile, it will be of paramount importance to exercise wage and pension restraint, and a rigorous prioritization of investment projects.

31. **In addition, there is scope to further strengthen Bolivia's fiscal position through well-designed structural reforms**. First, the tax system could be modified to simplify it and improve its efficiency and equity. To this end, the staff suggests eliminating the transactions tax and the complementary tax to the VAT, while increasing the VAT rate, closing loopholes in the corporate income tax, and transferring special regime taxpayers to the regular tax regime. At the same time, it would be important to rationalize intergovernmental relations, and in particular better balance expenditure allocations and available resources at each level of government. In addition, Bolivia would benefit from improving the budget process, a blueprint for which is available in the draft Budget Framework Law prepared back in 2005**.**

32. **A more active monetary policy would help speed up the decline in inflation, currently in the double digits**. The central bank is encouraged to conduct open market operations in a manner consistent with bringing about higher interest rates on non-indexed bonds, which are negative in real terms, and thereby eliminate the incentive for indexation. Higher real interest rates and lower inflation would also help consolidate the reduction in dollarization achieved in recent years.

33. **The exchange rate of the Boliviano is broadly appropriate**. While standard estimates suggest a mild overvaluation, and indeed the current account deficit could be significant in 2009, the outlook points to a subsequent improvement in the external current account. Regarding the exchange rate regime, the inflationary process—associated in part, until recently, with large unsterilized intervention—has highlighted the need for greater exchange rate flexibility. Looking forward, greater flexibility would help to minimize deviations from the real equilibrium exchange rate, as well as to absorb possible negative external shocks stemming from adverse movements in commodity prices.

34. **While the financial sector appears to be stable and highly liquid, efforts to reduce vulnerabilities should continue.** The staff welcomes plans to fully adopt international accounting standards and the ongoing efforts to improve risk management practices in banks. The authorities are encouraged to introduce prudential regulations to mitigate credit risks from dollarization and market risk. In addition, addressing some pending legal, prudential, and institutional issues may also contribute to reducing potential vulnerabilities. Priorities in this area are establishing a deposit insurance scheme; adopting legislation governing corporate bankruptcy/restructuring; and strengthening further the Financial Intelligence Unit and legislation on anti-money laundering.

35. **Improving the investment climate remains a top priority for Bolivia, as its private investment rate remains significantly below the levels observed in the past decade and well below the regional average**. The investment climate, which stands to gain from the recent easing in political tensions, would also benefit from restraint with regard to nationalizations—which should be pursued, as far as possible, through mutually agreeable arrangements with the concerned private parties.

36. **Bolivia's data provision to the Fund** has some shortcomings, but is broadly adequate for surveillance.

37. 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

					Est.	Projected				
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
	(Annual percentage changes)									
Income and prices										
Real GDP	4.2	4.4	4.8	4.6	5.9	4.0	4.2	3.9	3.6	3.4
GDP deflator	8.0	5.9	13.7	9.3	14.0	-2.3	10.0	6.2	5.3	6.9
CPI inflation (period average)	4.4	5.4	4.3	8.7	14.0	8.1	7.5	6.5	4.9	4.0
CPI inflation (end-of-period)	4.6	4.9	4.9	11.7	12.0	8.0	7.0	6.0	4.0	4.0
	(In percent of GDP)									
Investment and savings										
Total investment	11.0	14.3	13.9	15.2	18.0	19.3	21.2	21.0	20.9	20.5
Public sector	6.6	6.9	8.1	9.4	9.3	8.8	9.5	9.6	9.6	9.5
Private sector	4.4	7.4	5.7	5.8	8.7	10.5	11.7	11.3	11.3	11.0
Gross domestic savings	15.8	17.7	22.9	22.7	23.1	15.0	18.9	20.1	19.9	18.8
Gross national savings	15.9	18.8	26.4	29.3	29.1	18.8	22.4	23.6	23.4	22.1
Public sector	1.0	4.6	12.6	11.2	11.7	7.6	9.8	10.1	9.7	9.2
Private sector	14.8	14.2	13.8	18.1	17.4	11.3	12.6	13.6	13.7	12.9
Investment/saving balances 1/	4.8	4.6	12.5	14.1	11.0	-0.4	1.2	2.7	2.5	1.6
Public sector	-5.5	-2.2	4.5	1.7	2.4	-1.2	0.2	0.5	0.1	-0.3
Private sector	10.4	6.8	8.0	12.3	8.7	0.8	1.0	2.2	2.4	1.9
Combined public sector										
Revenues and grants	26.8	30.9	34.3	34.6	36.3	34.0	33.8	33.7	33.0	31.9
Of which:										
Royalties on hydrocarbons	3.4	6.5	9.4	9.0	8.3	6.9	6.9	6.9	6.6	6.0
Expenditure	32.3	33.2	29.8	32.9	34.0	35.2	33.6	33.2	32.9	32.2
Current	23.2	23.1	19.6	20.0	20.1	22.3	21.4	20.9	20.6	20.0
Capital 2/	9.1	10.0	10.2	12.9	13.9	12.9	12.2	12.3	12.3	12.2
Overall balance	-5.5	-2.2	4.5	1.7	2.4	-1.2	0.2	0.5	0.1	-0.3
Of which:										
Balance before nationalization costs	-5.5	-2.2	4.5	2.6	3.5	-0.5	0.2	0.5	0.1	-0.3
Non-hydrocarbons balance	-9.0	-8.9	-5.8	-6.9	-8.5	-9.2	-8.8	-8.7	-8.7	-8.2
Total net public debt	81.0	71.1	41.9	26.8	17.0	17.9	15.4	13.5	12.3	11.4
External sector										
Current account 1/	3.8	6.5	11.3	13.2	11.0	-0.4	1.2	2.7	2.5	1.6
Merchandise exports	24.4	29.2	33.6	33.8	35.7	26.6	26.6	27.0	25.8	23.9
Of which: natural gas	7.0	11.3	14.5	15.0	17.2	12.2	12.8	12.9	12.2	11.2
Merchandise imports	20.9	24.4	24.4	25.9	29.3	29.5	27.6	26.6	25.7	24.5
Terms of trade index (percent change)	9.4	12.3	15.2	3.6	3.6	-21.9	4.0	1.0	-3.0	-3.0
Gross international reserves 3/										
In millions of U.S. dollars	1,474	2,042	3,385	5,587	7,796	8,304	9,183	10,396	11,595	12,565
In percent of broad money	39.3	47.0	65.9	78.9	84.5	90.1	89.3	89.3	87.3	85.0
Exchange rates 4/										
Bolivianos/U.S. dollar (end-of-period)	8.04	8.00	7.93	7.57	6.97	...	...	...	...	...
REER, period average (percent change)	-6.5	-4.2	-0.4	2.9	27.0	...	...	...	...	...
	(Changes in percent of broad money at the beginning of the period, unless otherwise specified)									
Money and credit										
NFA of the financial system	2.9	20.7	31.3	35.4	28.0	5.6	9.7	11.9	10.3	7.3
NDA of the financial system	-4.3	-6.6	-12.9	-3.7	-4.4	2.0	4.7	2.7	3.4	4.0
Of which: credit to private sector (percent of GDP	42.3	39.6	34.7	33.1	31.8	32.5	32.3	32.2	32.1	31.5
Broad money	-1.4	14.1	18.5	31.7	23.6	7.6	14.4	14.6	13.7	11.3
Interest rates (percent, end-of-period) 5/										
Yield on treasury bills in local currency	9.6	7.9	5.4	6.2	9.6	...	...	...	...	...
Yield on treasury bills in U.S. dollars	5.8	7.4	4.9	4.6	4.5	...	...	...	...	...
Memorandum item										
Nominal GDP (in billions of U.S. dollars)	8.81	9.57	11.53	13.29	17.11	17.74	19.59	21.04	22.67	25.01

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/ Includes nationalization costs and net lending.

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

4/ Official (buying) exchange rate. For 2008, the nominal exchange rate is as of December 15, and the change in the real effective exchange rate is the year-on-year change as of October.

5/ For 2008, as of December 15.

Table 2. Bolivia: Operations of the Combined Public Sector
(In millions of Bolivianos)

	2004	2005	2006	2007	Est. 2008	Proj. 2009	2010	2011	2012	2013
Total revenue and grants	**18,661**	**23,829**	**31,473**	**35,669**	**45,209**	**42,924**	**48,930**	**53,853**	**57,538**	**61,469**
Current revenue	16,646	21,836	28,381	32,052	37,882	38,275	43,293	47,485	50,815	54,360
Tax revenue	14,319	19,370	25,524	28,659	34,327	34,196	38,728	42,491	45,418	48,474
IDH and royalties	2,333	5,019	8,645	9,266	10,366	8,780	10,044	10,996	11,507	11,579
Other Taxes	11,986	14,351	16,878	19,393	23,962	25,417	28,684	31,495	33,910	36,894
Direct taxes	2,475	3,254	4,357	3,901	5,492	5,853	6,716	7,414	8,037	8,807
Indirect taxes	9,511	11,097	12,522	15,493	18,470	19,564	21,968	24,081	25,873	28,088
Nontax revenue	2,327	2,466	2,857	3,393	3,555	4,079	4,565	4,994	5,397	5,886
Public sector enterprises operating balance	70	84	732	625	4,782	2,719	3,606	4,285	4,419	4,375
Central bank operating balance	201	259	668	1,297	1,040	875	721	638	730	800
Grants	1,744	1,651	1,692	1,695	1,505	1,055	1,310	1,445	1,575	1,934
Total spending	**22,520**	**25,558**	**27,372**	**33,016**	**40,905**	**43,539**	**48,602**	**53,127**	**57,353**	**61,979**
Current expenditure	16,172	17,822	18,000	20,594	25,023	28,133	30,930	33,466	35,912	38,465
Wages and salaries 1/	6,264	6,650	7,230	9,431	10,300	11,796	12,829	13,785	14,598	15,328
Goods and services	1,426	1,492	1,649	2,031	2,414	2,671	3,061	3,378	3,684	4,073
Interest	2,038	2,311	2,318	2,616	2,352	2,594	2,906	3,136	3,334	3,563
Transfers	1,334	1,714	1,396	2,132	5,314	5,535	6,085	6,653	7,192	7,838
Of which: Petroleum product subsidies	457	770	1,065	688	1,649	1,127	1,398	1,480	1,551	1,601
Social programs	0	0	0	671	2,834	3,075	3,525	3,890	4,242	4,690
Pensions	2,981	3,110	3,284	3,487	3,846	4,432	4,780	5,115	5,578	5,975
Other	2,128	2,545	2,123	897	796	1,107	1,269	1,400	1,527	1,688
Capital expenditure and net lending	6,349	7,736	9,372	12,422	15,882	15,406	17,672	19,661	21,441	23,514
Overall balance before nationalization (deficit -)	**-3,860**	**-1,729**	**4,101**	**2,653**	**4,304**	**-615**	**328**	**726**	**185**	**-510**
Of which: non hydrocarbons balance 2/	-6,263	-6,832	-5,276	-7,064	-10,536	-11,646	-12,794	-13,933	-15,096	-15,817
Nationalization cost	…	…	…	868	1,359	912	…	…	…	…
Overall balance after nationalization	**-3,860**	**-1,729**	**4,101**	**1,785**	**2,944**	**-1,526**	**328**	**726**	**185**	**-510**
Of which: non hydrocarbons balance 2/	-6,263	-6,832	-5,276	-7,932	-11,896	-12,558	-12,794	-13,933	-15,096	-15,817
Financing	3,860	1,729	-4,101	-1,785	-2,944	1,526	-328	-726	-185	510
External	2,724	1,721	370	1,146	676	1,264	659	561	447	349
Domestic	1,136	8	-4,471	-2,930	-3,621	262	-987	-1,287	-632	161
Of which: Central Bank	-561	-1,543	-5,726	-2,993	-4,705	0	-988	-1,279	-630	0
Memorandum Item										
Hydrocarbons related revenue	2,403	5,103	9,378	9,717	14,840	11,032	13,122	14,659	15,281	15,307

Sources: Bolivian authorities, and Fund staff estimates.

1/ In 2007, university salaries was reclassified from other spending into wages and salaries.

2/ Excludes the following hydrocarbon-related revenues: IDH, royalties, and the operating balance of YPFB.

