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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

BOLIVIA

PROJECT PAPER

ECONOMIC SUPPORT FUND

AID/LAC/P-382

Project Number: 511-0593
Grant Number: 511-K-602

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CLASSIFICATION:

AID 1120-1 PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO: 511-0593 511-K-602 2. COUNTRY: BOLIVIA 3. CATEGORY: Cash Transfer 4. DATE: June 23, 1987
5. TO: AA/LAC, Dwight Ink		6. OYB CHANGE NO.
7. FROM: LAC/DR, ~~Terrence J. Brown~~		8. OYB INCREASE TO BE TAKEN FROM:
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 14,660,000		10. APPROPRIATION - LES7-87-35511-KG31 (770365 511-00-50-71)

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
☐ LOAN ☒ GRANT	☐ INFORMAL ☒ FORMAL ☐ NONE	FY 1987	Date of Authorization

15. COMMODITIES FINANCED

N/A

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: $14,660,000
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: $14,660,000	Other:

18. SUMMARY DESCRIPTION

The purpose of the proposed $14,660,000 ESF Grant Program is to provide balance of payments assistance in support of the Government of Bolivia's (GOB's) economic reactivation efforts. The dollars provided will be placed in a separate account. The dollars will be used to finance private sector imports of machinery and equipment, spare parts, and raw materials from the U.S. or they may be used to finance official (public) debt service to the United States and to international financial organizations.

The local currency proceeds of the Program will be used to finance counterpart to A.I.D. and to multi-lateral development bank projects.

Of the authorized amount, $7,160,000 may be obligated immediately. The remaining $7,500,000 of the ESF assistance may be obligated* if and when it is determined that Bolivia has met the narcotics-related provisions of Section 611(2)(b) of the International Security and Development Assistance Act of 1985.

* only

19. CLEARANCES	DATE
ARA/ECP, JCrawford (draft)	7/10/87
LAC/SAM, KJohnson (draft)	6/19
LAC/DP, WWheeler (draft)	7/10
GC/LAC, GDavidson (draft)	7/9
PPC/EA, KKaufman (draft)	6/15
DAA/LAC, MButler	
FM, CChristensen for	8/5/87

20. ACTION

☒ APPROVED ☐ DISAPPROVED

Dwight Ink — 8/6/87

AUTHORIZED SIGNATURE — DATE

Assistant Administrator, LAC

TITLE

CLASSIFICATION:

FY-1987 PAAD OUTLINE

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TABLES:

BEST AVAILABLE DOCUMENT

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FY-87 PAAD

I. SUMMARY AND CONCLUSIONS

The Paz Estenssoro Government which assumed power on August 6, 1985 has been highly successful in ending Bolivia's hyperinflation. The rate of increase of the consumer price index was brought down from 11,750% in 1985 to 66% in 1986 (December to December), and to only 4.5% during the last quarter of the year. The rate of increase of the budget deficit of the Central Government was brought down from 3,300% in 1985 to a projected 72% in 1986. As a proportion of the GDP, the budget deficit of the consolidated public sector declined from 28% in 1984 to 12% in 1985, and is projected at 4% for 1986 and 6% in 1987. The annual rate of bank credit expansion to the public sector which was 3,891% in 1985 became a negative figure in 1986, while the rate of credit expansion to the private sector declined from 4,249% to 129% 1/. As a result, the rate of increase of the money supply (M1) declined from over 6,100% in 1985 to a projected 25% in 1986. 2/

The IMF team that visited Bolivia in August-September 1986 and in January 1987, found the GOB in full compliance with all targets in the Stand-By, except for the temporary failure to meet the reduction of arrears targeted in June. However, this deficiency was remedied by mid-July. Several other targets were over-fulfilled.

The balance of payments situation remains in deficit owing to the depressed state of the country's exports and the country's large debt service charges (only partially refinanced in 1986). Officially recorded export earnings declined sharply - from $724 million in 1984 to $623 million in 1985 and to an estimated $543 million in 1986, as the result of significant declines in the prices of Bolivia's major exports, natural gas and tin. The price of natural gas sold to Argentina is expected to decline by another 15% in 1987 (in addition to a decline of 10% in 1986). The price of tin dropped by 55% between the third quarters of 1985 and 1986. On the other hand, substantial relief to Bolivia's 1986 balance of payments situation resulted from the debt renegotiation with the Paris Club that took place last June. That relief amounted to some $250 million in refinanced interest and amortization payments falling due that year.

1/ Source: IMF, Bolivia - Staff Report for the 1986 Art. IV Consultation, page 13.

2/ Ibid., page 13.

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The 1986 balance of payments deficit would have been much larger than the $85 million projected had it not been for $118 million in net short term capital inflow, plus another $162 million in "Errors and Omissions" (see Table 9). Both of these items reflect the earnings of the informal sector (largely narcotics) and the repatriation of export earnings (and capital flight) effected in previous years. For 1987, USAID/Bolivia has projected a balance of payments deficit of $184 million and an unfinanced balance of payments gap (or decline in net international reserves) of $85 million. The IMF has set a limit of $20 million on the decline in net international reserves in 1987. To the extent this gap remains unfinanced, imports will have to be cut back, and the recovery target for this year may not prove achievable.

The main task that presently confronts the Bolivian authorities is the reactivation of the economy. The Central Bank's preliminary GDP projections show a decline of about 2.9% in real terms in 1986. While all indications point to the fact that the Government has succeeded in setting the basis to arrest and reverse the decline in economic activity, a number of factors have impeded an early recovery. These include credit tightness, the substantial difficulties faced by the mining industry, the multiplier effects of the sharp drop in export earnings, and continuing uncertainties in the private sector. The Government is in the process of addressing various impediments to economic reactivation along with continuing implementation of the stabilization program. The attached GOB Letter of Application for ESF Assistance (See Annex I) summarizes the steps the Government has already taken to stabilize and restructure the economy, as well as the measures it plans to take in the months ahead.

The basic rationale for the proposed $15 million ESF assistance program for FY 87 is as follows:

- 1. The ESF program will contribute some of the resources needed to finance economic reactivation by providing foreign exchange for the importation of raw materials, intermediate and capital goods for the private sector; and by generating local currency funds to be used to implement key elements of the narcotics control program.

- 2. The program will provide balance of payments support and thus help reduce the balance of payments gap. The case for such support is strengthened by the need to compensate for the combined losses to the Bolivian economy resulting from the fall in the prices of tin and natural gas, and for the foreign exchange losses and domestic multiplier effects resulting from the continuing disruption of narcotics trafficking. Failure to close the balance of payments gap is likely to impede economic recovery in 1987.

- 3. The ESF program has also been, and will continue to be, an important USG instrument for encouraging continued GOB cooperation in the area of narcotics control. Section 611 of the FAA imposes specific narcotics related conditions that apply to the approval of ESF for Bolivia in FY 1987. Recently, a joint USG-GOB commission elaborated an initial plan for GOB narcotics control actions on several fronts, including interdiction, coca production controls and development of alternative employment opportunities for the displaced labor. The ESF assistance will generate some of the local currency essential to the implementation of the development related activities of the plan.

- 4. Finally, a high Mission priority is to maintain continued U.S. support for Bolivia's democratically elected government that has shown considerable political courage in taking the necessary steps to stabilize the economy, free it from unnecessary government controls, establish a much more favorable environment for growth of the private sector, and undertake a determined campaign to eliminate narcotics trafficking.

The basic goals of USG policy in Bolivia are: (a) maintenance of a stable and democratic government and institutionalization of the democratic process, (b) private sector led economic recovery, and (c) narcotics control. The GOB's basic economic policies and priorities are fully in line with the recommendations of the USG, other donor countries and the international financial institutions, and merit continued USG support. Further assistance to the GOB's stabilization and recovery efforts will also help advance USG narcotics and democracy-related goals in Bolivia since the survival of the current government, which is making significant strides in institutionalizing democratic rule and in narcotics control, depends, to a large extent, on the success of its economic policies.

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II. HISTORICAL BACKGROUND

On taking office in August 1985, the Paz Estenssoro government was faced with a chaotic economic situation characterized by hyperinflation, a foreign exchange crisis substantially aggravated by the collapse of tin and petroleum prices, a growing debt servicing problem, a substantial budget deficit, and a real GDP that had declined each year since 1981. The following statistics illustrate the magnitude of the problem that confronted the new government. The rate of increase of the consumer price index accelerated from 123% in 1982 to 276% in 1983, 1281% in 1984 and 11,750% in 1985 (see Table 1). The rate of increase of the budget deficit of the consolidated public sector (a key cause of the hyperinflation) increased from 353% in 1983 to 1,964% in 1984 and 3,500% in 1985. 3/ As a proportion of the GDP, the overall deficit of the consolidated public sector increased from 16% in 1982 to 28% in 1984 4/ (See Tables 2 and 3).