Table 3. Bolivia: Operations of the Combined Public Sector
(In percent of GDP)

					Est.	Proj.				
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total revenue and grants	**26.8**	**30.9**	**34.3**	**34.6**	**36.3**	**34.0**	**33.8**	**33.7**	**33.0**	**31.9**
Current revenue	23.9	28.3	30.9	31.1	30.4	30.3	29.9	29.7	29.2	28.2
Tax revenue	20.6	25.1	27.8	27.8	27.6	27.1	26.7	26.6	26.1	25.2
IDH and royalties	3.4	6.5	9.4	9.0	8.3	6.9	6.9	6.9	6.6	6.0
Other Taxes	17.2	18.6	18.4	18.8	19.3	20.1	19.8	19.7	19.5	19.1
Direct taxes	3.6	4.2	4.7	3.8	4.4	4.6	4.6	4.6	4.6	4.6
Indirect taxes	13.7	14.4	13.6	15.0	14.8	15.5	15.2	15.1	14.8	14.6
Nontax revenue	3.3	3.2	3.1	3.3	2.9	3.2	3.2	3.1	3.1	3.1
Public sector enterprises operating balance	0.1	0.1	0.8	0.6	3.8	2.2	2.5	2.7	2.5	2.3
Central bank operating balance	0.3	0.3	0.7	1.3	0.8	0.7	0.5	0.4	0.4	0.4
Grants	2.5	2.1	1.8	1.6	1.2	0.8	0.9	0.9	0.9	1.0
Total spending	**32.3**	**33.2**	**29.8**	**32.1**	**32.9**	**34.5**	**33.6**	**33.2**	**32.9**	**32.2**
Current expenditure	23.2	23.1	19.6	20.0	20.1	22.3	21.4	20.9	20.6	20.0
Wages and salaries 1/	9.0	8.6	7.9	9.2	8.3	9.3	8.9	8.6	8.4	8.0
Goods and services	2.0	1.9	1.8	2.0	1.9	2.1	2.1	2.1	2.1	2.1
Interest	2.9	3.0	2.5	2.5	1.9	2.1	2.0	2.0	1.9	1.8
Transfers	1.9	2.2	1.5	2.1	4.3	4.4	4.2	4.2	4.1	4.1
Of which: Petroleum product subsidies	0.7	1.0	1.2	0.7	1.3	0.9	1.0	0.9	0.9	0.8
Social programs	0.0	0.0	0.0	0.7	2.3	2.4	2.4	2.4	2.4	2.4
Pensions	4.3	4.0	3.6	3.4	3.1	3.5	3.3	3.2	3.2	3.1
Other	3.1	3.3	2.3	0.9	0.6	0.9	0.9	0.9	0.9	0.9
Capital expenditure and net lending	9.1	10.0	10.2	12.1	12.8	12.2	12.2	12.3	12.3	12.2
Overall balance before nationalization (deficit -)	**-5.5**	**-2.2**	**4.5**	**2.6**	**3.5**	**-0.5**	**0.2**	**0.5**	**0.1**	**-0.3**
Of which: non hydrocarbons balance 2/	-9.0	-8.9	-5.8	-6.9	-8.5	-9.2	-8.8	-8.7	-8.7	-8.2
Nationalization cost	…	…	…	0.8	1.1	0.7	…	…	…	…
Overall balance after nationalization	**-5.5**	**-2.2**	**4.5**	**1.7**	**2.4**	**-1.2**	**0.2**	**0.5**	**0.1**	**-0.3**
Of which: non hydrocarbons balance 2/	-9.0	-8.9	-5.8	-7.7	-9.6	-9.9	-8.8	-8.7	-8.7	-8.2
Financing	**5.5**	**2.2**	**-4.5**	**-1.7**	**-2.4**	**1.2**	**-0.2**	**-0.5**	**-0.1**	**0.3**
External	3.9	2.2	0.4	1.1	0.5	1.0	0.5	0.4	0.3	0.2
Domestic	1.6	0.0	-4.9	-2.8	-2.9	0.2	-0.7	-0.8	-0.4	0.1
Banking system	-0.6	-2.4	-6.2	-3.1	-4.1	0.0	-0.7	-0.8	-0.4	0.0
Of which: Central Bank	-0.8	-2.0	-6.2	-2.9	-3.8	0.0	-0.7	-0.8	-0.4	0.0
Memorandum Item										
Hydrocarbons related revenue	3.5	6.6	10.2	9.4	11.9	8.7	9.1	9.2	8.8	7.9

Sources: Bolivian authorities, and Fund staff estimates.

1/ In 2007, university salaries was reclassified from other spending into wages and salaries.
2/ Excludes the following hydrocarbon-related revenues: IDH, royalties, and the operating balance of YPFB.

Table 4. Bolivia: Central Bank of Bolivia 1/

	2004	2005	2006	2007	Est. 2008	Proj. 2009
(Flows in millions of Bolivianos, unless otherwise indicated)						
Net international reserves	1,112	4,105	10,270	15,491	15,518	3,154
(In millions of U.S. dollars)	*138*	*503*	*1,289*	*1,999*	*2,135*	*443*
Net domestic assets	-354	-2,208	-7,676	-10,162	-10,816	-1,526
Net credit to the nonfinancial public sector	-561	-1,543	-5,725	-2,993	-4,705	0
Net credit to financial intermediaries	-355	-604	-1,620	-6,131	-4,713	-429
Of which: o pen market operations (increase -) 2/	-356	-168	-1,171	-5,397	-4,992	-327
Net medium- and long-term foreign liabilities (increase -)	873	8	5	6	24	5
Other items (net)	-311	-69	-336	-1,044	-1,422	-1,101
Currency issue	758	1,897	2,594	5,329	4,905	1,629
(Stocks in millions of Bolivianos, unless otherwise indicated)						
Net international reserves	8,640	12,785	24,291	40,705	54,284	56,337
(In millions of U.S. dollars)	*1,076*	*1,568*	*3,050*	*5,252*	*7,467*	*7,910*
Net domestic assets	-4,357	-6,605	-15,517	-26,602	-35,276	-35,701
Net credit to the nonfinancial public sector	1,710	236	-6,952	-9,337	-12,746	-12,746
Net credit to financial intermediaries	1,200	627	-1,455	-7,906	-13,200	-13,629
Of which: open market operations 2/	-517	-690	-1,868	-7,290	-12,103	-12,430
Net medium- and long-term foreign liabilities	-227	-220	-212	-207	-178	-173
Other items (net)	-7,039	-7,248	-6,898	-9,152	-9,152	-9,152
Currency issue	4,283	6,180	8,774	14,103	19,008	20,637
(Changes in percent of beginning-of-period currency issue)						
Net international reserves	31.6	95.8	166.2	176.6	110.0	16.6
Net domestic assets	-10.0	-51.6	-124.2	-115.8	-76.7	-8.0
Net credit to the nonfinancial public sector	-15.9	-36.0	-92.6	-34.1	-33.4	0.0
Net credit to financial private sector	-10.1	-14.1	-26.2	-69.9	-33.4	-2.3
Of which: open market operations (increase -) 2/	-10.1	-3.9	-19.0	-61.5	-35.4	-1.7
Net medium- and long-term foreign liabilities (increase -)	24.8	0.2	0.1	0.1	0.2	0.0
Other items (net)	-8.8	-1.6	-5.4	-11.9	-10.1	-5.8
Currency issue	21.5	44.3	42.0	60.7	34.8	8.6
Memorandum items						
Currency issue (average stock in percent of GDP)	4.6	5.6	7.1	9.8	16.7	16.5
NIR coverage of broad money (in percent)	28.6	36.8	59.7	76.0	84.5	84.0

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

1/ Stocks and flows in foreign currency are valued at accounting exchange rates for 2004-05 and at beginning-of-period exchange rates for 2006-09.

2/ Includes direct placements to individuals

Table 5. Bolivia: Financial System Survey 1/ 2/

	2004	2005	2006	2007	Est. 2008	Proj. 2009
(Flows in millions of Bolivianos, unless otherwise indicated)						
Net short-term foreign assets	867	6,249	10,892	14,415	14,996	3,618
(In millions of U.S. dollars)	*108*	*766*	*1,368*	*1,860*	*2,063*	*508*
Net domestic assets	-1,277	-1,998	-4,469	-1,502	-2,375	1,268
Net credit to the public sector	-359	-2,134	-5,760	-3,482	-5,116	0
Credit to the private sector	-1,108	1,068	1,958	4,400	6,851	2,181
Net medium- and long-term foreign liabilities (increase -)	635	-390	-105	359	-292	-52
Other items (net)	-444	-543	-562	-2,779	-3,818	-861
Broad money	-410	4,251	6,423	12,913	12,621	4,886
Liabilities in domestic currency	1,544	3,441	5,578	11,511	10,397	-287
Foreign currency deposits	-1,954	810	845	1,402	2,224	5,174
(Stocks in millions of Bolivianos, unless otherwise indicated)						
Net short-term foreign assets	13,141	19,496	31,494	46,823	59,399	61,812
(In millions of U.S. dollars)	*1,636*	*2,391*	*3,954*	*6,042*	*8,170*	*8,678*
Net domestic assets	17,024	15,269	9,212	6,765	4,871	5,225
Net credit to the public sector	4,393	2,361	-4,884	-7,760	-11,623	-11,623
Credit to the private sector	29,287	30,778	32,171	36,537	40,995	42,520
Net medium- and long-term foreign liabilities	-2,896	-3,326	-3,368	-3,006	-3,122	-3,114
Other items (net)	-13,760	-14,544	-14,707	-19,007	-21,379	-22,559
Broad money	30,165	34,765	40,706	53,588	64,270	67,036
Liabilities in domestic currency	6,764	10,206	15,784	27,295	38,427	38,139
Foreign currency deposits	23,401	24,559	24,922	26,293	25,843	28,897
(Changes in percent of broad money at the beginning of the period)						
Net short-term foreign assets	2.9	20.7	31.3	35.4	28.0	5.6
Net domestic assets	-4.3	-6.6	-12.9	-3.7	-4.4	2.0
Net credit to the public sector	-1.2	-7.1	-16.6	-8.6	-9.5	0.0
Credit to the private sector	-3.7	3.5	5.6	10.8	12.8	3.4
Net medium- and long-term foreign liabilities (increase -)	2.1	-1.3	-0.3	0.9	-0.5	-0.1
Other items (net)	-1.5	-1.8	-1.6	-6.8	-7.1	-1.3
Broad money	-1.4	14.1	18.5	31.7	23.6	7.6
Liabilities in domestic currency	5.2	11.4	16.0	28.3	19.4	-0.4
Foreign currency deposits	-6.6	2.7	2.4	3.4	4.2	8.0
Memorandum items						
Broad money (average stock in percent of GDP)	41.0	41.7	38.7	45.2	46.5	47.7
Credit to private sector (average stock in percent of GDP)	42.3	39.2	33.9	33.1	31.8	32.5
Financial system NFA coverage of deposits (percent)	50.0	66.8	96.3	115.7	128.5	130.3
Dollarization (end-period stocks)						
Foreign currency and dollar-indexed deposits	89.0	84.2	76.2	65.0	55.9	60.9
Foreign currency and dollar indexed credit	95.7	92.6	86.9	79.1	78.5	81.1

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

1/ The financial system comprises the central bank; commercial banks; nonbanks financial institutions; 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 2004-05 and at beginning-of-period exchange rates for 2006-09.

Table 6. Bolivia: Balance of Payments
(In millions of U.S. dollars, unless otherwise indicated)