These large deficits were financed, to a large extent, by Central Bank credit expansion. Total net credit extended by the Central Bank to the public sector increased from $b 16 billion in 1981 to $b 2,926 billion in 1984 5/. Net domestic financing covered 81% of the overall public sector deficit in 1984. The annual rate of increase of bank credit expansion to the non-financial public sector accelerated from 287% in 1983 to 1,166% in 1984 and to 17,029% in 1985 (See Table 4). However, credit to the public sector was not the only cause of the increase in money supply as bank credit expansion to the private sector increased at comparable rates during 1984 and 1985 (Table 4). As a result, the supply of currency plus demand deposits (M1) increased at a rate of 1,780% in 1984 and 6,137% in 1985. M2 (M1 + savings and time deposits) increased at rates comparable to M1 over this period (Table 5).

Predictably, substantial deficits appeared in the current account of balance of payments. These rose from $ 176 million in 1982 to about $282 million in 1985. The overall balance of payments was consistently in deficit since 1982, with the balance fluctuating between a negative US$ 103 million in 1984 and a negative US$ 363 million in 1982. A substantial improvement occurred between 1985 and 1986, with the overall deficit declining from $312 million to $25 million (Table 9). Net official reserves increased during 1983-86, in large part as a result of the substantial accumulation of arrears and debt rescheduling that occurred in 1983 and of the Paris Club negotiations in June, 1986.

3/ Source: IMF, Bolivia - Recent Economic Developments, Dec. 2, 1986, Table 35.
4/ Ibid. Table 1
5/ Central Bank, Estadísticas Monetarias y Financieras, Aug. 1986, Table 8, P. 19.

The balance of payments problem can be attributed to the following major causes:

1. Collapse of the price of tin (it fell by 55% between the third quarters of 1985 and 1986) and a 10% reduction in the price of natural gas negotiated with Argentina in November 1985. The disruption of narcotics exports is another aggravating factor.

2. Large debt service payments resulting from substantial borrowing for poorly conceived projects in the 1970s and early 1980s, and from financing the operating deficits of poorly managed state enterprises.

3. Faulty fiscal-monetary policies leading to the rapid increase in the money supply and price level. The impact on the balance of payments was further aggravated by maintenance of a heavily overvalued exchange rate until August 1985 which heavily penalized exports, stimulated imports, and expanded the balance of payments gap throughout the 1981 - August 1985 period.

As a combined result of the contraction of export earnings and of poorly conceived domestic economic policies that produced the hyperinflation and aggravated the balance of payments disequilibrium, the real GDP between 1982 and 1985 declined by 17.2%, while the real per capita GDP was estimated to have fallen by 26% over this period.

The following appear to be the major causes of the economic difficulties inherited by the Paz Estenssoro government:

1. Considerable political instability: Not only were there frequent changes of and within governments during 1980-1985 period, but the governments in power failed to develop coherent economic policies and were unable to resist the demands of strong, leftist-dominated labor unions for higher wages and other benefits. This was particularly true in the mining industries. The García Meza Government that took power in a coup in July 1980 suspended Congress, outlawed political activity and openly engaged in cocaine traffic. As a result, the economic support it received was eliminated or sharply restricted by the United States and other Western democracies. During 1980-81, the economy deteriorated more rapidly. Cut off from concessional and commercial credits, the García Meza regime borrowed heavily from other Latin American countries, notably Argentina, to finance its rapidly expanding deficits. The peso became highly overvalued and contraband imports flourished.

García Meza resigned in August 1981 and was followed by two, more benign, military presidents. However, these regimes could not command public support for the economic measures they attempted to adopt. The Vildoso Government announced a set of economic measures in June 1982, but reaction was so hostile that the military reconvened the 1980 Congress and turned over rule to a civilian government headed by Hernan Siles Zuazo, which took office on October 10, 1982.

The Siles government, which lasted until August 1985, was weak and vacillating, particularly on the economic front. Siles was weak and undecided. Moreover, the participants in the coalition government included communists and leftist political parties. Siles' leadership style, which aimed at achieving a consensus, never worked and led to eight major cabinet reshuffles during his term. He was particularly unable to deal with the leftist dominated unions, or to check demands for wage increases and expanding communist influence within the government's bureaucracy. 6/

2. The second major cause of the difficulties inherited by the Paz government consisted of the substantial operating deficits produced by the state enterprises. Bolivia's mining industry faced serious difficulties even before the collapse of tin prices owing to high production costs, low productivity, numerous strikes and high transportation costs. Large deficits incurred by the mines and other government enterprises, particularly the state operated railroads, were a significant contributory factor to the budget deficit and the hyperinflation.

3. The Paz government was also faced with a huge foreign debt which had been contracted to finance the operating deficits of both the general government and the state enterprises, as well as to cover persistent balance of payments deficits and to finance unsound projects during the 70s and early 80's. The total external public (and publicly/guaranteed) debt outstanding on December 31, 1985 stood at $2.7 billion, equal to 145% of the GNP (as estimated by the World Bank). Total accumulated arrears were $1.05 billion, of which $706 million was due to foreign commercial banks. The total debt service (interest and amortization) on current maturities, exclusive of amortization of arrears, due in 1985 was estimated at $500 million 7/, an amount approximately equal to Bolivia's estimated registered 1986 exports.

4. An inelastic revenue collection system combined with faulty economic policies greatly aggravated the magnitude of the budget deficit and was a major cause of the hyperinflation. While government expenditures increased somewhat during the period (total general government expenditures increased from 26% of GDP in 1982 to 28% in 1984), and the overall deficit of the state enterprises increased from 1.8% to 4.7% of GDP, it was the substantial lag of revenue collections behind GOB expenditures that was the major cause of the deficit. Total revenue of the General Government as a

6/ Source: AID Mission to Bolivia PAAD, October 28, 1985, pages 5-6
7/ Source: IMF, "Bolivia - Recent Economic Development", Sept. 6, 1985, Appendix Tables 60 and 61, Pages 136-137.

proportion of GDP declined from 11.5% in 1982 to only 4.8% in 1984, causing the General Government's overall deficit to increase from 14% to 23% of GDP, while the overall deficit of the Consolidated Public Sector increased from 16% to 28%. 8/ This dismal revenue performance was due in large part to the refusal of the government to devalue the peso (thus causing a substantial drop in the real value of import duty collections), its reluctance to raise the price of gasoline in the domestic market, and its failure to adjust specific taxes and duties. The inefficiency of tax and customs administration also contributed to the decline.

5. Central Bank credit expansion to the public sector was not the only cause of inflation. The banking system also substantially expanded credit granted to the private sector. The annual rate of bank credit expansion to the private sector increased from 119% in 1983 to 1400% in 1984 and 15,066% in 1985 (See Table 4). Borrowing from the commercial banking system was encouraged by the policy of placing ceilings on interest rates. For example, in 1984, when inflation accelerated to over 2,000%, interest rates on deposits were held at less than 140%, thus becoming sharply negative. This not only encouraged excessive borrowing but resulted in a substantial drop in the real value of the deposits held by the banking system. From a level of $781 million in 1980, the value of currency in bank deposits declined to $117 million (measured at the parallel market rate) by the end of 1984, 9/ a factor that caused serious difficulties to Bolivia's commercial banking system. 10/

6. Other current economic policies that exacerbated the economic difficulties include overvaluation of the exchange rate and the "dedolarization" 11/ of dollar deposits. Overvaluation of the exchange rate not only contributed significantly to the budget deficit by causing serious lags in revenue collections. It also greatly discouraged exports, since exporters were legally obliged to deposit their hard currency earnings in the Central Bank at the official rate which was only a fraction of the parallel market rate. At one time in 1985, exporters received in pesos as little as 5% of the true value of their exports. 12/ As a result, exports in a wide range of activities almost disappeared. Bolivia's non-traditional

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8/ Source: IMF, "Bolivia - Staff Report for the 1986 Art. IV Consultation Nov. 26, 1986, P. 43.

9/ AID Mission - PAAD, October 28, 1985, Pages 8-9.

10/ While bank deposits staged a remarkable recovery in recent months, their real value is still considerably below the 1981 level.

11/ "Dedolarization" refers to the government's decision to convert all US dollar or dollar denominated deposits held by Bolivian banking entities into Bolivian Pesos at the official rate.

12/ David Morowitz, Consultant to the World Bank, After Tin and Natural Gas, What?, August 1986, Page 151 exports (other than tin, other metals, and natural gas) declined from $97 million in 1982 to only $33 million in 1985. 13/

The major impact of dedolarization was to: (1) reduce substantially the real value of savings ; (2) further undermine the confidence of the private sector in the government; and (3) contribute to the financial difficulties of the Bolivian banking system, as banks were compelled to accept repayments in depreciated Bolivian pesos of their dollar loans. While the Central Bank had also promised to allow the national banks to repay their dollar obligations to foreign creditors in Bolivian pesos, the Central Bank and the government subsequently used a series of devices to avoid accepting such peso deposits. This issue remains unresolved to date.

13/ IMF, Request for Stand-By Arrangement, Op. Cit, Table 18, Page 59.

III. THE AUGUST 29 1985 "NEW ECONOMIC PROGRAM"

On August 29, 1985, soon after President Victor Paz Estenssoro assumed power, the government issued Decree No. 21060 that contained a far-reaching program to arrest the hyperinflation and the country's slide toward economic chaos. This decree contained the New Economic Program, the main features of which are summarized below. 14/

1. Major Measures Adopted

a. Adoption of a flexible foreign exchange adjustment mechanism: Under the new exchange system announced on August 29, the official exchange rate would be adjusted at least twice weekly at auctions conducted by the Central Bank at which foreign exchange would be offered for sale. While exporters still had to surrender all of their export proceeds to the Central Bank at the official rate, they were provided guaranteed access to specified quantities of foreign exchange they required to meet their raw material and capital goods requirements. These export proceeds provide the principal source of foreign exchange for the free market auctions.

The official Central Bank selling rate of foreign exchange immediately increased from 75,000 pesos to the dollar to $b 1,078,000 to US$1 (Table 6). The export sales of COMIBOL (mining) and YPFB (natural gas and petroleum) and other state enterprises increased substantially in terms of pesos, thus yielding much larger tax revenues. Imports valued at the new rate produced substantial increases in duty collections. While the servicing of the foreign debt and public sector purchases of goods and services also increased in peso terms, the net fiscal effect was strongly positive.

b. Petroleum price adjustment: The domestic petroleum price was increased significantly so as to be in line with the world market price translated into pesos at the new market determined exchange rate. This represented an immediate tenfold increase over the previous price. Petroleum prices subsequently were adjusted periodically through 1985 to maintain the dollar equivalency. As a result of monetary stability, no further adjustments took place during 1986.

c. Increases in the rates of other utilities, including electricity and telephone rates: These rates were increased to compensate for actual service costs. Public utility prices were fixed in dollars, with bills paid in pesos at the exchange rate of the day.

d. Monetary Reform: The program eliminated interest rate ceilings on all deposits and loans. Other provisions authorized commercial banks to

14/ Based on Robert Burke's analysis of Oct. 22, 1985.

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carry out foreign exchange rate transactions and to offer foreign exchange denominated accounts with dollar-maintenance of value clauses, and to make dollar denominated loans.

e. Tariff Reform: Bolivia, like most of its South America neighbors, had a long history of high tariffs on imports of finished manufactured goods combined with low or non-existent tariffs on capital goods and industrial and agricultural inputs. In addition, since 1982, most imports of consumer goods had been prohibited, a feature that greatly encouraged contraband. The new GOB program abolished all import prohibitions and replaced the former high tariff structure with a flat 10% percent ad-valorem duty plus a variable duty equal to 10% of the formerly prevailing tariff. This provision was replaced in August of 1986 by a flat 20% ad-valorem duty (with a few exceptions, such as imports of machinery, which continued to pay 10%). This measure was designed to improve revenue collections as well as to reduce the degree to which import tariffs distort the allocation of resources.

f. Fiscal, Wage and Labor Policy: The New Economic Program froze public sector wages until December 31, 1985, in an attempt to reduce real GOB expenditures. The program also substantially increased the free play of market forces in the private sector labor market by allowing employers to discharge employees for any reason, subject to the payment of severance pay. 15/ In addition, the implementing decree provided that private sector wages would be freely negotiated between employers and employees. This replaced the previous practice of government-decreed across-the-board wage increases applicable to both private and public sector workers.

g. Price Decontrol: The GOB abolished all price controls on commodities produced by the private sector.

h. Improved Accounting by State Enterprises: The Decree required all state enterprises to submit a set of accounts as of July 31, 1985, and to submit a detailed budget for the last quarter of 1985. Moreover, the law prohibits the extension of Central Bank credit to enterprises that did not comply with this provision. All state enterprises were required to maintain peso deposits at the Banco del Estado, and were prohibited from maintaining banks accounts outside the country. All legal monopolies were abolished.

15/ Equal to a minimum of three-months pay for employees with a tenure of less than five years. For those with a tenure of over five years, the legal severance pay is one month's pay for every year of employment. An additional three-months' pay must be paid if the employee is discharged (i.e. involuntary separation).

i. State Enterprise Decentralization: The decree divided the state mining company, COMIBOL, into four regional enterprises and YPFB (the state petroleum company) into three, and turned other state enterprises over to the Departmental Development Corporations. Decentralization serves a number of purposes, all directed at increasing management efficiency of state enterprises. First, it was designed to enable the GOB to dispense with most of the bloated central bureaucracy of YPFB and COMIBOL. Second, it was intended to increase fiscal discipline of state enterprises by placing strict controls on access to Central Bank credit to cover operating deficits. Third, the move appeared to be an attempt to reduce the power of the disruptive mining and YPFB employee unions. However, the decentralization provision has been only partially implemented. The Government has not yet decentralized COMIBOL and the YPFB, though it has reiterated its plan to do so in the Memorandum of Understanding subscribed with an IMF team in October 1986.

2. Follow-up measures

As far ranging as this program is, it does not represent the sum total of the Government's efforts in the area of stabilization. A number of additional measures were enacted in 1986, while others were incorporated into the 1986 Stand-By agreement with the IMF. The most important measure is the tax reform enacted in May 1986, which abolished a number of existing revenue measures, including the corporate income tax, and replaced them with a general 10% value added tax on all transactions. This tax is complemented by a 10% personal income tax, from which payments for the value added tax may be deducted. Another new tax was levied on the net worth of enterprises, amounting to 3% during the first year and 2% thereafter. The 3% net worth tax also will be applied to the updated value of automobiles, dwellings and land holdings. Internal revenue collections were further increased by updating a number of specific taxes, including those on beer, other alcoholic beverages and cigarrettes, and the introduction of a 1% tax on transactions. The uniform rate of the customs tariff was raised to 20% in August 1986.

3. Negotiation of the IMF Stand-by Agreement

In the spring of 1986, the GOB negotiated a Stand-By Agreement with the IMF for SDR 50 million (US$59 million) for the twelve-month period ending on June 30, 1987. The key element of the program is the reduction of the deficit of the non-financial public sector from an estimated 14% in 1985, to 6.5% in 1986 and to below 6% of GDP during the program period. On the expenditure side, achievement of this target is made possible by pursuit of a tight wage policy. On the revenue side, the Government promised to raise revenue collections from about 8% of GDP in 1985 to about 12% in 1986 through the following measures: the 10% value added tax (which replaces the existing selective sales tax of 6%), the wealth or net worth tax, a substantial increase in the collection of import duties as a result of the adoption of a realistic exchange rate, the simplification of the customs tariff, the elimination of duty exemptions and the liberalization of trade. It was noted that the pursuit of a realistic exchange rate policy and the price

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adjustments of petroleum and other services provided by the state enterprises have already substantially improved the financial condition of state enterprises. The agreement sets limits on the borrowing requirements of the non-financial public sector, on changes in the net domestic assets of the Central Bank of Bolivia, on losses in net international reserves, and on the permissible increase of public and publicly guaranteed debt; as well as targets for the reduction of payments arrears. GOB compliance with these terms will be discussed in the following section. Other agreements recently negotiated with the IMF, including use of the Compensatory Financing Facility and a Structural Adjustment Arrangement, will be discussed in the Section on Donor Coordination (Section IX) of this paper.

IV. EVALUATION

This Section reviews the progress achieved by the GOB in stabilizing the economy and setting the basis for economic reactivation and growth. The performance of the Government's stabilization program is analyzed in terms of the behavior in the price level, the budget deficit, expansion of bank credit and money supply, stablization of the exchange rate, debt renegotiation, the balance of payments deficit, compliance with IMF performance targets and the status of economic reactivation todate.

1. Stabilizing Prices

The key indicator of the success of a stabilization program is the behavior of freely determined market prices. The general consumer price index presented in Table 1 shows that the annual rate of increase of the consumer price index, which peaked at 11,750% in 1985, declined to 276% in 1986. The increase between December 1985 and December 1986 was 66%. During the last quarter of 1986, the annual rate of increase of the consumer price index was down to 4.5%. Thus it appears at this time (March 87) that the Government has succeeded in achieving nearly complete price stability.

2. Reduction of Fiscal Deficits and Bank Credit Expansion

It is estimated that the rate of increase of the budget deficit of the consolidated public sector slowed to about 212% in 1986, down from 3,384% in 1985 (Table 2). As a proportion of the GDP, the budget deficit of the consolidated public sector declined from 28% in 1984 to 12% in 1985, and is estimated to be only about 3.8% in 1986 and 6.1% in 1987, which reflects a very substantial reduction in real terms (Table 3). The total rate of bank credit expansion to the consolidated public sector is expected to slow from 17,000% in 1985 to only 28% in 1986; while the rate of expansion of bank credit to the private sector is projected to decline from 15,000% in 1985 to only 104% in 1986 (Table 4). Credit expansion to both sectors declined sharply in real terms over this period.