					Est.	Proj.				
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Current account	**337**	**625**	**1,297**	**1,758**	**1,889**	**-79**	**236**	**566**	**568**	**410**
Trade balance	302	457	1,060	1,046	1,091	-529	-207	74	31	-154
Exports, f.o.b.	2,146	2,791	3,875	4,490	6,104	4,713	5,208	5,674	5,855	5,983
Natural gas	620	1,086	1,669	1,989	2,948	2,159	2,504	2,716	2,772	2,792
Of which:										
To Brazil	542	896	1,357	1,624	2,781	1,890	2,008	2,076	2,119	2,135
Volume (mmm3 p/day)	19.5	22.4	24.4	26.9	31.1	31.1	31.1	31.1	31.1	31.1
Price ($/000cf3)	2.2	3.1	4.3	4.7	6.9	4.7	5.0	5.2	5.3	5.3
To Argentina	49	162	280	326	167	269	496	640	653	658
Volume (mmm3 p/day)	2.2	4.8	5.1	4.6	1.5	3.6	6.2	7.7	7.7	7.7
Price ($/000cf3)	1.7	2.6	4.3	5.5	8.6	5.9	6.2	6.4	6.6	6.6
Mining	456	544	1,061	1,372	1,947	1,321	1,484	1,601	1,609	1,596
Soy - related 1/	387	264	237	266	311	231	239	252	272	292
Other	684	897	907	864	898	1,002	981	1,105	1,202	1,303
Imports, c.i.f.	-1,844	-2,334	-2,814	-3,444	-5,013	-5,242	-5,415	-5,600	-5,824	-6,137
FDI/project related	-50	-358	-213	-158	-195	-213	-185	-187	-192	-175
Non FDI/project related	-1,794	-1,976	-2,602	-3,286	-4,818	-5,029	-5,229	-5,414	-5,632	-5,962
Services (net)	-71	-42	-168	-159	-216	-226	-236	-246	-257	-268
Income (net)	-385	-374	-418	-212	-64	-301	-330	-337	-338	-343
Of which: interest due on external public sector de	-107	-135	-133	-109	-123	-134	-138	-139	-138	-136
Of which: investment income (net)	-289	-268	-389	-324	-370	-388	-408	-428	-449	-472
Transfers (net)	491	584	822	1,083	1,078	977	1,009	1,075	1,131	1,176
Of which: HIPC assistance from grants	68	62	44	2	0	0	0	0	0	0
Of which: public sector grants				207	209	194	190	202	205	198
Of which: non identified				6	-34	0	0	0	0	0
Capital and financial account	**-211**	**-132**	**224**	**232**	**245**	**522**	**547**	**523**	**535**	**472**
Capital transfers 2/	8	9	1,813	1,180	0	0	0	0	0	0
Direct investment (net)	63	-280	281	204	413	510	585	591	593	535
Gross investment	385	404	582	739	973	852	927	933	935	877
Disinvestment and investment abroad	-322	-684	-301	-535	-560	-342	-342	-342	-342	-342
Portfolio investment (net)	-35	-153	40	-10	-164	-67	-111	-128	-108	-102
Public sector loans	234	163	-1,543	-1,082	97	174	86	72	57	44
Disbursements	547	499	337	395	325	401	269	244	220	195
Amortization 2/	-313	-336	-1,880	-1,477	-228	-227	-183	-173	-163	-150
Fin system net foreign assets, excl. liquid asset requ	18	-97	-109	127	80	3	-5	-4	-2	0
Nonbank private sector loans	65	380	-25	-92	-28	-92	-3	-2	-1	0
Other, including errors and omissions	-563	-153	-231	-92	-148	0	0	0	0	0
Overall balance	**126**	**493**	**1,520**	**1,990**	**2,135**	**443**	**784**	**1,089**	**1,102**	**883**
Financing	**-126**	**-493**	**-1,520**	**-1,990**	**-2,135**	**-443**	**-784**	**-1,089**	**-1,102**	**-883**
Memorandum items										
Current account (in percent of GDP)	3.8	6.5	11.3	13.2	11.0	-0.4	1.2	2.7	2.5	1.6
Merchandise exports (in percent of GDP)	24.4	29.2	33.6	33.8	35.7	26.6	26.6	27.0	25.8	23.9
Merchandise imports (in percent of GDP)	-20.9	-24.4	-24.4	-25.9	-29.3	-29.5	-27.6	-26.6	-25.7	-24.5
Gross official reserves (end-of-period)	1,212	1,674	3,064	5,252	7,466	7,909	8,693	9,782	10,885	11,767
(In months of imports of goods and services)	5.1	5.8	9.0	11.0	15.0	15.3	16.3	17.6	18.6	17.1
GDP (in millions of U.S. dollars)	8,809	9,574	11,526	13,292	17,114	17,742	19,589	21,040	22,671	25,012

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$ 1,804.3 million. In 2007 includes effect of MDRI relief from IADB equivalent to US$ 1,099 million.

Table 7. Bolivia: Alternative Medium-Term Scenario 1/

	Proj.				
	2009	2010	2011	2012	2013
	(Annual percentage changes)				
Income and prices					
Real GDP	4.0	4.2	3.9	3.6	3.4
GDP deflator	-7.9	10.8	6.2	4.9	6.7
CPI inflation (period average)	8.1	7.5	6.5	4.9	4.0
CPI inflation (end-of-period)	8.0	7.0	6.0	4.0	4.0
	(In percent of GDP)				
Investment and savings					
Total investment	19.7	21.3	20.9	20.9	20.5
Public sector	9.3	9.5	9.6	9.6	9.5
Private sector	10.4	11.7	11.3	11.3	11.0
Gross domestic savings	11.4	15.2	16.3	16.3	15.5
Gross national savings	15.4	18.6	19.7	19.8	19.0
Public sector	5.7	8.3	8.5	8.3	8.0
Private sector	9.7	10.4	11.2	11.5	11.0
Investment/saving balances	-4.3	-2.6	-1.2	-1.2	-1.5
Public sector	-3.6	-1.3	-1.1	-1.3	-1.5
Private sector	-0.6	-1.3	-0.1	0.2	0.0
Combined public sector					
Revenues and grants	33.7	33.2	33.1	32.5	31.6
Of which:					
Royalties on hydrocarbons	6.3	6.2	6.1	5.9	5.4
Expenditure	37.3	34.5	34.2	33.8	33.1
Current	23.6	22.3	21.9	21.5	20.9
Capital 2/	13.7	12.2	12.3	12.3	12.2
Overall balance	-3.6	-1.3	-1.1	-1.3	-1.5
Of which:					
Balance before nationalization costs	-2.8	-1.3	-1.1	-1.3	-1.5
Non-hydrocarbons balance	-10.1	-8.6	-8.5	-8.4	-8.0
Total net public debt	21.4	19.8	19.0	18.8	18.5
External sector					
Current account	-4.3	-2.6	-1.2	-1.2	-1.5
Merchandise exports	24.7	24.4	24.7	23.8	22.1
Of which: natural gas	9.7	10.1	10.2	9.7	8.9
Merchandise imports	31.6	29.2	28.1	27.2	26.0
Terms of trade index (percent change)	-30.3	3.8	0.8	-3.6	-3.3
Gross international reserves 3/					
In millions of U.S. dollars	7,673	7,829	8,243	8,626	8,826
In percent of broad money	89.3	86.0	84.1	80.6	76.2
(Changes in percent of broad money at the beginning of the period, unless otherwise specified)					
Money and credit					
NFA of the financial system	-1.4	1.9	4.6	3.9	1.9
NDA of the financial system	1.9	6.8	4.5	5.1	6.4
Of which: credit to private sector (percent of GDP)	32.5	32.3	32.2	32.1	31.5
Broad money	0.5	8.7	9.1	9.0	8.3
Memorandum item					
Nominal GDP (in billions of U.S. dollars)	16.72	18.59	19.97	21.46	23.63

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

1/ Reflects a 25 percent reduction in oil prices relative to the baseline.
2/ Includes nationalization costs and net lending.
3/ Excludes reserves from the Latin American Reserve Fund (FLAR) and includes Offshore Liquidity Requirements (RAL).

Table 8. Bolivia: Selected Vulnerability Indicators

	2002	2003	2004	2005	2006	2007	Nov. 2008
Liquidity coverage							
Net international reserves (US$ million)	772	888	1,076	1,568	3,050	5,252	7,596
NIR coverage, in percent of:							
Dollar deposits	24.0	28.1	36.9	52.1	97.5	154.8	228.9
Total deposits	22.3	26.0	32.9	43.8	74.3	100.6	119.8
Broad money	20.1	23.2	28.6	36.8	59.7	76.0	90.8
Net foreign assets of the financial system (US$ million)	1,345	1,479	1,636	2,391	3,954	6,042	7,688
NFA coverage, in percent of:							
Dollar deposits	41.8	46.9	56.2	79.4	126.4	178.1	231.6
Total deposits	38.8	43.3	50.0	66.8	96.3	115.7	121.2
Broad money	35.0	38.6	43.6	56.1	77.4	87.4	91.8
Debt ratios 1/							
(In percent of GDP)							
Total gross public debt	69.1	74.1	76.7	80.4	55.2	40.9	35.0
Domestic public debt	20.0	23.0	24.4	22.5	16.6	24.9	27.0
External public debt	49.2	51.1	52.3	57.9	38.6	16.1	8.1
Financial dollarization							
(In percent)							
Dollar deposits	92.9	92.3	89.0	84.2	76.2	65.0	52.3
Dollar credit	95.8	97.2	95.7	92.6	86.9	79.1	73.6
Banking sector indicators							
Nonperforming loans (in percent of total loans)	17.6	16.7	14.0	11.3	8.7	5.6	4.7
Restructured loans (in percent of total loans)	31.9	33.9	33.1	25.8	19.4	13.0	9.0
Nonperforming and restructured loans (in percent of total loans)	49.5	50.6	47.1	37.1	28.1	18.6	13.7
Capital adequacy ratio	16.1	15.3	14.9	14.7	13.3	12.6	13.8
Profits after tax (in percent of equity)	0.6	2.7	-1.2	6.3	12.9	21.2	21.3
Cash and short-term investments as percent of total assets	25.9	25.8	28.3	30.7	33.9	35.2	40.6
Memorandum items							
Fiscal balance (in percent of GDP) 2/	-8.8	-7.9	-5.5	-2.2	4.5	1.7	2.4
Total financial system deposits (US$ million)	3,463	3,420	3,275	3,578	4,105	5,222	6,412
Of which: Sight deposits	1,177	975	868	934	1,099	1,375	1,321

Sources: Bolivian authorities; and Fund staff estimates.

1/ Reflects end-2008 projected debt levels.

2/ For 2008, reflects the full-year estimate.

Table 9. Bolivia: Millennium Development Goals

	First Observation	2004	2005	2006	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)	...	36.7	37.7	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)	...	...	…	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)		94.0	94.5	92.2	100.0
Percentage of cohort reaching grade 5	55.4 (1992)	79.5	77.8	75.6	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)	...	0.3	-0.6	0.0
Gender disparities at completion of secondary education (percent)	3.4 (1992)	...	-0.4	-1.5	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)	...	...	…	30.0
Immunization against measles (percent of children under 12-months)	68 (1994)	...	84.5	82.6	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)	...	...	…	104.0
Proportion of births attended by skilled health personnel (percent)	27 (1995)	59.6	61.9	65.0	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 (percent ages 15-24)	1.8 (1990)	13.4	19.3	19.2	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)	4.1	5.5	5.2	2.0
Incidence of tuberculosis cases cured (percent of diagnosed)	52.6 (1995)	...	78.7	76.3	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)	72.3	71.7	73.1	78.5
Access to improved water source (percent of population)	28 (1992)	41.6	43.5	55.7	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 expenditure)	17.8 (1995)	...	...	…	15.0

Source: Bolivian authorities.

ANNEX 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 November 30, 2008, Bolivia did not have any outstanding purchases or loans. The latest SBA expired on March 31, 2006. The last Article IV consultation was completed by the Executive Board on July 13, 2007 (IMF Country Report No. 07/248). Bolivia has received wide-ranging TA in recent years. An update safeguards assessment was completed in 2004. 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. Currently, the Central Bank of Bolivia is not subject to the policy. 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 under the Interim Strategy Note (ISN) approved in November 2006 concluded in June 2008. The World Bank and the Government are negotiating a new strategy in order to continue and deepen the Bank's long-term support to Bolivia's development priorities. Preliminary discussions focused on extreme poverty eradication. Lending under the last ISN included only IDA resources, which financed 11 investment projects, with disbursements of US$140 millions over the last two years. The Bank's current portfolio in Bolivia comprises eleven projects under implementation, with total commitments of US$272.8 million of which US$196.2 million remain undisbursed.

Relations with the Inter-American Development Bank

As of November 30, 2008, Bolivia's outstanding debt to the IDB was approximately US$530.0 millions with undisbursed approved funds for US$460.0 millions. New IDB lending to Bolivia will be following newly adopted operational guidelines for concessional funds under the Fund of Special Operations performance-based allocation system. The Bank's 2008 operative program contains a portfolio of sovereign guaranteed operations of 6 loans for a total amount of US$105.0 millions for the year, concentrated in water, housing and agricultural productivity sectors. Seven additional loans for US$130.0 millions have been identified and are already in the Bank's lending pipeline for the 2008-2009 cycles.

Statistical issues

Data provision to the Fund has some shortcomings, but is broadly adequate for surveillance. 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. 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 2008 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department

December 11, 2008

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Appendix 1. Bolivia—Fund Relations
(As of November 30, 2008)

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
Fund holdings of currency	162.64	94.83
Reserve position in Fund	8.87	5.17

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	26.70	100.00
Holdings	27.47	102.89

IV. **Outstanding Purchases and Loans:** None

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):

	Forthcoming			
	2009	**2010**	**2011**	**2012**
Principal				
Charges/Interest	0.00	0.00	0.00	0.00
Total	**0.00**	**0.00**	**0.00**	**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**
III. 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)			

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).

Eligible Debt

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

VIII. **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 on June 27, 2003, and while no systemic risks with the CBB's safeguards were identified, uncertainties were expressed about the de facto lack of operational independence and program monetary data. An update assessment was completed on 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. Currently, CBB is not subject to the policy.

IX. **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 November 30, 2008, the official selling rate was US$7.07 per U.S. dollar.

X. **Article IV Consultation**. The last Article IV consultation was completed by the Executive Board on July 13, 2007 (IMF Country Report No. 07/248). Bolivia is on a standard 12-month consultation cycle.