3. Stabilization of Money Supply and Exchange Rate

This deceleration in the rate of increase of bank credit predictably resulted in a sharp reduction in the rate of expansion of money supply. The annual rate of increase of M1 (currency plus demand deposits) is estimated to have declined from 6,100% in 1985 to only 25% in 1986; while the rate of increase of M2 has declined from 7,300% to 84% (Table 5).

The official exchange rate, which had long been allowed to lag significantly behind the decline of the internal value of the Bolivian peso, was allowed to rise sharply. Between August and September of 1985, the Central Bank's dollar selling rate increased from $b 75,000 to US$ 1 to $b 1,078,000 to US$ 1, an increase of 1,337%. Subsequently, it rose only moderately - to $b 1,588,613 by December 1985. After a sharp jump in January, 1986 (to $b 2,057,645), it has remained very stable at around

$b 1.9 million to $1 through 1986. Following initiation of a more aggressive anti-narcotics campaign in July, the demand for dollars increased temporarily as the result of a speculative wave and of the perceived need to replace the narcotics dollars used to finance imports with foreign exchange purchased in the official auction market. At the same time, the amount of foreign exchange offered for sale declined. This forced the Central Bank to sell dollars in excess of its current dollar earnings for a relatively brief period of time. However, the authorities were able to maintain the exchange rate after only a very small rise, partly as a result of strict fiscal discipline and tight credit management, and partly as a result of large private capital inflows in 1986. 16/

4. Meeting the IMF's Performance Targets

The IMF team that visited Bolivia in August-September 1986, found that the GOB had complied fully with all the established Stand-By targets, except temporarily with one: the target set for the reduction of arrears to foreign suppliers, which were scheduled to decline from $17 million to $11 million by June 30, 1986. In fact, these arrears had increased to almost $ 22 million, and a waiver was required to permit the June 30 IMF disbursement. That waiver was granted on two grounds: a) arrears in fact had been reduced to $8.4 million by mid-July, and b) failure to meet this target was the result of a misunderstanding as the GOB believed that it was complying with the terms of the Paris Club agreement which provided that Bolivia should not extend to other creditors treatment more favorable than to Paris club members. This, however, was not in line with the IMF's understanding of GOB commitments, and the error was quickly corrected.

With regard to the other targets, particularly those relating to the budget deficit, the change in international reserves and credit expansion, the IMF found that these targets had been substantially overfulfilled. While the June 30 targets permitted Bolivia to reduce its net international reserves by $70 million, in fact they had gained $20 million. In addition, while credit expansion to the public sector was permitted to grow by $b 30 trillion (US$ 15.6 million), it had in fact contracted by $b 28 trillion (US$ 14.6 million). As a result of this tight credit policy, interest rates remained very high (the banks' lending rate for Bolivian peso loans during the last two quarters of 1986 was about 4% a month), the private sector complained about tight credit conditions, and by year end, there were as yet no clear signs of reactivation. The GOB's reactivation plan (discussed below) promises to reduce interest rates. They began to decline in February-March of 1987.

16/ Its causes are discussed below in the Balance of Payments Section (IV-5).

5. The Balance of Payments

The current account of the balance of payments presented in Tables 8-9 does not reflect the improvement that is generally associated with a substantial devaluation. In fact, the trade deficit has increased substantially in 1986 as a combined result of the decline in the prices of tin and natural gas (the agreement with Argentina negotiated last November called for a 10% reduction in the price of natural gas), and a substantial (30%) increase in the dollar value of imports 17/.

Nevertheless, Bolivia's overall balance of payments deficit declined substantially in 1986 as a combined result of (1) the Paris Club debt renegotiations that took place in June of 1986, (2) a large repatriation of capital and (3) substantial unregistered foreign exchange earnings originating in the informal sector.

The terms obtained in Paris were extremely favorable to Bolivia as they provided for the capitalization of all interest payments on both arrears and current maturities falling due through June 30, 1987. A five-year grace period was granted on all amortization of principal. Interest was to be renegotiated by creditors on a case by case basis. Bolivia's payments, limited to $3.75 million a month between July 1986 and June 1987, are to be credited against Bolivia's obligations for interest payments falling due during this period. Except for these payments, Bolivia need make no payments on either amortization or interest until July 1, 1987, and then only for interest payments on the renegotiated terms.

The second factor which explains the substantial improvement in the overall balance of payments situation in 1986 is a substantial capital inflow from unidentified sources. These include earnings from prior-year exports, particularly those realized over 1983-85, which were kept in overseas bank accounts because their repatriation would have involved the loss of most of their actual value due to the substantial over-valuation of the Bolivian peso prior to August, 1985. On the other hand, in 1986, with a unified and stable exchange rate, the incentive for keeping the money abroad disappeared. The foreign exchange held by commercial banks increased from some $24 million in 1985 to $118 million at the end of 1986 (see item II-B-ii of Table 9). At the same time, substantial earnings of foreign exchange remain unexplained (as reflected in the $162 million "Errors and Omissions" item), and presumably originated, in large part, in the

17/ The upsurge of registered imports in 1986 may be partly the result of formerly illegal imports currently entering the country legally as a consequence of the removal of import restrictions and of lower import duties. It is also believed to reflect the release of pent-up demand following the removal of restrictions on imports and foreign exchange transactions.

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narcotics export sector. In practice, it is impossible to separate the net capital inflow resulting from repatriation of prior-year export earnings (and prior-year capital flight) from the earnings resulting from illegal narcotics exports. What is certain, however, is that net international reserves (as defined by the IMF) increased by almost $100 million in 1986, and that registered imports increased by some $165 million (Table 9); while registered exports and official net capital imports cannot account for the financing of these items.

USAID estimates of balance of payments results in 1986 and projections for 1987 are presented in Table 9. Note the following with respect to the 1987 projection:

1. Exports are expected to continue to decline due to the continuing drop in the price of natural gas sold to Argentina.

2. Imports were projected to rise by 8%, allowing 4% for inflation and 4% for an increase in real terms (presumed needed to fuel economic reactivation).

3. A modest increase (to $253 million) in the disbursement of medium and long-term offical capital was projected, much less than the nearly $400 million projected by the Central Bank. This disbursement projection is in line with that of the IMF.

4. All rescheduled interest and amortization payments were entered "above the line," and hence were counted as credit items before calculating the balance of payments deficit, and are thus partial offsets to total interest and amortization payments falling due over 1986-87.

5. The "short-term net capital inflow" projected for 1987 was reduced from $118 million (in 1986) to $60 million; while the "Errors and Omissions" item (which includes earnings from the informal sector) was reduced from $162 (in 1986) to $100 million. These reductions are based on the assumptions that net capital repatriation is likely to decline in 1987, and that the narcotics interdiction program will succeed in curbing (though not in eliminating) Bolivia's narcotics exports.

6. USAID/Bolivia therefore projects an overall balance of payments deficit of $184 million in 1987, up from $25 million in 1986 (Item IV of Table 9). This $184 million deficit will be financed in large part from interest and amortization payments accruing but not paid (and not refinanced), which, for the most part, are due to foreign commercial banks. Another $14.7 million may be financed by the ESF balance of payments requested in this PAAD. This would still leave an unfilled gap of $84.6 million as shown under IV-C. The IMF is not likely to permit a decline of net international reserves in excess of $20 million. Thus, the alternatives are to seek additional assistance above the level projected, most likely in the form of additional debt rescheduling; reduce imports below the level projected (which, may well impede economic reactivation); or draw down reserves below the level that the IMF is likely to tolerate. The latter alternative is clearly self-defeating and should be ruled out.

V. THE GOB THREE-YEAR INVESTMENT PROGRAM

The GOB has adopted a three-year reactivation and investment program aiming at achieving a 3.5% annual real GDP growth rate. While the plan places major reliance on private investment, it recognizes that substantial public investment will also be required to provide essential infrastructure (primarily to improve the very deficient road and rail systems) and to create jobs, since in the short term, the private sector cannot be expected to generate sufficient employment opportunities to relieve the country's substantial unemployment, recently aggravated by large lay-offs in the mining industry. Thus, the emphasis of the reactivation program is on labor-intensive construction activities. Another major feature is the provision of loans to the "productive" private sector, with emphasis on agriculture, manufacturing, mining and construction, at rates of interest lower than those currently prevailing in the market. The preferential interest rate for these activities is expected to be 6% above the LIBOR rate, currently about 5.5% 18/.

A summary of the GOB's planned public investment program for the period 1987 through 1989 is presented in Table 10. The three-year public sector investment plan totals US$1,177 million, of which external financing is scheduled to provide US$908 million. The major sectors to which this investment is directed include gas and oil (38%), transportation (34%) and agriculture (11%).

This plan is very ambitious, particularly for 1987 and 1988. Total public investment planned for these two years is $479 million and $382 million, respectively (Table 10). USAID's assessment is that these targets may make inadequate allowance for both financial and administrative constraints 19/. The maximum disbursement of public investment funds that may be possible in light of these constraints is estimated at about $300 million annually, or $900 million for the three-year period, with external financing supplying between two-thirds and three-fourths of the total requirement.

18/ The interest rate on Bolivian peso loans charged by banks to prime borrowers has declined in recent weeks from 4% a month to about 3%, still too high to permit the financing of most agricultural and manufacturing activity. The rate on dollar loans is about 18% to 24% a year.

19/ Historically, the Government has executed an average of about 60% of the planned investment budget.

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Information on the major policy measures that the GCB is planning to adopt to implement the three-year reactivation-investment program is contained in the Memorandum of Understanding 20/ prepared by the IMF team following its visit of October, 1986. The main measures described in this document are:

- Continued emphasis on a tight fiscal policy, with the 1987 deficit of the consolidated public sector not rising above 6.0% of GDP. Major emphasis will be placed on continued wage restraint. Total public sector wage adjustments in 1987 will not exceed 10%, except as increases can be financed with savings resulting from cutbacks in the public sector payroll. The non-financial public sector will continue to refrain from using domestic bank financing on a net basis during the program period (July 1986 - December 1987).

- The government will make every effort to raise revenue collections during the program period. A Minister of Revenue Collections was appointed in December of 1986 and put in charge of customs and internal revenue administration, which is to be thoroughly reorganized during the program period.

- The government is determined to enforce the taxes on corporate net worth and selected property items, as well as monthly taxes on transactions and on selected consumer goods.

- The government expects to accelerate public investment activity, in part through increased donor financing following the December 1986 Consultative Group meeting, and in part through increased rates of disbursement of funds already obligated. The government hopes to increase investment spending from 3.3% to 5.0% of GDP.

- The government will continue to exercise strict control over the finances of state enterprises and refrain from granting them Central Bank loans to cover operating deficits. The accounts of the state enterprises will be transferred from the Central Bank to the commercial banks, and the Central Bank will enforce a 100% reserve requirement on state enterprise deposits. The government will refrain from issuing any guarantees for credit extended by the commercial banks to state enterprises.

- The government will continue to restructure the state enterprises, particularly COMIBOL. Of the company's 23 mines, the two most unproductive will be closed permanently, 9 will be offered to their workers as cooperatives, and 12 will be operated by COMIBOL in a decentralized fashion.

20/ IMF - Memorandum of Understanding on Economic Policy through the End of 1987, Unpublished.

- To alleviate the unemployment problem, the government has decided, through a temporary "Emergency Social Fund," to implement immediately an employment program to construct and repair roads and build simple housing in both urban and rural areas. It is expected that the program will provide employment to 20,000 - 30,000 workers.

- The borrowing requirement of the public investment program will be satisfied fully with external resources without government recourse to domestic bank credit. To that end, continued credit subceilings are being established.

- The private sector will benefit in full from the growth of deposits in the domestic financial system. It is estimated that private sector credit will expand by 14% in real terms during the second half of 1986, and by 25.5% in real terms in 1987.

- To reduce bank lending rates to the private sector, the Central Bank will revise its procedures to ensure that relatively low-cost external lines of credit are passed on to private end-users at interest rates that reflect refinancing costs in international financial markets. These resources will be directed to the productive sectors of the economy, including the export sector.

- The Central Bank will be reorganized to improve its accounting procedures, as well as the efficiency of its Development Loan Department (which will become eventually an independent development bank for the intermediation of foreign lines of credit) 21/. The Central Bank will no longer handle the deposits of state enterprises.

- The government will actively seek to promote exports by providing pre-export credit, attempt to reduce transportation costs, and rebate domestic taxes and import duties to producers for the export market. The government will also seek to negotiate additional government-to-government contracts for the export of natural gas. (e.g. with Brazil).

21/ Source: IMF - Memorandum of Understanding on Economic Policy through the End of 1987, Oct. 1986, (unpublished version), Page 15.

VI. MAJOR REMAINING PROBLEMS AND GOB PRIORITIES

1. Reactivation of the economy: Now that the GOB has successfully implemented the stabilization program, economic reactivation becomes the first priority. The private sector has identified a number of obstacles to increased economic activity that need to be addressed. These include the acute shortage of working capital (which the Government's Reactivation Plan is seeking to relieve), the application of the net worth tax on enterprises currently experiencing losses, the need for export incentives, including expanding the tax rebate provided by export certificates (which involves a 10% premium to exporters for foreign exchange sold to the Central Bank), the request for countervailing import duties on export products subsidized by neighboring countries, tighter controls on smuggling, exemption from duties on imports of intermediate and capital goods, and the simplification of bureaucratic procedures that currently impede exports, imports, the obtention of credit and even the payment of taxes. These points merit serious consideration by the Government.

2. Renegotiation of Bolivia's debt with foreign commercial banks: As noted, Bolivia's balance of payments situation does not permit it to meet its amortization payments, particularly the amortization of its substantial arrears to bank and private suppliers (some $840 million at the end of 1985), over anything like a five-year period. Even with additional ESF assistance and increased loan disbursements from multilateral and bilateral donors, the resulting balance of payments gap could not be filled. The renegotiation of Bolivia's debt to foreign commercial banks is currently under way.

3. Restructuring the Economy: Some restructuring of the economy appears to be essential if the country is to be able to resume GDP growth and make progress in reducing its balance of payment disequilibrium. Work is needed in the area of project development, investment strategy and strengthening export and investment incentives for the private sector. The following areas will be among the prime targets of the restructuring program:

a. Expansion and diversification of exports: These might include adjustment in the exchange rate, provision of pre-export credit, exempting imports of intermediate and capital goods from import duties, exemption of export products from sales and import taxes on inputs, end or at least streamline bureaucratic procedures that interfere with incentives to export, and removal of remaining export taxes (e.g. on timber, cut flowers, rubber, castaña nuts and coffee) .

b. Closing unprofitable mines and ending the deficits of COMIBOL and ENFE: The Government is well aware of the need to address this problem and is currently doing its best to arrive at a solution. However, there is strong opposition to the closing of mines that would lead to the discharge of thousands of workers. The GOB will require additional financial resources to meet severance payments as well as to finance alternative employment opportunities for the discharged miners.

c. Reducing the public sector's payroll and raising government salaries in order to improve the level of efficiency and competence in the public sector: there has been a substantial decline in the level of real wages of public servants. Between the 1980 and May 1985, the IMF reports that average monthly salaries (in constant 1970 pesos) of employees in the service sector (which includes public administration) dropped by 45%. 22/ There has been another substantial drop since then. While it is recognized that restoring the real wage to its previous level would not automatically reduce corruption, it is nonetheless clear that the fight against corruption is not likely to make much progress without a significant adjustment in real wages, particularly for workers in strategic areas such as customs and tax collections and police. In assessing the impact of salary adjustments on public sector finances, account must be taken of the potential increase of such adjustments on revenue collections, as well as their obvious impact on increased current expenditures. While the government bureaucracy is heavily overstaffed, particularly in state enterprises, the discharge of surplus workers alone is not likely to generate sufficient savings to finance needed salary adjustments.

d. Proceeding with divestiture or closing of unprofitable enterprises: inefficient and non-salvageable mines should be closed, while divestment should be considered for enterprises that could be operated more efficiently by private businesses. At the same time, the Government should remove all major obstacles to their efficient operation (e.g. permit discharge of employees in excess of requirements).

22/ IMF, Recent Economic Developments, Sept. 6, 1985, Table 34, Page 92.

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VII. BASIC RATIONALE FOR ESF ASSISTANCE

The basic rationale for the proposed $ 14.66 million ESF assistance proprosed for FY-87 is as follows:

a. The ESF program will contribute some of the resources needed to finance economic reactivation by providing the foreign exchange for the importation of raw materials, intermediate and capital goods for the private sector.

b. The program will provide balance of payments support and thus help reduce the balance of payments gap. The case for balance of payments support is strengthened by the need to compensate for the combined losses to the Bolivian economy resulting from the fall in the prices of tin and natural gas, and for the foreign exchange losses expected to result from the disruption of narcotics trafficking. Failure to eliminate the balance of payments gap is likely to force a reduction of imports, which would probably interfere with implementation of the GOB's economic reactivation program.

c. The ESF program has also been, and will continue to be, an important USG instrument for encouraging continued GOB cooperation in the area of narcotics control. Section 611 of the FAA imposes specific narcotics related benchmarks that apply to the approval of ESF for Bolivia in FY 1987. Recently, a joint USG-GOB commission elaborated a three-year plan for GOB narcotics control actions on several fronts--including narcotics interdiction, coca production controls, and agricultural development designed to provide alternative employment opportunities. ESF assistance is an important element of that plan as it will generate the local currency required to help resettle farm families currently engaged in coca production that are willing to shift to other agricultural pursuits.

d. Finally, there is a strong case for continued U.S. support for Bolivia's democratically elected government that has shown considerable political courage in taking the necessary steps to stabilize the economy, free it from unnecessary government controls, establish a much more favorable environment for the growth of the private sector, and undertake a determined campaign to eliminate narcotics trafficking.