XI. **Technical Assistance, 2004–08**

Department	**Purpose**	**Date**
FAD	Tax administration	Aug.2004
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
FAD	Public finance information system	December 2006
STA	ROSC Data Module	January 2007
MCM	Inflation targeting	June 2007
STA	National Accounts	September 2007
FAD	Tax policy	March 2008
STA	National Accounts	August 2008
FAD	Treasury Operations, Cash and Debt Management	November 2008

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

APPENDIX 2. BOLIVIA: RELATIONS WITH THE WORLD BANK[1]

1. **Based on preliminary conversations with the Government, the World Bank Group has begun the preparation of a new strategy that will conduct the Bank's support to Bolivia in the upcoming years.** The Interim Strategy Note (ISN) approved in November 2006 allowed supporting to Bolivia during FY07 and FY08. This support included lending operations, trust funds, analytical work and technical assistance in areas where the Bank and the Government agreed upon: enhancing good governance and transparency; fostering jobs through growth; and providing better services to the poor. This strategy concluded in June 2008, thus the World Bank and the Government have begun conversations to define areas and instruments that will be included in the new strategy in order to continue and deepen the Bank's long-term support to Bolivia's development priorities. Preliminary discussions focused on extreme poverty eradication.

2. **The World Bank's portfolio in Bolivia comprises 11 investment projects for a total amount of US$272.8 million of which US$196.2 million remain undisbursed.** Under the last ISN, all IDA14 resources allocated to Bolivia (US$140 million) were committed in eight investment projects approved over the last two years. Out of the 11 projects, three were approved under the FY04-05 Country Assistance Strategy (CAS), seven were conceived under the last ISN, and one was incorporated at the Government's request to address the impacts of flooding caused by the natural disasters of El Niño and La Niña. The portfolio, entirely financed with IDA resources, includes the following projects:

Project	**Commitment US$ million**	**Closing date**
Decentralized Infrastructure for Rural Transformation	20	June 2009
Road Rehabilitation and Maintenance	77	December 2009
Land for Agricultural Development	15	June 2010
Urban Infrastructure for the Poor	30	November 2010
Secondary Education Transformation	10	December 2010
Emergency Recovery and Disaster Management	16.9	June 2011
Rural Alliances	28.4	September 2011
Investing in Children and Youth	17	December 2013
Participatory Rural Investment II	20	March 2013
Lake Titicaca Local Sustainable Development	20	June 2013
Expanding Access to Reduce Health Inequities	18.5	January 2014

[1] Prepared by World Bank staff.

3. **Additionally, the World Bank program includes Trust Funds and Global Programs**. The Bank is currently managing five grants amounting to $8.7 million, which support institutional strengthening and project preparation and execution. These include: Global Partnership on Output Based Aid ($5.2 million), GAIN Global Food Fortification ($2.6 million), Strengthening of the Deputies Chamber Finance Commission ($0.2 million), Capacity Building to Support Carbon Finance Transactions ($0.5 million), and Strengthening Donor Aid Coordination ($0.1 million).

4. **Under the last ISN, the World Bank concluded the following studies**:

- *Policies for Increasing Firms' Formality and Productivity* that assesses productivity constraints faced by Bolivian firms and policies to encourage their formalization and productivity. This study triggered an additional piece of work that assesses the informality among women entrepreneurs.
- Two phases of the *Programmatic Social Protection Study* that presents a diagnosis on poverty, vulnerability and exclusion, an assessment of existing social protection programs, the involvement of sub-national governments and communities in the provision of social services, an in-depth analysis of financing to the sector and the urban dimension of social protection. The study provides recommendations for the design and implementation of the Government's Social Protection Strategy. This study contributed to the design of the Investing in Children and Youth Project.
- *Strengthening Competitiveness for Export Diversification and Inclusive Growth* that evaluates the trade policy and its effects on non-traditional exports.
- *Operational Review of the Fondo de Inversión Productiva y Social* that evaluates the core capabilities and operational and organizational elements required for the agency to successfully fulfill its mandate.

5. **While the preparation of the new strategy takes place, the Bank and the Government have decided to advance in the design of two investment projects that were in the pipeline, as well as in the development of economic and sector works.** The Government and the Bank agreed on postponing three projects originally included in the last ISN – Job Creation and Competitiveness, Building Government Monitoring and Evaluation Systems, and Strengthening State Efficiency and Transparency. Two of these projects have advanced in their preparation, in close coordination with the Government (Job Creation and Competitiveness and Building Government M&E Systems). Moreover, an additional financing for the Rural Alliances Project is under consideration. In terms of analytical and advisory activities, studies on municipal services and finances, and on food inflation are currently being prepared to be delivered in FY09.

APPENDIX 3. BOLIVIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK [1]

6. **As of November 30, 2008, the Inter-American Development Bank (IDB) had approved loans to Bolivia amounting to US$4.11 billion, with disbursements totaling US$3.34 billion.** Bolivia's outstanding debt to the IDB was approximately US$530.0 millions with undisbursed approved funds for US$460.0 millions. Differently from what happened in the first half of the decade, net cash flows to the country were negative during 2006 and 2007, a trend expected to continue during 2008. In the recent past the IDB financial engagement with the country included successive debt relief agreements, first under HIPC initiative, and then under it's own initiative following the MDRI. The last round of debt relief wrote off a total of US$741.1 million in principal payments and US$307.3 millions of future interest payments, generating an estimated annual fiscal space of more than US$18.0 millions on average.

7. **The IDB is implementing new criteria of allocation of concessional lending**. Consistent with the application of the Debt Sustainability Framework and after the last round of debt relief, new IDB lending to Bolivia will be following newly adopted operational guidelines for concessional funds under the Fund of Special Operations performance-based allocation system. Parallel lending operations, modality that features differential combination between ordinary and concessional funding, will be enacted as the preferred lending instrument up to 2015. During the 2007-2008 transitional period, the concessional element of the blend will amount 37% of an estimated annual allocation of US$74.3 millions.

8. **Under the 2008-2010 Bank's country strategy with Bolivia, the government and the IDB have agreed on keeping sustainable poverty reduction as main objective of their strategic engagement**. In pursuit of this objective, the Bank has aligned its actions with those contained by Bolivia's National Development Plan in order to achieve a grater degree of coordination among international cooperation entities acting in Bolivia, while better targeting priority areas in the poverty reduction action plan. Four main strategic areas are proposed under the new strategy: (i) productivity, competitiveness and productive infrastructure, to promote economic growth consistent with poverty reduction targets; (ii) water, sanitation and social development to target high-poverty municipalities; (iii) building opportunities for the majority and development with identity to enhance the participation of the bottom tiers of the income distribution; and (iv) institutional strengthening of the state at both national and sub-national levels, to achieve higher efficiency of the public sector while promoting the decentralization process.

9. **As of November 30, 2008 the portfolio of executing sovereign guaranteed operations in Bolivia consists of 28 loans totaling US$826.0 millions, of which 45% has already been disbursed**. The current executing portfolio supports mostly water and

[1] Prepared by IDB staff.

sanitation, education, health, infrastructure and productivity interventions. The undisbursed sovereign portfolio is concentrated (53%) in the transportation sector. The non-sovereign guaranteed executing portfolio consists of 3 loans totaling US$114.0 millions, of which 81.6% has already been disbursed. Seven additional loans for US$130.0 millions have been identified and are in the Bank's lending pipeline.

10. **The conditions for the strategy's implementation remain complex, with important institutional, social and political definitions yet to be clarified thus representing direct and indirect risks to the fulfillment of the strategy objectives**. Widespread economic reform reorientation, macroeconomic and financial stability, vulnerability in front of changing external conditions and natural disasters risks also pose indirect challenges to the implementation scenarios of the Bank's strategy. In the prospective risk assessment of the new strategy, weak policy implementation and institutional capacity has been identified as additional risk factors to be mitigated in the implementation of the Bank's strategic program with Bolivia.

APPENDIX 4. BOLIVIA: STATISTICAL ISSUES

Data provision to the Fund has some shortcomings, but is broadly adequate for surveillance. A data ROSC mission in early 2007 confirmed advances in recent years, and reiterated the existence of data shortcomings that may hamper the formulation of appropriate policies. 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 National Institute of Statistics (INE) has begun a thorough revision of the national accounts statistics, including the updating of the base year (currently dating from 1990) and an intensified implementation of the *System of National Accounts 1993 (SNA 1993)*. The National Accounts Directorate (NAD) is in the process of compiling a set of integrated economic accounts by institutional sectors and sub sectors. The IMF Statistics Department has provided technical assistance to INE on the ongoing revision of Bolivia's national accounts.

- **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.** In April 2008, INE released a revamped consumer price index (CPI) covering the nine largest cities and based on expenditure weights derived from a 2003/04 household budget survey. Industrial producer price indices and external trade unit values are compiled by INE, but are in need of revision as regards concepts and definitions consistent with *SNA 1993*, as well as treatment of seasonal products, missing items, quality changes, and introduction of new products.

II. FISCAL SECTOR

- **The Ministry of Finance (MoF) provides timely information on operations for the consolidated general government (central government and decentralized entities), public enterprises and the central bank**. 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 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 for publication in *International Financial Statistics (IFS)* upon request, Fund staff has access to more detailed and timely balance of payments and external debt data.

- **The authorities have disseminated on the World Bank QEDS website gross liabilities of short and long-term private debt**. There have been some improvements in the coverage of private capital flows and positions since the foreign direct investment survey was undertaken in 2007 by the central bank. However, as noted 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 subscriber, Bolivia is disseminating the Data Template on International Reserves and Foreign Currency Liquidity. STA has extended an invitation to Bolivia to disseminate its Reserves Template on the Fund's website.

IV. Monetary Sector

- **Coverage, sectorization, and timeliness of monetary statistics are 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 has been expanded to cover the investment funds managing societies (SAFIS). The BCB has also started compiling 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.

BOLIVIA: INDICATORS REQUIRED FOR SURVEILLANCE

(As of December 2, 2008)

	Date of latest observation	Date received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of publication[1]	Memo Items: Data Quality–Methodological soundness[10]	Memo Items: Data Quality–Accuracy and reliability[11]
Exchange Rates	Oct. 2008	Nov. 2008	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Sep. 2008	Nov. 2008	D	D	M		
Reserve/Base Money	Oct. 2008	Nov. 2008	M	M	M	O, LO, LO, O	O, O, O, O, O
Broad Money	Aug. 2008	Oct. 2008	M	M	M		
Central Bank Balance Sheet	Oct. 2008	Nov. 2008	M	M	M		
Consolidated Balance Sheet of the Banking System	Aug. 2008	Oct. 2008	M	M	M		
Interest Rates[3]	Oct. 2008	Nov. 2008	W	W	M		
Consumer Price Index	Oct. 2008	Nov. 2008	M	M	M	LO, O, LO, O	O, LO, LNO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[4] – General Government[5]	Sep. 2008	Nov. 2008	M	M	M	LO, LO, LNO, LO	LO, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[4]– Central Government[6]	n/a	n/a	n/a	n/a	n/a		
Stock of Central Government and Central Government-Guarantee Debt[7]	Sep. 2008	Nov. 2008	M	M	M		
External Current Account Balance	Sep. 2008	Nov. 2008	Q	Q	Q	O, LO, LO, LO	LO, O, LO, O, LO
Exports and Imports of Goods and Services[8]	Sep. 2008	Nov. 2008	M	M	M		
GDP/GNP	Jun. 2008	Oct. 2008	Q	Q	Q	LO, LO, LO, O	LNO, LO, LNO, O, LO
Gross External Debt	Sep. 2008	Nov. 2008	M	M	M		
International Investment Position[9]	Sep. 2008	Nov. 2008	Q	Q	Q		

[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] Guaranteed non-financial public sector debt. Including currency and maturity composition.
[8] Monthly frequency for goods only.
[9] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[10] Reflects the assessment provided in the data ROSC (published on August 13, 2007, and based on the findings of the mission that took place during January 24–February 7, 2007) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[11] Same as footnote 10, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND

BOLIVIA

External and Public Debt Sustainability Analysis

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

Approved by Jose Fajgenbaum and Alan MacArthur

December 11, 2008

Following MDRI debt relief, the sustainability of Bolivia's public debt has continued to improve as a result of overall fiscal surpluses. Debt ratios continue to display ample margins with respect to risk thresholds, and are expected to decline further under baseline policies. Given the predominantly long maturities of remaining stocks of both domestic and foreign debt, debt service is projected to remain low. The path of debt ratios would reach an inflexion point and take on an upward trend under standard stress tests, but would remain within manageable bounds over the medium- and long run.

Background

1. **Bolivia's gross public debt (domestic and external) decreased significantly over the last two years, benefiting from fiscal surpluses following the MDRI**. The gross public debt-to-GDP ratio—35 percent in 2008—is projected to decline further to 23 percent by 2013, and to 16 percent in 2027. Similarly, the NPV of public debt-to-GDP ratio is projected to decline from 33 percent in 2008 to 16 percent during the DSA's projection period. Moreover, with the accumulation of deposits of the nonfinancial public sector in the financial system—amounting to about 18 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. On account of declining gross debt, net debt ratios would reach very low levels during the projection period.