The basic goals of USG policy in Bolivia are: (a) maintenance of a stable and democratic government and institutionalization of the democratic process, (b) private sector led economic recovery, and (c) narcotics control. The GOB's basic economic policies and priorities are fully in line with the recommendations of USG, other donor countries and the international financial institutions, and merit continued USG support. Further assistance to the GOB's stabilization and recovery efforts will also help advance USG narcotics and democracy-related goals in Bolivia as the survival of the current government, which is making significant strides in institutionalizing democratic rule and in narcotics control, depends, to a large extent, on the success of its economic policies.

VIII. ESF DOLLAR AND LOCAL CURRENCY PROGRAMMING AND DISBURSEMENT PROCEDURES

A. ESF Dollars. FY 1987 ESF dollars will be obligated in two tranches of approximately $7.0 million each. The ESF funds will be disbursed in acknowledgement of GOB progress in implementing the joint overall USG-GOB Accord on narcotics control as established in a Side Letter to the Accord. The $14,660,000 authorized by this memo will be disbursed in four tranches. The $7,160,000 which will be initially obligated will be disbursed in two tranches. The first tranche of $3,000,000 would be disbursed upon signature of the implementing annexes of the overall USG-GOB Agreement on Narcotics Cooperation as well as the standard C.P.s to disbursement. The second tranche of $4,160,000 would be disbursed upon eradication of a sufficient number of hectares to satisfy the Congressional criteria that sufficient progress has been made in eradicating coca.

The stipulations explained below will be included in Article IV of the FY 1987 ESF Grant Agreement to be signed with the Ministry of Planning and Coordination.

Dollar disbursements will be made to a Special Account established by the Bolivian Central Bank (BCB) - most likely in a United States bank. The account will earn interest which will be programmed in the same manner as the funds originally deposited. Dollars deposited into the Special Account will be available for only two categories of expenditures:
a) private sector imports of equipment and machinery, spare parts and raw materials from the United States; and b) public and private sector debt service payments to United States creditors or international financial institutions (IFIs) made in accordance with Paris Club agreements, only after consultation with AID/W. The Cash Transfer Agreement will explicitly prohibit the use of Special Account dollars for any military or paramilitary uses.

The BCB will disburse dollars from the Special Account for eligible uses and, at least once a quarter, present documentary evidence (see below) to USAID to support the disbursements made. USAID will review the documentation provided and formally notify the BCB of its concurrence or non-concurrence, the Agreement will provide for reimbursement to the Special Account of the amount in question.

It should be noted that the GOB currently does not restrict sales of foreign exchange to the public. Any person or company can legally buy and sell foreign exchange. The Central Bank operates an auction mechanism under which it sells foreign exchange to individuals or companies (or banks acting on their behalf) every few days. No documents are required from buyers which indicate the intended use of the foreign exchange. The BCB does, however, operate lines of credit from several donors to finance imports. Relatively simple mechanisms have been developed to provide foreign exchange from these credit lines for private sector imports through the financing of letters of credit opened at the request of the importers' banks. The current terms of these credits are 13% interest, with dollar maintenance of value (4% to the ICI, 8.5% to the Treasury and 0.5% to the BCB, with 3 months grace period for loans up to one year. Loans up to $500,000 which refinance up to 75% of import transaction costs are extended.

In order to control the use of dollars provided under FY 1987 cash transfers, and be able to present required documentation to USAID, the BCB plans to operate a similar importation credit line with the cash transfer funds it receives, establishing its own regulations for its use.

The Central Bank may use relatively limited foreign exchange to be provided under the 1987 ESF Program to finance public debt service payments to the U.S. Government or IFIs such as the World Bank subject to the terms of the Paris Club Agreement and the prior approval of the Assistant Administrator for Latin America and the Caribbean.

Documentation requirements will be as follows: a) for import transactions, copies of (1) BCB authorizations to local banks to request the opening of irrevocable letters of credit charging Special Account funds, and (2) the telexed confirmations of the opening of the irrevocable L/Cs from the U.S. bank in which cash transfer dollars are deposited; and (b) for debt payments, acknowledgements from creditors of payments made which indicate relevant loan numbers and dates payments were executed, along with proof (bank statement, payment confirmation cable, or the like) that payment was made from the Special Account.

As stated above, quarterly reports on the uses of ESF dollars will be required from the Central Bank. The quarterly reports will contain copies of the payment documents mentioned above, along with a statement from the bank in which the Special Account is held showing credits to, and disbursement from, the Account. Each report will certify that financial documentation, books and records covering the use of dollar funds are being maintained by the BCB and its correspondent bank in accordance with generally accepted accounting principles and practices consistently applied, and are available for inspection by A.I.D. or any of its authorized representatives, at all times as A.I.D. may reasonably require, for a period of three years after the date of last disbursement by A.I.D. under the FY 1987 ESF Program.

B. <u>ESF Local Currency Generations</u>. The procedures for the use of local currencies explained below will be incorporated in a Memorandum of Understanding accompanying the FY 1987 ESF Agreement. Procedures were developed under the FY 1986 ESF Program, which are referenced in Annex II to this PAAD, under which USAID is specifically approving commitments of local currency for eligible activities, with funds being managed by the GOB PL 480 Executive Secretariat. The same procedures will be used for the FY 1987 Program.

A new Special Account will be established in the BCB in the name of the Title III Executive Secretariat following the first disbursement of dollars under the FY 1987 ESF Agreement. Upon the request of USAID, a series of local currency deposits totalling the amount of dollars disbursed (calculated at the highest exchange rate not illegal in Bolivia on the dates of disbursement) will be made to the Special Account by the BCB within a period of six months from the date of the dollar disbursement, unless A.I.D. otherwise agrees in writing to disbursements beyond the six-month deadline. Local currency will be due for the ESF dollars disbursed plus any interest earned on the Special Account in which the dollars are deposited. Local currency funds from the Special Account will be eligible for use only for:

a. Costs associated with reducing the size of the public sector (e.g. severance pay);

b. Costs associated with strengthening and improving public administration (e.g. salary payments to GOB technicians);

c. Financing employment generating activities (e.g. through the GOB Emergency Social Fund);

d. Financing economic development and narcotics awareness activities contributing to the GOB's narcotics control efforts;

e. Counterpart contributions to other donor development projects; and

f. The USAID Trust Fund Account for administrative expenses (10% of total funds generated).

USAID will only request disbursement to the Special Account as they are needed for expenditure for these uses. In this way, the purchasing power of the local currency will be preserved.

The Memorandum of Understanding will provide for the Executive Secretariat to transfer funds from the BCB Special Account to a USAID Trust Fund Account for expenditures in categories d and f at the request of the Mission. Expenditures for activities in categories a, b, c, and e will be explicitly approved by A.I.D. by Operational Letter. Disbursement will then be made for implementing these activities by the Executive Secretariat. The BCB and the Executive Secretariat will be required to maintain accounting records for the local currency Special Account, to which A.I.D. or its representatives will have access.

Quarterly reports on commitments and disbursements of Special Account funds for approved activities will be sent to the Mission for review.

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IX. DONOR COORDINATION

There is informal coordination of donor programs in Bolivia. Coordination has been greatly facilitated by the fact that the World Bank, the IDB and USAID all share the same building. Visiting teams almost always visit other donor offices. For example, the recent Agricultural Assessment Team sponsored by the IBRD visited USAID and the IDB, with all parties taking an active interest in the analysis, and each suggesting topics relevant to its particular program.

Another example of donor cooperation on projects is provided by the Financial Sector Strengthening project, where the IBRD has assumed responsibility for strengthening public sector institutions (i.e. reorganization of the Central Bank, implementation of the tax reform program and improving the auditing system at the Contraloría), while USAID has been working on providing training to the staffs of commercial banking institutions to improve their efficiency, and establishing a deposit guarantee program to restore public confidence in the safety of bank deposits. Frequent discussions are taking place between representatives of the IBRD, AID and the Central Bank on this project.

On a formal level, major responsibility for coordinating the economic assistance provided by the various groups is assumed by the Ministry of Planning. In addition, under UNDP coordination, donor representatives meet for lunch on a monthly basis. The revived Consultative Group for Bolivia (under the aegis of the IBRD) met in Paris in December 1986. Annual meetings will be held hereafter, with the next one scheduled for October-November 1987. At this meeting, the GOB is expected to submit a medium-term public investment plan and investment strategy.

The role assumed by major multilateral donors in promoting economic reactivation is summarized as follows:

The IMF: While the IMF's major responsibility is to ensure the continuing success of the stabilization program and monitor the GOB's macro-economic policies, the Fund is also concerned with the adoption of strategies and structural adjustments conducive to growth. Thus, it pays attention to the investment component of the GOB budget and urges the adoption of an exchange rate that is flexible and consistent with export development, as well as the provision of adequate credit for the productive private sector.

The IMF has made available substantial resources for Bolivia. These include a one-year Stand-by for SDR 50 million approved in June of 1986; a three-year Structural Adjustment Arrangement for SDR 42.6 million approved in Nov. of 1986; and an SDR 64.1 million loan from the Compensatory Financing Facility that was fully disbursed in November 1986.

The World Bank: The World Bank provides substantial balance of payments assistance, though it is not labelled as such. In 1986, the IBRD approved "Reconstruction Import Credit I" for $55 million, of which $40 million is projected for disbursement in 1987. A second Reconstruction Import Credit is scheduled for approval in July or August of this year, also for $50 million, to be disbursed over a 1-2 year period. These credits are designed for the importation of raw materials and capital goods for the private sector.

The World Bank is also involved in improving the basic institutional and policy framework of the GOB. A Financial Sector Management Credit for $8 million has been programmed involving monthly technical assistance to support the reorganization of the Central Bank, implementation of the tax reform program and improvement of the auditing system for the Contraloría. The fiscal 1988 program includes a $5 million Public Investment Program providing substantial technical assistance and some equipment to train GOB staff in preparing public sector investment projects and a public investment program. The project is for $5 million and will be disbursed mostly in 1988 and 1989. Total IBRD activities in Bolivia involve an average annual loan disbursement of $60 million, mostly in the form of soft IDA loans.

The IDB: The IDB provides no balance of payments support, per se, but has a substantial $100 million Agricultural Credit program, of which $40 million is projected for disbursement in CY 1987. Another $4 million is for seeds. Its total program for the private sector in 1987 is $54 million. The IDB is also active in the area of sanitation ($12 million in 1987), while its disbursements for energy and transportation (mostly roads) involve the disbursement of another $45 to $50 million during the current calendar year.

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X. GOB COMMITMENTS

The GOB has already adopted the measures that are essential to achieve economic stabilization. It has committed itself in its agreements with the IMF and other donors to continue these measures, as well as to adopt a number of structural adjustments designed to set the basis for economic reactivation and long-term growth. The Minister of Planning has sent a Letter of Application to the AID Mission (appended as Annex 1) setting forth the nature of the program, including the major economic adjustments already made, those that are planned, and some specific targets and benchmarks.

The structural changes already adopted and initiated during 1986 include a comprehensive program of tax reform along with the introduction of a new value added tax; a tariff reform assessing all imports at a uniform 20% rate; the closing of a number of tin mines that could not be operated profitably; a significant reduction of the payroll of the public sector; and the freeing of the economy from price, import and exchange controls. Structural reforms under way include the identification of enterprises to be transferred to the private sector; the reorganization and decentralization of various state enterprises; measures to improve investment and export incentives; the expansion of credits to the private sector and the reduction of interest rates; and reforms designed to improve the efficiency of both state-owned financial institutions as well as private commercial banks. The Government is also in the process of refining its public investment program and of formulating an investment strategy, both to be submitted to the next Consultative Group meeting projected to take place in November 1987. This effort will include the preparation of new projects as well as the identification and removal of impediments to the disbursement of external loans that have resulted in the accumulation of a sizeable pipeline. It is expected that both the public investment plan and the development strategy will be completed by the last quarter of 1987.

CJoel - 3/18/87

TABLE 1

GENERAL CONSUMER PRICE INDEX

1966 = 100

	Index Average of Period	Annual Rate of Increase
1981	923.1	
82	2,063.5	123.5
83	7,750.2	275.7
84	107,058.2	1,281.4
85	12,686,008.0	11,749.7
86	47,742,000.0	276.3

		Annualized Quarterly Rate of Increase
June 85	6,023,641.8	
Sep. 85	26,098,526.4	1,333.1
Dec. 85	30,873,311.6	73.2
March 86	44,343,478.3	174.5
June 86	48,357,088.1	36.2
Sep. 86	50,661,830.1	19.1
Dec. 86	51,238,413.0	4.5

Source: Instituto Nacional de Estadistica, cited in Estadisticas Monetarias y Financieras, No. 31, May 1986; and January 87 update.

TABLE 2

BUDGET DEFICIT OF THE CONSOLIDATED PUBLIC SECTOR

(In Billions of Bolivian Pesos)

		Annual Rate of Increase
1982	57.2	
83	259.2	353.3
84	5,531.4	2,033.2
85	192,695.5	3,383.9
86(Progr)	600,555.6	211.7

TABLE 3

BUDGET DEFICIT OF CONSOLIDATED PUBLIC SECTOR AS % OF GDP

82	16.0
83	19.2
84	28.1
85	12.4
86	3.8*
87	6.1*

*Projected.

Sources: IMF, Bolivia - Request for Stand-By Arrangement, June 2 1986, Tables 10 (page 48), and 9 (Page 44); IMF report on Bolivia - Recent Economic Developments Dec. 2, 1986, Table 35, P. 82; and IMF, Bolivia - Staff Report for the 1986 Art. IV Consultation, Table 11, P. 43.

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TABLE 4
BANK CREDIT EXPANSION

	Annual Rate of Increase of Bank Credit	
	To Non-Financial Public Sector	To Private Sector
1982	635	304
83	287	119
84	1,166	1,405
85	17,029	15,066
86	28	104

Source: IMF, Bolivia - Request for Stand-By Arrangement, June 2, 1986, Table 5 (Page 7).

TABLE 5
MONEY SUPPLY OUTSTANDING AT END OF YEAR
(In Billions of Bolivian Pesos)

	(1) M1	(2) Annual Rate of Increase of M1	(3) Quasi Money	(4) M2 (1) + (3)	(5) Annual Rate of Increase of M2
1982	57		31	88	
83	178	212.3%	78	256	190.9
84	3,347	1,780.0%	527	3,874	1,413.3
85	208,765	6,137.4%	76,873	285,638	7,272.2
86	262,100	25.5%	263,500	525,600	84.0

Nov. 86, IMF, Bolivia - Staff Report for the 1986 Art. IV Consultation, Table 6, P. 13.

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Table 6
Official and Parallel Exchange Rates

Year/Months	Official* Exchange Rate (b/US)	Parallel* Exchance Rate (b/US)
1980	24.51	24.51
1981	24.51	31.49
1982	129.61	144.03
1983	247.00	646.05
1984	2,791.67	8,287.92
March 85	50,000.00	128,137.00
June 85	75,000.00	481,756.00
September 85	1,077,887.00	1,087,441.00
December 85	1,588,613.00	1,715,869.00
March 86	1,866,762.00	1,962,669.00
June 86	1,904,857.00	1,946,611.00
September 86	1,915,090.00	1,924,233.00
December 86	1,925,400.00	1,949,607.00
February 87**	1,941,000.00	1,945,100.00

* Selling rate

** While we continue to cite the rate in Bolivian pesos, a new unit (the Boliviano) was created in January 1987:
One (new) Boliviano = 1,000,000 Bolivian pesos.

SOURCE: BCB, UDAPE, and The American Embassy.

TABLE 7

EXPORTS, IMPORTS AND BALANCE OF PAYMENTS DEFICIT
(IN MILLIONS OF US DOLLARS)

	Exports	Imports (CIF)	Deficit on Current Account	Overall BOP Deficits
1982	828	578	176	- 363
83	755	589	- 155	- 332
84	724	492	- 129	- 103
85	623	552	- 282	-312
86	543*	717*	-313**	- 25**

* Revised Central Bank projections.
** AID estimates based on preliminary Central Bank/IMF data. See Table 9.

Source: IMF, Bolivia-Request for Stand-By Arrangement, June 2, 1986, Table 6, Page 9, and revised Central Bank/IMF estimates.

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Table 8. Bolivia: Summary Balance of Payments

(In millions of U.S. dollars)

	1982	1983	1984
Current account	-176	-155	-129
Exports f.o.b.	828	755	724
Imports c.i.f.	-578	-589	-492
Interest, net	-391	-320	-334
Other services, net	-81	-107	-116
Transfers, net	46	106	89
Capital account	-159	-178	25
Nonfinancial public sector 1/	-71	-223	-172
Disbursements	207 2/	92	104
Amortization	-278	-315	-276
Banking system 3/	-51	-14	-7
Private sector 4/	78	157	16
Overdue receipts for gas exports to Argentina	-145	-98	188
Allocation of SDRs and gold monetization	2	1	1
Overall balance	-363	-332	-103
Unpaid debt service (changes)	295	634	251
Arrears and deferred debt	177	150	251
Rescheduling	118	484 5/	—
Net official reserves (increase -)	68	-302 5/	-148
Memorandum items:			
Current account 6/	-4.0	-3.6	-3.0
Exports, f.o.b. 6/	18.6	17.6	16.9
Imports, c.i.f. 6/	-13.0	-13.8	-11.4
Gross official reserves (in millions of U.S. dollars)	182	175	286
(In months of imports, c.i.f.)	3.8	3.6	7.0
Official exchange rate (period average, $b per U.S. dollar)	67	230	2,981
Terms of trade (percentage change)	-1.4	3.6	1.7
Stock of external payments arrears, end of period (in millions of U.S. dollars) 7/	312	462	713

Source: IMF, Bolivia - Request for Stand-By Arrangement, June 2, 1986, Page 9.