Baseline scenario

2. **The main assumptions** of the baseline scenario for the period 2008–27 are:

- ***Average annual real GDP growth***: 4.2 percent until 2013, on account of implementation of already identified mining projects, declining to 4 percent during 2014–27.

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

- *Average deflator inflation*: 6.7 percent per year until 2013, in line with the latest medium-term staff projections, and would decline further to 4 percent over the long term.

- *Export and import growth*: in line with the medium-term staff projections and the assumption of 7½ percent growth beyond 2013. The latter would imply stable import and export ratios to GDP over the long term.

- *FDI*: in line with expected investments for the hydrocarbons and mining sectors.

- *Financing strategy:* commercial debt is expected to remain nil, with CAF expected to remain as the main source of financing.

- *Average concessionality of the public sector borrowing*: projected to evolve, in the medium-term, according to the pipeline of official loans. Over the longer run, concessionality is expected to decrease gradually.

3. **Given the above assumptions, Bolivia's external debt is expected to remain sustainable throughout the projection period**. After a projected small deficit in 2009, the fiscal position would remain close to balance in the period 2010-2013, with an average overall surplus of about 0.1 percent of GDP. Afterwards, the fiscal position would weaken gradually, mainly reflecting lower hydrocarbons-based revenues in relation to GDP, reaching a deficit of about 1 percent of GDP by the end of the projection period. Under the baseline outlook, Bolivia's indebtedness and debt service levels would remain very manageable. Specifically, the total stock of external debt (public and private) is projected to fall to about 16 percent of GDP by 2013, and to stabilize around 5½ percent of GDP by 2027. Consequently, Bolivia's risk of debt distress is very low[2]—an assessment that would holds even under significant stress tests.

Stress tests

4. **Standard stress tests suggests that Bolivia's low external indebtedness is resilient to severe exogenous shocks**. Under the most extreme stress test—a combined shock to debt concessionality, GDP growth, export growth, and external inflation—the ratio of the NPV of debt to GDP deteriorates significantly but eventually stabilizes. In all cases, it would remain below risky levels. Flow indicators also remain manageable under all stress tests.

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[2] The World Bank's three-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 percent and 150 percent, respectively) leave the country's current levels with significant safety margins.

Table 1. Bolivia: External Debt Sustainability Framework, Baseline Scenario, 2005-28 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical	Standard	Projections									
	2005	2006	2007	Average 2/	Deviation 2/	2008	2009	2010	2011	2012	2013	Avg. 2008-13	2018	2028	Avg. 2014-28
External debt (nominal) 1/	**64.7**	**40.2**	**25.9**			**19.4**	**20.1**	**19.0**	**18.2**	**17.4**	**16.3**		**11.3**	**5.2**	
Of which: public and publicly guaranteed (PPG)	52.3	...	...			13.3	14.2	13.6	13.2	12.6	11.9		8.3	3.8	
Change in external debt	-3.2	-24.5	...			-6.6	0.7	-1.1	-0.8	-0.9	-1.1		-0.9	-0.4	
Identified net debt-creating flows	-8.3	-24.1	-21.8			-13.4	-2.5	-4.9	-6.4	-6.0	-5.0		-2.6	-0.2	
Non-interest current account deficit	-8.4	-13.7	-14.6	-3.6	7.4	-12.2	-0.5	-2.7	-4.0	-3.7	-2.9		-1.2	0.5	-0.4
Deficit in balance of goods and services	-4.4	-7.7	-6.6			-5.1	4.4	2.1	0.8	1.0	1.7		3.3	2.9	
Exports	34.7	38.2	36.9			38.5	29.6	30.2	30.8	29.9	28.3		25.5	23.2	
Imports	30.3	30.6	30.3			33.4	34.1	32.2	31.6	30.9	29.9		28.8	26.0	
Net current transfers (negative = inflow)	-6.2	-7.3	-8.1	-5.6	1.3	-6.3	-5.5	-5.3	-5.3	-5.2	-5.0		-4.3	-2.7	-3.8
Of which: official	-3.2	-2.6	-1.6			-1.2	-1.1	-1.0	-1.0	-1.0	-0.9		-0.7	-0.3	
Other current account flows (negative = net inflow)	2.1	1.3	0.0			-0.8	0.6	0.6	0.5	0.5	0.5		-0.3	0.3	
Net FDI (negative = inflow)	3.0	-2.2	-2.1	-5.3	5.1	-1.2	-2.3	-2.7	-2.9	-2.7	-2.5		-1.6	-0.8	-1.3
Endogenous debt dynamics 3/	-2.8	-8.3	-5.1			-0.1	0.4	0.4	0.4	0.4	0.4		0.2	0.1	
Contribution from nominal interest rate	1.9	1.9	1.5			1.1	1.1	1.2	1.1	1.1	1.0		0.6	0.3	
Contribution from real GDP growth	-2.8	-2.6	-1.5			-1.2	-0.8	-0.8	-0.7	-0.6	-0.5		-0.4	-0.2	
Contribution from price and exchange rate changes	-1.9	-7.6	-5.1			…	…	…	…	…	…		…	…	
Residual (3-4) 4/	**5.0**	**-0.4**	**7.5**			**6.9**	**3.2**	**3.9**	**5.6**	**5.1**	**3.9**		**1.7**	**-0.2**	
Of which: exceptional financing	0.0	0.0	-0.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 5/	...	...	...			17.4	16.3	16.4	16.0	15.4	14.5		10.6	5.2	
In percent of exports	...	...	...			45.2	55.2	54.5	51.8	51.5	51.3		41.6	22.3	
NPV of PPG external debt	**...**	**...**	**...**			**11.4**	**10.5**	**11.0**	**10.9**	**10.6**	**10.1**		**7.5**	**3.7**	
In percent of exports	...	...	...			29.5	35.3	36.6	35.4	35.6	35.8		29.6	15.9	
In percent of government revenues	...	...	...			41.9	36.8	39.2	38.2	36.4	34.2		26.1	14.0	
Debt service-to-exports ratio (in percent)	16.5	12.6	21.5			14.5	17.5	16.4	15.0	14.4	13.8		11.2	5.7	
PPG debt service-to-exports ratio (in percent)	11.8	7.5	15.4			10.3	12.2	11.3	10.3	9.8	9.3		7.8	3.9	
PPG debt service-to-revenue ratio (in percent)	14.0	8.7	19.3			14.7	12.8	12.1	11.1	10.0	8.9		6.9	3.4	
Total gross financing need (billions of U.S. dollars)	0.0	-1.2	-1.2			-1.1	0.6	0.1	-0.2	-0.3	-0.2		0.2	0.9	
Non-interest current account deficit that stabilizes debt ratio	-5.2	10.8	-0.3			-5.6	-1.3	-1.6	-3.2	-2.9	-1.8		-0.3	0.9	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.4	4.8	4.6	3.7	1.0	5.9	4.0	4.2	3.9	3.6	3.4	4.2	3.4	3.4	3.4
GDP deflator in US dollar terms (change in percent)	2.9	13.3	14.5	3.5	8.0	20.1	-1.0	3.6	2.3	2.9	4.5	5.4	4.0	4.1	4.0
Effective interest rate (percent) 6/	3.0	3.5	4.6	3.1	0.8	5.5	6.1	6.3	6.3	6.2	6.0	6.1	5.6	5.3	5.4
Growth of exports of G&S (US dollar terms, in percent)	28.0	31.0	15.4	19.5	12.4	32.9	-20.8	9.9	8.5	3.3	2.4	6.0	7.3	0.0	6.6
Growth of imports of G&S (US dollar terms, in percent)	22.9	19.9	18.5	10.6	10.9	40.4	5.0	2.1	4.2	4.0	4.9	10.1	7.2	0.0	6.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	9.9	10.4	9.3	9.0	8.6	8.1	9.2	7.0	5.0	6.0
Aid flows (in billions of US dollars) 7/	0.4	0.4	0.4			0.3	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		0.4	0.7	
Of which: Concessional loans	0.2	0.1	0.2			0.1	0.1	0.1	0.1	0.1	0.1		0.1	0.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.4	1.4	1.2	1.1	1.1	1.1		1.1	1.0	1.1
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			44.7	40.9	48.0	50.3	54.2	58.5		67.3	79.3	74.6
Memorandum items:															
Nominal GDP (billions of US dollars)	9.5	11.2	13.4			17.1	17.6	19.0	20.2	21.6	23.3		33.5	69.4	
(NPVt-NPVt-1)/GDPt-1 (in percent)						-0.7	1.5	0.6	0.5	0.3	0.3	0.4	0.0	0.0	0.0

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 proj. 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).

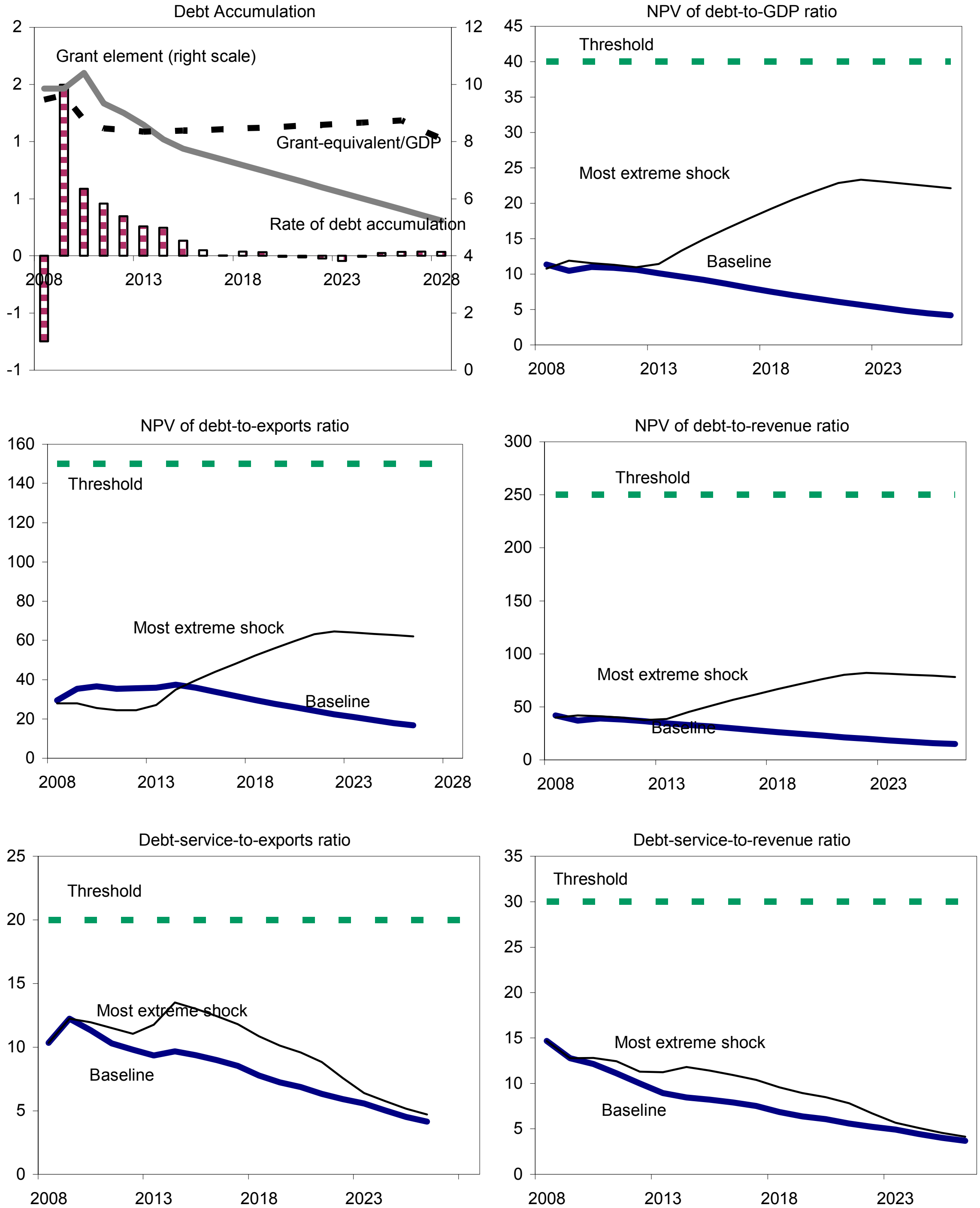
Table 2. Bolivia: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2008-27
(In percent)

	Projections											
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2028
NPV of debt-to-GDP ratio												
Baseline	11	10	11	11	11	10	10	9	9	8	8	4
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2008-27 1/	11	10	11	11	11	10	10	9	9	8	8	4
A2. New public sector loans on less favorable terms in 2008-27 2/	11	12	13	13	13	12	12	12	11	11	10	3
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviat	11	12	12	11	11	11	10	9	9	8	8	4
B2. Export value growth at historical average minus one standard dev	11	12	12	11	11	11	13	15	16	18	19	21
B3. US dollar GDP deflator at historical average minus one standard	11	12	12	12	11	11	10	9	9	8	8	4
B4. Net non-debt creating flows at historical average minus one stanc	11	16	19	19	19	17	16	15	13	12	11	4
B5. Combination of B1-B4 using one-half standard deviation shocks	11	11	11	11	11	11	13	15	16	18	19	22
B6. One-time 30 percent nominal depreciation relative to the baseline	11	17	17	16	16	15	14	13	12	12	11	5
NPV of debt-to-exports ratio												
Baseline	29	35	37	35	36	36	38	36	34	32	30	16
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2007-26 1/	29	35	37	35	36	36	38	36	34	32	30	16
A2. New public sector loans on less favorable terms in 2007-26 2/	28	42	42	41	42	44	47	46	44	42	40	15
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviat	28	40	38	37	37	37	38	36	34	32	30	16
B2. Export value growth at historical average minus one standard dev	28	28	26	24	24	27	34	39	43	47	50	61
B3. US dollar GDP deflator at historical average minus one standard	28	40	38	37	37	37	38	36	34	32	30	16
B4. Net nondebt creating flows at historical average minus one standa	28	53	64	62	62	62	63	58	53	47	43	17
B5. Combination of B1-B4 using one-half standard deviation shocks	28	28	26	24	24	27	35	40	44	48	52	65
B6. One-time 30 percent nominal depreciation relative to the baseline	28	40	38	37	37	37	38	36	34	32	30	16
NPV of debt-to-revenue ratio												
Baseline	42	37	39	38	36	34	33	31	30	28	26	14
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2007-26 1/	42	37	39	38	36	34	33	31	30	28	26	14
A2. New public sector loans on less favorable terms in 2007-26 2/	40	44	45	45	43	42	41	40	39	37	35	13
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviat	40	42	42	40	38	36	34	32	30	28	27	14
B2. Export value growth at historical average minus one standard dev	40	42	41	40	38	39	45	51	56	62	67	81
B3. US dollar GDP deflator at historical average minus one standard	40	41	42	40	38	36	34	32	31	29	27	14
B4. Net non-debt creating flows at historical average minus one stanc	40	56	69	67	64	59	55	51	46	42	38	15
B5. Combination of B1-B4 using one-half standard deviation shocks	40	40	40	38	36	37	44	50	56	61	67	82
B6. One-time 30 percent nominal depreciation relative to the baseline	40	60	59	57	54	50	48	46	43	40	38	20
Debt service-to-exports ratio												
Baseline	10	12	11	10	10	9	10	9	9	9	8	4
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2008-27 1/	10	13	11	9	9	5	3	0	-2	-5	-9	4
A2. New public sector loans on less favorable terms in 2008-27 2/	10	13	12	11	10	10	6	6	6	6	6	5
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviat	10	12	11	10	10	9	10	9	9	9	8	4
B2. Export value growth at historical average minus one standard dev	10	8	6	4	3	0	-3	-3	-2	-2	-2	2
B3. US dollar GDP deflator at historical average minus one standard	10	12	11	10	10	9	10	9	9	9	8	4
B4. Net non-debt creating flows at historical average minus one stanc	10	12	12	12	11	12	14	13	12	12	11	4
B5. Combination of B1-B4 using one-half standard deviation shocks	10	8	6	4	3	0	-4	-3	-3	-3	-3	2
B6. One-time 30 percent nominal depreciation relative to the baseline	10	12	11	10	10	9	6	5	5	5	5	6
Debt service-to-revenue ratio												
Baseline	15	13	12	11	10	9	8	8	8	8	7	3
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2008-27 1/	15	13	11	9	9	5	2	0	-2	-4	-8	3
A2. New public sector loans on less favorable terms in 2008-27 2/	15	13	13	12	10	10	6	6	5	5	5	4
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviat	15	13	12	11	10	9	9	8	8	8	7	3
B2. Export value growth at historical average minus one standard dev	15	13	10	6	5	1	-4	-3	-3	-3	-3	2
B3. US dollar GDP deflator at historical average minus one standard	15	13	12	11	10	9	9	8	8	8	7	3
B4. Net nondebt creating flows at historical average minus one standa	15	13	13	12	11	11	12	11	11	10	10	4
B5. Combination of B1-B4 using one-half standard deviation shocks	15	12	9	6	5	0	-4	-4	-4	-4	-4	2
B6. One-time 30 percent nominal depreciation relative to the baseline	15	18	17	16	14	13	7	7	7	7	7	7
Memorandum item:												
Grant element assumed on residual financing (i.e., financing required	-2	-2	-2	-2	-2	-2	-2	-2	-2	-2	-2	-2

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 1. Bolivia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2008-2027



Source: Staff projections and simulations.
Note: Scenarios based on recent history yield better outcomes on NFA because of recent large current account
surpluses. It is assumed that this would translate into larger reserve accumulation as opposed to a reduction in gross debt

Table 3. Bolivia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2008-2027

(In percent of GDP, unless otherwise indicated)

	Actual			Historical	Standard	Projections									
												Average			Average
	2005	2006	2007	Average 1/	Deviation 1/	2008	2009	2010	2011	2012	2013	2007-13	2018	2027	2013-27
Public sector debt 2/	80.4	55.2	40.9			35.0	35.7	30.9	27.6	25.2	23.1		17.9	16.0	
Of which: foreign-currency denominated	61.4	38.5	27.3			22.6	23.0	19.9	17.8	16.2	14.9		11.5	10.3	
Change in public sector debt	-9.2	-25.1	-14.3			-5.9	0.7	-4.8	-3.4	-2.4	-2.1		-0.8	0.0	
Identified debt-creating flows	-7.7	-17.8	-10.3			-12.4	1.0	-4.1	-2.9	-2.4	-2.1		-0.8	0.0	
Primary deficit	-0.8	-7.0	-5.1	1.1	4.3	-5.3	-1.6	-2.2	-2.4	-2.0	-1.6	-2.5	-0.7	0.5	-0.3
Revenue and grants	30.9	34.3	34.6			36.3	34.0	33.8	33.7	33.0	31.9		29.3	26.3	
Of which : grants	2.1	1.8	1.6			1.2	0.8	0.9	0.9	0.9	1.0		0.9	0.9	
Primary (noninterest) expenditure	30.2	27.3	29.5			31.0	32.4	31.5	31.3	31.0	30.3		28.5	26.8	
Automatic debt dynamics	-5.9	-10.8	-5.1			-7.1	2.6	-1.8	-0.5	-0.3	-0.5		-0.1	-0.5	
Contribution from interest rate/growth differential	-3.8	-4.8	-1.5			-2.3	0.5	-0.8	-0.1	0.2	0.2		0.2	-0.3	
Of which : contribution from average real interest rate	0.0	-1.1	0.9			0.0	1.9	0.6	1.0	1.2	1.1		0.8	0.2	
Of which : contribution from real GDP growth	-3.8	-3.7	-2.4			-2.3	-1.3	-1.4	-1.2	-1.0	-0.8		-0.6	-0.5	
Contribution from real exchange rate depreciation	-2.1	-6.0	-3.7			-4.8	2.0	-1.0	-0.4	-0.5	-0.7		...	...	
Other identified debt-creating flows	-1.1	0.0	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)	-1.1	0.0	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	-1.5	-7.3	-4.0			6.5	-0.3	-0.7	-0.4	0.0	0.0		0.0	0.0	
NPV of public sector debt	55.5	49.3	38.9			32.9	34.1	29.2	25.3	22.4	21.0		17.3	15.9	
Of which : foreign-currency denominated	36.5	32.6	25.2			20.4	21.3	18.1	15.5	13.4	12.7		10.9	10.2	
Of which : external	...	20.5	14.8			11.9	13.3	12.1	10.8	9.4	9.1		7.0	3.7	
NPV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	12.1	0.6	1.4			0.4	5.5	3.9	3.1	2.9	3.0		2.3	2.7	
NPV of public sector debt-to-revenue and grants ratio (in percent)	...	143.6	112.4			90.5	100.3	86.3	75.2	67.8	65.7		59.2	60.4	
NPV of public sector debt-to-revenue ratio (in percent)	...	151.7	118.0			93.6	102.8	88.7	77.2	69.7	67.9		61.0	62.6	
Of which : external 4/	...	63.0	44.7			33.9	40.1	36.7	33.1	29.4	29.5		24.8	14.5	
Debt service-to-revenue and grants ratio (in percent) 5/	31.8	20.0	17.7			15.3	16.4	14.3	12.6	11.4	10.9		7.6	6.6	
Debt service-to-revenue ratio (in percent) 5/	34.2	21.1	18.6			15.8	16.8	14.7	13.0	11.7	11.3		7.9	6.8	
Primary deficit that stabilizes the debt-to-GDP ratio	8.4	18.1	9.2			0.6	-2.2	2.5	0.9	0.4	0.6		0.1	0.5	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.4	4.8	4.6	3.1	1.5	5.9	4.0	4.2	3.9	3.6	3.4	4.2	3.4	3.4	3.4
Average nominal interest rate on forex debt (in percent)	3.6	3.7	5.9	4.3	0.9	7.5	7.5	7.5	7.9	8.5	9.7	8.1	9.8	7.9	9.5
Average real interest rate on domestic currency debt (in percent)	-1.8	-8.5	-3.7	-5.5	2.8	-10.7	5.6	-5.0	-0.7	0.6	-1.6	-2.0	-1.6	-6.3	-3.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-3.2	-10.2	-9.5	0.0	6.8	-17.7	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	5.9	13.7	7.4	6.1	3.4	14.0	-2.3	10.0	6.2	5.3	6.9	6.7	4.0	4.0	4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	7.1	-5.2	13.0	4.0	6.1	11.2	8.7	1.4	3.0	2.7	1.1	4.7	2.3	2.8	2.5
Grant element of new external borrowing (in percent)	...	...	4.0	...	...	4.6	5.0	5.2	5.2	5.2	5.2	5.1	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/ Nonfinancial public sector gross debt.

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.

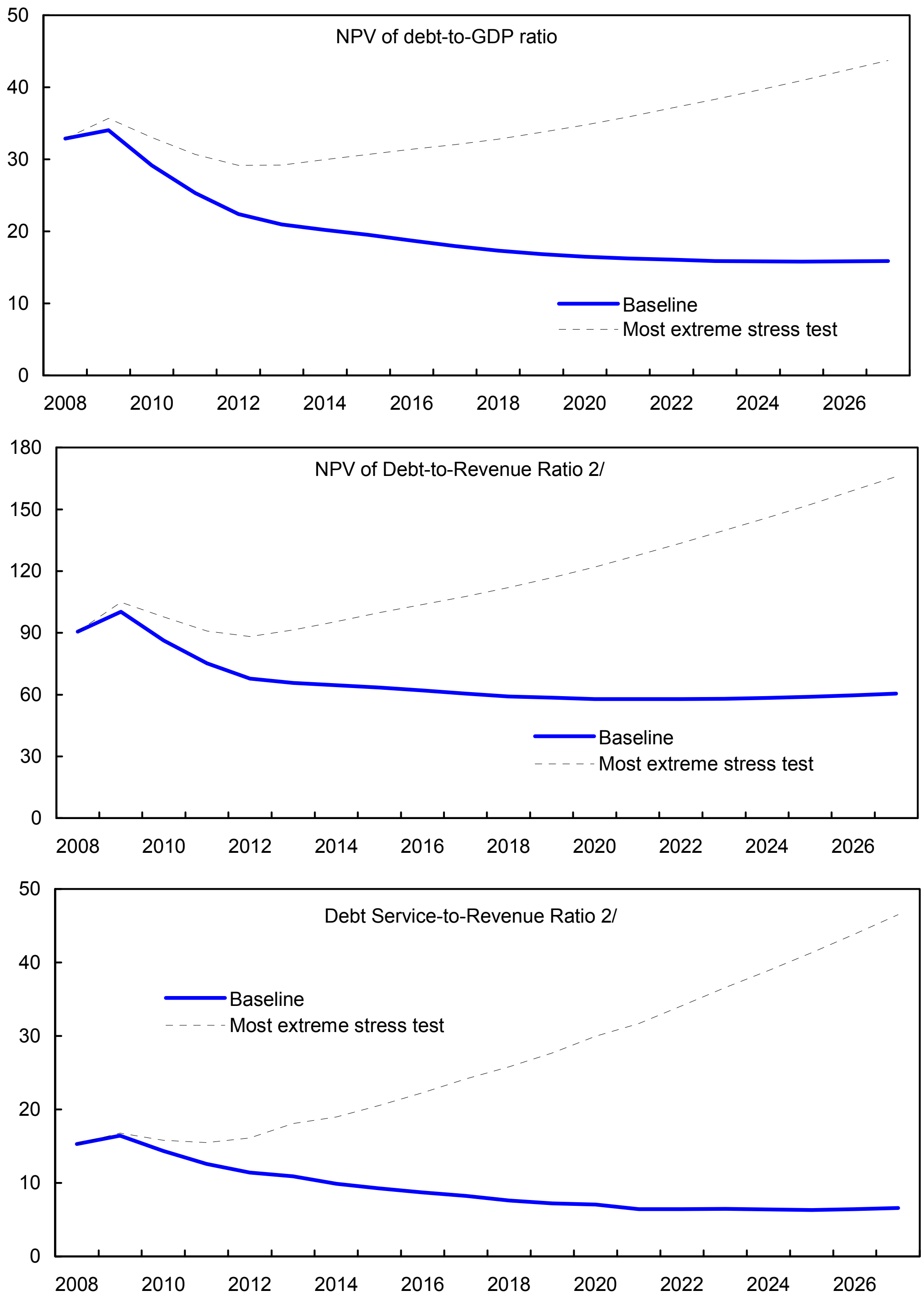
5/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

Table 4. Bolivia: Sensitivity Analysis for Key Indicators of Public Debt 2008-2027

	Projections							
	2008	2009	2010	2011	2012	2013	2018	2027
NPV of Debt-to-GDP Ratio								
Baseline	33	34	29	25	22	21	17	16
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	33	37	36	36	36	37	45	55
A2. Primary balance is unchanged from 2008	33	33	27	23	19	16	2	-28
A3. Permanently lower GDP growth 1/	33	34	30	26	24	23	23	35
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	33	36	33	31	29	29	33	44
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	33	39	39	35	32	31	27	26
B3. Combination of B1-B2 using one half standard deviation shocks	33	38	38	34	31	30	26	24
B4. One-time 30 percent real depreciation in 2009	33	45	40	36	32	31	28	29
B5. 10 percent of GDP increase in other debt-creating flows in 2009	33	44	39	35	32	31	27	26
NPV of Debt-to-Revenue Ratio 2/								
Baseline	91	100	86	75	68	66	59	60
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	91	109	106	106	109	117	154	208
A2. Primary balance is unchanged from 2008	91	96	80	67	56	49	8	-105
A3. Permanently lower GDP growth 1/	91	101	88	78	72	72	80	132
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	91	105	98	91	88	91	112	166
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	91	113	115	103	97	96	92	98
B3. Combination of B1-B2 using one half standard deviation shocks	91	112	113	101	94	93	89	93
B4. One-time 30 percent real depreciation in 2009	91	133	118	106	98	97	97	109
B5. 10 percent of GDP increase in other debt-creating flows in 2009	91	130	116	105	98	97	94	100
Debt Service-to-Revenue Ratio 2/								
Baseline	15	16	14	13	11	11	8	7
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	15	17	17	19	22	27	42	65
A2. Primary balance is unchanged from 2008	15	16	13	10	8	6	-9	-54
A3. Permanently lower GDP growth 1/	15	16	15	13	12	12	14	32
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	15	17	16	15	16	18	26	47
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	15	16	19	22	22	24	21	22
B3. Combination of B1-B2 using one half standard deviation shocks	15	17	18	21	21	22	19	20
B4. One-time 30 percent real depreciation in 2009	15	18	17	16	15	16	17	23
B5. 10 percent of GDP increase in other debt-creating flows in 2009	15	16	24	23	24	26	22	23

Sources: Bolivian authorities; and Fund staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one s.d. divided by the square root of 20 (i.e., the length of the projection period).
2/ Revenues are defined inclusive of grants.

Figure 2. Bolivia: Indicators of Public Debt Under Alternative Scenarios, 2008-2027 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2018.
2/ Revenue including grants.

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January 29, 2009

International Monetary Fund
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IMF Executive Board Concludes 2008 Article IV Consultation with Bolivia

On January 14, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bolivia.[1]

Background

In recent years, Bolivia experienced an export boom led by the hydrocarbons and mining sectors, which supported an improvement in the growth performance and a strengthening of the external and fiscal positions, but inflation accelerated and investment remained low in the context of persistent political tensions. The rise in export prices through mid-2008 led to exceptionally high external current account surpluses and reserve accumulation. Changes in the hydrocarbons taxation regime in 2005-06 further boosted fiscal revenue, shifting the public sector accounts from deficits into substantial surpluses. Increases in food prices combined with external surpluses that fueled demand pressures, caused inflation to rise to double digits in 2007-08. As part of its policy response, the central bank gradually allowed the Boliviano to appreciate, which contributed to a significant reduction in deposit dollarization. However, despite the predominantly positive trends, private investment rates remain among the lowest in the region.

In 2008, strong hydrocarbons and mining exports have continued to support Bolivia's growth performance as well as its fiscal and external positions. Real GDP growth has picked up to an

[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.

estimated 5.9 percent (from an average of 4.7 percent in 2006-07), boosted in part by the start of production at a large mining project. The external current account has recorded a surplus of 11 percent of GDP, and central bank reserves have risen to historical highs. The combined public sector has also remained in surplus, benefiting from continued high export-based revenues.

Following an increase of inflation to 17 percent in the first half of 2008, twelve-month inflation declined to 12 percent at the end of the year. While the earlier increase was driven partly by food inflation, external developments generated demand pressures, compounding the effects of the supply shock. The external developments and associated partial monetization of the increase in reserves have contributed to double-digit inflation, which peaked in mid-year and has since eased somewhat. The role of excess aggregate demand in the inflationary process is evidenced by increases in non-food inflation. The deceleration in recent months reflects moderation in food prices, slower monetary expansion as reserves stabilized, a modest appreciation of the Boliviano, and substantial depreciations of trading partners' currencies.

Bolivia's overall fiscal position has improved in 2008, benefiting from high hydrocarbons-based revenue. The overall fiscal surplus is estimated to rise to 3.5 percent of GDP (from 2.6 percent of GDP in 2007), reflecting in part a strong increase in the surplus of the state energy company YPFB, which benefited from high natural gas export prices and the incorporation of activities such as refining and distribution, previously carried out by private sector enterprises. However, the non-hydrocarbon deficit has risen to an estimated 8.5 percent of GDP—reflecting, among other things, outlays on new social programs and higher fuel subsidies. Net public debt has continued to fall, with the overall fiscal surplus reflected in rising public sector deposits at the central bank.

Booming hydrocarbon and mining exports, together with high remittance inflows, led to a record-high current account surplus and large reserve accumulation, with major pressures on monetary/exchange rate policy during the first three quarters of 2008. In the period through September, the central bank stepped up open market operations, mainly through greater placement of indexed instruments. However, foreign exchange inflows were only partially sterilized, so that monetary expansion remained strong. Meanwhile, the authorities continued to implement small nominal upward adjustments to the exchange rate under the crawling peg regime. Since September, central bank reserves have declined somewhat, in part as a result of lower foreign exchange inflows and greater demand for foreign assets, resulting in a significant slowdown of monetary expansion. As a result, the growth rates of broad money and currency in circulation declined somewhat to, respectively, 24 percent and 35 percent for the year as a whole. During the last three months, the exchange rate has been stable, following about three years of gradual nominal increases. In real effective terms, the Boliviano has appreciated markedly over the past year, reflecting mainly the high inflation in Bolivia and significant currency depreciations in trading partners.

The banking system appears to be stable and liquid, although some vulnerable areas require special attention. Mainly reflecting sluggish demand in the context of political uncertainties, credit to the private sector has continued to expand at a very low pace, contributing to high levels of bank liquidity. Bank capitalization stands at 14 percent, and nonperforming loans have fallen to 5 percent of total loans. However, the level of restructured loans (about 9 percent of total loans or 40 percent of equity) still raises concerns. In addition, the system remains exposed to exchange-rate-induced credit risk, as loan dollarization remains high.

As Bolivia's integration with international capital markets is very limited, the current global crisis affects Bolivia mainly through declines in commodity prices and remittances. Capital inflows have been negligible for many years, except for foreign direct investment (FDI) in hydrocarbons and mining, thereby largely insulating Bolivia's financial system from the external turmoil. However, current trends in commodity prices will have a major impact on export receipts and related fiscal revenue—starting in 2009, because of the lagged response of contractual gas export prices.

Executive Board Assessment

Executive Directors noted that strong hydrocarbons and mining exports have continued to support Bolivia's growth and macroeconomic performance. In 2008, real GDP growth picked up, the external current account surplus remained large, and international reserves reached record levels. The combined public sector balance remained in surplus, benefiting from continued high export-based revenues. The currency strengthened, which contributed to a further significant reduction in deposit dollarization.

Directors noted that risks to Bolivia's outlook have increased because of the sharp deterioration of the global economic environment. Lower energy and mineral prices and an expected decline in remittances could slow GDP growth and push both the fiscal and external current accounts into deficits. Key policy challenges for the authorities will be to maintain sound fiscal and external positions, to consolidate the decline in inflation observed in recent months, and to reduce widespread poverty through increased investment.

Directors stressed that the increase in risks to the outlook requires a proactive fiscal response. They welcomed the authorities' fiscal strategy, which includes cuts in lower-priority capital expenditure while preserving social spending. To reduce dependency on volatile export-based revenue and ensure inter-generational sharing of hydrocarbon wealth, Directors saw a need to target a reduction in the non-hydrocarbons fiscal deficit over the medium term. They encouraged the authorities to seize the opportunity of declining oil prices to reduce gradually hydrocarbons subsidies, while using part of the resulting fiscal savings to protect vulnerable groups. Appropriate wage restraint, and a rigorous prioritization of investment projects will also be important.

Directors emphasized the importance of well-designed structural reforms for further strengthening Bolivia's fiscal position. They considered that the tax system could be simplified to improve its efficiency and equity, including through streamlining the value added tax framework and closing loopholes in the corporate income tax. They noted the need to better balance expenditure allocations and available resources at each level of government, and to improve the budget process.

While recognizing the role of supply shocks in raising inflationary pressures, most Directors saw merit in a more active monetary policy to help speed up the decline in inflation to single digits. In particular, they encouraged the central bank to conduct open market operations in a manner consistent with bringing about positive real interest rates on non-indexed bonds, and thereby eliminate the incentive for indexation. Higher real interest rates and lower inflation would also help consolidate the reduction in dollarization achieved in recent years. A few Directors cautioned against proposals that could affect the independence of the central bank.

Executive Directors considered the real effective exchange rate level to be broadly appropriate. Many Directors believed that greater exchange rate flexibility, supported by an appropriate monetary policy framework, would help absorb possible negative external shocks stemming from adverse movements in commodity prices. A few Directors, however, noted that greater flexibility in the current environment could rekindle inflationary pressures and risk reversing the de-dollarization trend of recent years.

Directors noted that Bolivia's financial sector appears to be stable and highly liquid, and is unaffected by the global financial crisis. Nonetheless, efforts to reduce vulnerabilities need to continue. Directors welcomed plans to fully adopt international accounting standards and the ongoing efforts to improve risk management practices in banks. They encouraged the authorities to introduce prudential regulations that mitigate market risks and credit risks from dollarization. Other pending reforms to be addressed include the introduction of a deposit insurance scheme, the adoption of legislation governing corporate bankruptcy and restructuring. A few Directors called for the strengthening of the anti-money laundering regime. Directors supported the proposed FSAP update in 2010.

Directors stressed the importance of improving the investment climate—including constructive negotiations with investors in disputed contracts—as Bolivia's private investment rate remains significantly below the levels observed in the past decade and well below the regional average. This will be the key to fostering broad-based economic growth and reducing poverty.

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. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2008 Article IV Consultation with Bolivia is also available.

Bolivia: Selected Economic Indicators

	2005	2006	2007	Est. 2008	Proj. 2009
(Annual percentage changes)					
Income and prices					
Real GDP	4.4	4.8	4.6	5.9	4.0
GDP deflator	5.9	13.7	9.3	12.0	-2.3
CPI inflation (period average)	5.4	4.3	8.7	14.0	8.9
CPI inflation (end of period)	4.9	4.9	11.7	12.0	8.0
(In percent of GDP)					
Combined public sector					
Revenues and grants	30.9	34.3	34.6	36.3	34.0
Of which: Royalties on hydrocarbons	6.5	9.4	9.0	8.3	6.9
Expenditure	33.2	29.8	32.9	34.0	35.2
Overall balance	-2.2	4.5	1.7	2.4	-1.2
Total net public debt	71.1	41.9	26.8	17.0	17.9
External sector					
Current account	6.5	11.3	13.2	11.0	-0.4
Merchandise exports	29.2	33.6	33.8	35.7	26.6
Of which: Natural gas	11.3	14.5	15.0	17.2	12.2
Merchandise imports	24.4	24.4	25.9	29.3	29.5
Gross international reserves					
In millions of U.S. dollars	2,042	3,385	5,587	7,796	8,304
In percent of broad money	47.0	65.9	78.9	84.5	90.1
(Changes in percent of broad money at the beginning of the period)					
Money and credit					
NFA of the financial system	20.7	31.3	35.4	28.0	5.6
NDA of the financial system	-6.6	-12.9	-3.7	-4.4	2.0
Of which: Credit to the private sector (in percent of GDP)	39.6	34.7	33.1	31.8	32.5
Broad money	14.1	18.5	31.7	23.6	7.6
Interest rates (percent, end of period)					
Yield on treasury bills in local currency	7.9	5.4	6.2	...	...
Yield on treasury bills in U.S. dollars	7.4	4.9	4.6	...	...

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

Statement by Pablo Pereira, Executive Director for Bolivia and Victor Hugo De la Barra, Advisor to Executive Director January 14, 2009

The Bolivian authorities thank the staff for their assessment of Bolivia's current situation and for the policies suggested. The authorities also wish to underscore the commendable efforts of the mission staff, which are highly appreciated.

Background and Overview

1. Since the last Article IV Consultation, Bolivia has shown a satisfactory performance. Growth in 2008 reached more than 6 percent and foreign direct investment increased vis-à-vis 2006 and 2007. On the supply side, the main drivers were mining, construction, and hydrocarbons. Agriculture was affected by adverse climate conditions during the first quarter, but its growth recovered to 2.4 percent after being negative in 2007. The agricultural production frontier was extended in 2008. On the demand side, domestic consumption and investment supported such growth. Inflation in 2008 was almost similar to 2007 (around 11.7 percent) after reaching 17.3 percent by mid-year.

2. Fiscal performance was very positive in 2008, supported by additional income from the tax and royalty structure on hydrocarbons, approved in 2005, and the 2008 tax reform for the mining sector. The fiscal authorities managed to obtain a surplus in the last three years, which will allow fiscal room to overcome the effects from the current global slowdown.

3. The balance of payments and capital flows have been strong. Capital good imports increased more than 43 percent, enhancing the production capacity for the incoming years. Exports increased to \$6.1 billion and the trade surplus was \$1.1 billion, as a result of a positive international environment -reflected in higher prices- as well as increases in quantum, especially in the mining sector. This trend led to a historic level of international reserves of \$7.8 billion (around 45 percent of GDP in 2008 while in 2005 they were approximately 21 percent).

4. Nevertheless, the authorities recognize that the country will not be immune to this global financial and economic downturn. Therefore, they are ready to apply the necessary stimulus to boost the economy and offset the negative effects from such a crisis. They consider that GDP for 2009 will be greater than projected in the staff report (5 percent compared to 4 percent), since public investment will be used as a stimulus for the economy. The authorities envisage \$1,850 million in public investment (around 9.8 percent of GDP), as budgeted, along with an increase in private investment. Public investment may be even greater if Congress authorizes the state oil company, Yacimientos Petrolíferos Fiscales Bolivianos (YPFB), to borrow \$1 billion from the Central Bank of Bolivia (CBB).

5. The political situation in Bolivia has stabilized. A referendum for the approval of the New Constitution is scheduled for late January 2009, after the agreement reached in October 2008 between the government and the opposition parties regarding controversial issues related to land tenure, local government autonomy, and presidential re-election.

Fiscal Policy

6. Improved tax collection and control over expenditure led to a surplus of more than 6 percent of GDP in 2008[1]. This outcome surpassed the projected surplus in the 2008 budget and contributed to reducing inflationary pressures, even though expenses for health care, education, and infrastructure were expanded. Social expenditure was increased through conditional cash-transfers such as the *Bono Juancito Pinto* and the *Renta Dignidad* granted to elementary school students and to the elderly, respectively. The former reached 1.6 million students and the latter 676,000 people above the age of 60, which combined represent 23 percent of the population. Through these benefits poverty level has been reduced to 60 percent from 64 percent before 2007. The authorities are not comfortable with such a high level of poverty and they intend to reduce it further. To this end, the authorities are preparing an Extreme Poverty Eradication Plan which will be put into action in 2009. In 2008, additional resources to municipalities in poor regions were available for targeted projects.

7. To boost fiscal revenue, the Tax Code for the mining sector was modified. Thus, rates were streamlined and differentiated levies were introduced depending on the type of product and the export prices. This policy allowed producing regions to benefit more from royalties and taxes. Surtaxes on mining and hydrocarbons were suppressed altogether.

8. The 2009 budget envisages a small surplus. In this vein, wages in the public sector will only be increased for teachers, health workers, and police officers, given the need to be at level with the rest of the salaries in the economy. Likewise, in light of the potential decline in fiscal revenue, the amount of yearly social benefits created in 2006-2008 (*Bono Juancito Pinto* and *Renta Dignidad*) will not be increased as planned.

9. The non-oil revenue, has increased from 68 percent of the tax revenue in 2007 to 70 percent in 2008, which means that budget oil-revenue dependency is gradually diminishing in Bolivia, and—most importantly—that declining oil prices will affect Bolivia's fiscal revenue less severely. This is particularly important since the National Treasury has more constraints for expenditure than sub-national governments due to the

[1] In Tables 3 and 4 of the Staff Report, nationalization costs and transfers to the Bank of Productive Development are registered above the line while the authorities register them below the line. These different approaches, as well as different GDP and exchange rate projections, result in diverse figures for the fiscal balance in 2008 and 2009.

fact that the Hydrocarbons Law's allocation of oil revenue favors the latter over the National Treasury. Even the state oil company—which now operates the entire oil network— has a variable intake percentage while sub-national governments have a fixed intake percentage.

10. The authorities are well aware of the level and effects of fuel subsidies and the need to eliminate them. This issue was raised by the authorities during the Article IV Consultation discussions, ahead of the staff's recommendation. In fact, the authorities have been working to find ways to reduce such subsidies as a means to release resources for social expenditure but before proceeding to eliminate them, a well-targeted safety net must be put in place to avoid negatively affecting the poor. The authorities envisage that this priority could be addressed after the approval of the New Constitution.

11. Public investment will be allocated mainly in infrastructure and public enterprises to supply paper, milk, cement, sugar, and food. The authorities expect private investment in Bolivia will follow as a consequence of the impulse of public investment. The authorities are aware of the need to continue with fiscal consolidation efforts. Hence, 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 that enable targeting high-social return. The authorities continue implementing administrative adjustments that improve the efficiency of the tax-collecting agencies dealing with customs and domestic taxes. The implementation of reform of taxation in other sectors, such as the informal commerce, is under evaluation and the authorities expect to apply it gradually over the medium term.

12. The reform of the pension system is underway. The authorities are fully aware of the need to preserve macroeconomic stability while finding means to aid affiliates to overcome rigidities that impede them to retire with the minimum pension, even though they have reached retirement age. These rigidities were not addressed by the pension system reform implemented in 1997. The draft law for this reform was presented to Congress and has been approved by the House of Representatives. The authorities note that this reform creates a complimentary pension system with a minimum pension benefit, fully-funded through contributions from high-income affiliates. Since the current defined-contribution pension funds will not be modified, there will be no additional fiscal cost.

Monetary and Exchange Rate Policies

13. The authorities stress that inflation was mainly driven by supply shocks (especially natural disasters that affected agricultural output), imported inflation, partial monetization of foreign flows, and expectations. The latter were exacerbated by speculative operations which were politically handled by private entrepreneurs with market power in key products such as edible oil, rice, beef, and chicken, in order to

politically undermine the current administration. Additionally, road blockades disrupted the normal supply of products.

14. The staff calls for a more active monetary policy to curb inflation; however, at this stage, the authorities prefer a more cautious policy stance considering the uncertain effects of the global slowdown in the Bolivian economy. The authorities believe that inflation is set to recede due to diminishing political tension, as well as lower international food prices. Indeed, food items were the main drivers of the head-line inflation. Thus, the authorities will remain vigilant to ensure macroeconomic stability.

15. In any context, the monetary policy will continue to attain lower inflation rates through Open Market Operations (OMOs), analyzing the global financial crisis and its effects on the Bolivian economy. In 2008, the Central Bank of Bolivia (CBB) absorbed liquidity through non-indexed and indexed domestic currency instruments and by lengthening maturities, while up to 2006, mostly short-term foreign currency denominated securities were available for OMOs, given the high level of dollarization. The CBB also implemented OMOs for non-financial institutions and citizens, which again displays the authorities' commitment to reduce inflation. Increased placements in local currency mitigate debt-management risks, and serve as a means to reduce financial dollarization. The CBB authorities will continue to closely coordinate financial programming with the Ministry of Finance; in fact a Memo of Understanding between these institutions is in place. By December 2008, the CBB had raised rates on non-indexed instruments, but financial institutions did not change their rates for banking deposits in domestic currency. Nonetheless, real interest rates on CBB securities have been positive since the third quarter of 2008, vis-à-vis the relevant expected inflation rate.

16. The staff report mentions that 22 percent of inflation could be explained by changes in money stock; however, the authorities emphasize that due consideration must be given to changes in the currency composition of asset-holders' portfolio towards a preference for domestic currency, promoted by the appreciation of the Boliviano (dedollarization). Indeed, the authorities stress that there was an amount of dollar banknotes already circulating in the Bolivian economy[2] that never went through the financial system, which were converted in domestic currency, driving an endogenous increase in international reserves as well as the base money.

17. The exchange rate regime (crawling peg) also contributed to offsetting the trend in reserve money, through appreciation up to early October 2008. The appreciation of the exchange rate in 2008 caused a substantial decrease in dollarization, especially in banking deposits, reaching a low of 50 percent and also helped to control inflationary pressures. The authorities intend to avoid a reversal of the dedollarization.

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[2] It is worth noting that in Bolivia, dollar banknotes used to be -and still are- a generalized means of payment, which quantity is extremely hard to determine.

18. Regarding the exchange rate level, the CBB considers that the real exchange rate is in equilibrium, supported by a positive stance both in the fiscal and the balance of payments positions since 2006. Therefore, they believe that the exchange rate level is appropriate, backed by a strong level of international reserves ($7.8 billion). In addition, they are convinced that the current level is consistent with the prevailing internal and external equilibrium. The CBB believes that a label of overvaluation backed by uncertain staff's calculations may generate depreciation expectations that will negatively affect the economy. The authorities will continue using the crawling peg regime. Nevertheless, determining the necessary exchange rate adjustment is particularly complex in the case of Bolivia, since inflation expectations are extremely sensitive to exchange rate depreciation, particularly in the context of the current international financial turmoil. The authorities will exercise greater flexibility, as needed, to avoid undermining the external stability but also preventing inflationary pressures.

Financial Developments

19. Bolivia's financial system remained stable in 2008. Nonperforming loans were reduced, provisions increased, and profitability also improved. Banking deposits grew 27 percent while credit increased by 17 percent in 2008. Credit to the private sector is expected to increase in 2009 as a result of political stability and the fiscal stimulus to the economy through public investment. Liquidity risk at this stage is low, even for foreign-currency denominated deposits, since the CBB is prepared to provide enough resources to the financial system. As the staff rightly points out, its international reserves cover 120 percent of bank deposits.

20. Despite these achievements, the authorities are aware of the remaining vulnerabilities in certain entities of the banking system and close supervision will be applied. Bolivia's financial system has been relatively insulated from the global financial crisis, but the risk aversion from investors could pose challenges over time as the global crisis evolves. The Superintendency of Banks (SB) is conducting stress tests, which were available for the supervised entities in order for them prepare action plans in case risk factors materialize. Moreover, the CBB and the SB are engaged in preparing joint contingency plans. Credit risk regulations are serving well, but the authorities are aware that credit risk related to exchange rate may be an issue for those who borrowed in foreign currency but generate revenues in domestic currency. The SB is preparing prudential regulations to deal with this risk, including changes in the provision regime. The SB is also working on the 2003 FSAP recommendations and has expressed its willingness to undergo a FSAP in 2010.

Development Policy and Structural Reforms

21. Foreign investment expanded in 2008 and it is expected to grow further in 2009. Mining and hydrocarbons are still key sectors in the Bolivian economy. The public

policy applied in these sectors, as well as in telecommunications, sought to correct severe biases and distortions of the privatization contracts signed between 1993 and 1996. The change in the government's relationship with foreign companies made it possible to implement new programs to address the need to help the poor, while preserving fiscal stability. This policy has only been applied in strategic economic sectors. Amicable arrangements are always pursued to buy the targeted enterprises, but controversies may arise. The government intends to continue on the same path along with fiscal discipline and pro-poor and pro-growth development policies.

22. Although the public sector led investment in the last two years, the authorities are aware that private investment is important to growth and job creation, thus they emphasize that public investment in other economic sectors will be complementary. 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, the major cause of poverty. In addition, the government is engaged in obtaining access to foreign markets for non-traditional exports to off-set the effects of the suspension of trade preferences with the United States.