1/ Includes short-term debt; excludes balance of payments support loans, forced financing of gas exports to Argentina, and impact of rescheduling.
2/ Includes assumption of US$19 million of short-term bank debt of the financial public sector under the April 1981 financing agreement.
3/ Includes contributions to international organizations, and due but unpaid amortization of banking system.
4/ Includes errors and omissions.
5/ Includes rescheduling of US$370 million of unpaid short-term debt of the Central Bank.
6/ In percent of dollar GDP, calculated using real growth and U.S. inflation with a 1986 base.
7/ Includes deferred debt service payments in 1982-83.

TABLE 9

BOLIVIA: SUMMARY OF BALANCE OF PAYMENTS FOR 1985, 1986 AND 1987
(In millions of US dollars)

		YEAR	
	1985(p)	1986(p)	1987
I. CURRENT ACCOUNT (A+B)	-281.9	-312.9	-487.5
A. Goods, Services and Interest (1+2+3)	-361.9	-404.7	-582.8
1. Merchandise	71.5	-174.1	-280.2
Exports FOB	623.4	543.4	494.8 1/
Imports CIF	-551.9	-717.5	-775.0 2/
2. Services	-60.0	-26.0	-42.0
Exports	98.0	117.0	128.0 1/
Imports	-158.0	-143.0	-170.0 1/
3. Earnings from Interest	-373.4	-204.6	-260.6
i) Received	16.0	13.3	20.0 1/
ii) Due	-389.4	-321.9	-324.6
- Interest Paid on medium and Long Term External Public Debt	-88.8	-62.3	-151.7 1/
- Other Interest Paid	-73.8	-58.7	-65.7 1/
- Interest not Paid	-174.0	-159.9	-70.1 1/
- Other Income	-52.8	-41.0	-37.1 1/
iii) Rescheduled Interest	-	104.0	44.0 3/
B. Unilateral Transfers	80.0	91.8	95.3 4/
II. CAPITAL ACCOUNT	-210.3	126.1	203.9
A. Direct Investment	10.0	10.0	20.0
B. Other Capital	-220.3	116.1	183.9
i) Medium and Long-Term Capital	-244.8	-2.4	123.9
- Disbursements on medium and long-term External Public Debt	108.7	197.7	253.0 5/
- Amortizations Paid on Medium and long-term External Public Debt	-159.3	-111.0	-66.2 1/
- Amortizations not Paid	-184.7	-220.3	-244.9 1/
- Refinanced Amortization Payments	-	146.0	186.0 3/
- Other Capital (net)	-9.5	-14.8	-4.0 1/
ii) Short-term Capital (Net)	24.5	118.5	60.0 6/
III. ERRORS AND OMISSIONS	180.5	162.1 9/	100.0 6/
IV. TOTAL CURRENT TRANSACTIONS AND CAPITAL MOVEMENT (I+II+III)	-311.7	-24.7	-183.6
A. COUNTERPART ITEMS	9.9	0.0	0.0
B. EXTRAORDINARY FINANCING 7/	358.0	122.4	99.0
- ESF BOP Assistance	-	7.2	14.7
- Interest Not Paid and not Refinanced (Increase in Arrears)	174.0	55.9	26.1 8/
- Amortization Not Paid and not Refinanced (Increase in Arrears)	184.0	74.3	58.9 8/
- Reduction of Arrears	-	-15.0	-0.7
C. NET INTERNATIONAL RESERVES (Increase = -) -	-56.9	- 97.7 10/	84.6 9/

(p) Preliminary Figures
Date: Jan.14, 1987

Source: For 1985-86, Central Bank/IMF estimates; for 1987, see footnotes.

Footnotes to Table 9

1/ Central Bank projection.

2/ USAID projection, assuming 8% increase over 1986 (4% for inflation, 4% real).

3/ USAID projection.

4/ Central Bank projected unilateral transfers of $110 million. We deducted $14.7 million in ESF assistance since we regard such assistance as Balance of Payments (BOP) support, which belongs "below the line", i.e. as part of the financing required to cover the overall BOP deficit. We made a $7.2 million deduction (for ESF) from the "Unilateral Transfers" projected by the Central Bank for 1986.

5/ The Central Bank's official loan disbursement projection of $318.6 million for 1987 impressed us as excessive. The $253 million figure entered in the table was arrived at as follows:

IMF projection	$ 439 million (including Paris Club debt rescheduling)
Less allowance for Paris Club debt rescheduling	$ 186
New loan disbursements in 1987	$ 253

6/ USAID projection

7/ Exclusive of balance of payments assistance from the Fondo Andino de Reserva and IMF credits, both of which are treated as short-term credits and do not affect net international reserves as defined by the IMF.

8/ Obtained by difference between the total amount of debt service due (but not paid) and the amounts rescheduled. Specifically, for 1987:

	Amount due but not paid	Amount Rescheduled	Increase in Arrears (entered under IV-B)
Interest	70.1	44.0	26.1
Amortization	244.9	186.0	58.9

9/ Calculated as a residual.

10/ The Central Bank estimated this item at $197.7 million. However, this amount includes $100 million credit from the Fondo Andino de Reserva (FAR) which the IMF regards as a short-term loan and which we netted out.

SOURCES: For 1985 and 1986, Central Bank Data

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Table 10

PLANNED PUBLIC INVESTMENT
(Mill.$us)

	1987	1988	1989	TOTAL
Planned Total Investment	478.7	381.8	316.8	1177.3
Source of Financing:	478.7	381.8	316.8	1177.3
External Credit*	294.6	236.2	149.5	680.3
Counterpart Resources (USAID)	102.2	75.2	50.1	227.5
Internal Resources	81.9	70.4	117.2	269.5
Required public investment to achieve 3.5% annual econ. growth	268.6	301.4	315.1	885.1

*Multilateral sources 70%, of which 70% corresponds to the IDB.
Bilateral sources 30%, of which 30% corresponds to Argentina.

SECTORIAL DISTRIBUTION
(%)

Agriculture	10.60
Mining	2.90
Hidrocarbons	38.30
Industry & Commerce	1.20
Energy	2.30
Transportation	34.00
Communications	5.90
Social Services	4.80

SOURCE: Summary table by Muller & Machicado Asociados, based on the Plan Trienal

Table 11

GROSS DOMESTIC PRODUCT BY ECONOMIC ACTIVITY
(In Millions of Constant 1980 Bolivian Pesos)

ctivity Years	1980	1981	1982(p)	1983(p)	1984(p)	1985(e)	1986(e)
INDUSTRIES	106.050	105.644	102.573	94.363	93.233	91.421	88.625
1. Agriculture, Forestry and Fishing	22.563	22.359	23.879	17.507	20.732	21.417	21.095
- Agricultural Products	15.727	17.255	18.428	12.015	14.971	16.244	15.693
- Animal Products	5.893	4.214	4.530	4.535	4.821	4.151	4.263
- Forestry, and fishing	943	881	920	957	990	1.022	1.051
2. Mining and Quarry Production	19.407	19.290	18.339	18.108	15.602	13.751	11.083
- Crude Oil and Natural Gas	5.728	7.157	7.704	7.219	7.037	6.899	6.629
- Metallic and Non-Metallic Minerals	13.679	12.133	10.635	10.889	8.565	6.852	4.454
3. Manufacturing Industry	17.974	16.664	14.344	13.387	11.814	10.729	10.622
4. Electricity, Gas and Water	806	919	923	919	931	935	915
5. Construction and Public Works	4.521	4.025	3.928	3.751	3.590	3.591	3.562
6. Commerce	13.261	14.360	13.599	13.055	13.924	13.195	13.393
7. Transportation, Storage and Communications	7.321	8.195	7.770	7.931	7.983	8.057	8.163
8. Financial Establishments, Insurance Real Estate, and and Services to Companies	17.248	16.443	16.562	15.659	15.734	16.875	17.052
- Financial Services to Companies	7.189	6.324	6.413	5.490	5.555	6.685	6.853
- Housing	10.059	10.119	10.149	10.159	10.179	10.189	10.199
9. Social and Personal Services	4.331	4.877	4.731	4.565	4.403	4.425	4.403
- Banking Services (imputed)	-1.932	-1.480	-1.501	-1.519	-1.534	-1.565	-1.604
PUBLIC ADMINISTRATION SERVICES	12.940	13.201	13.504	13.909	13.965	13.636	13.234
DOMESTIC SERVICES	658	637	655	646	633	622	615
AL: At producer prices	119.353	119.622	116.743	108.918	107.831	105.722	102.475
ndirect Taxes on mports	3.289	3.753	3.162	3.132	3.221	3.391	2.502
AL: At Prices to End Users	122.945	123.375	119.905	112.050	111.054	109.113	105.977

SOURCES:Central Bank of Bolivia - National Accounts Department
(p): Preliminary
(e): Estimated
Note: The present series is estimated according to UN recommendations contained in document Series F, No. 2, Rev. 3 and to the new methodology adopted.

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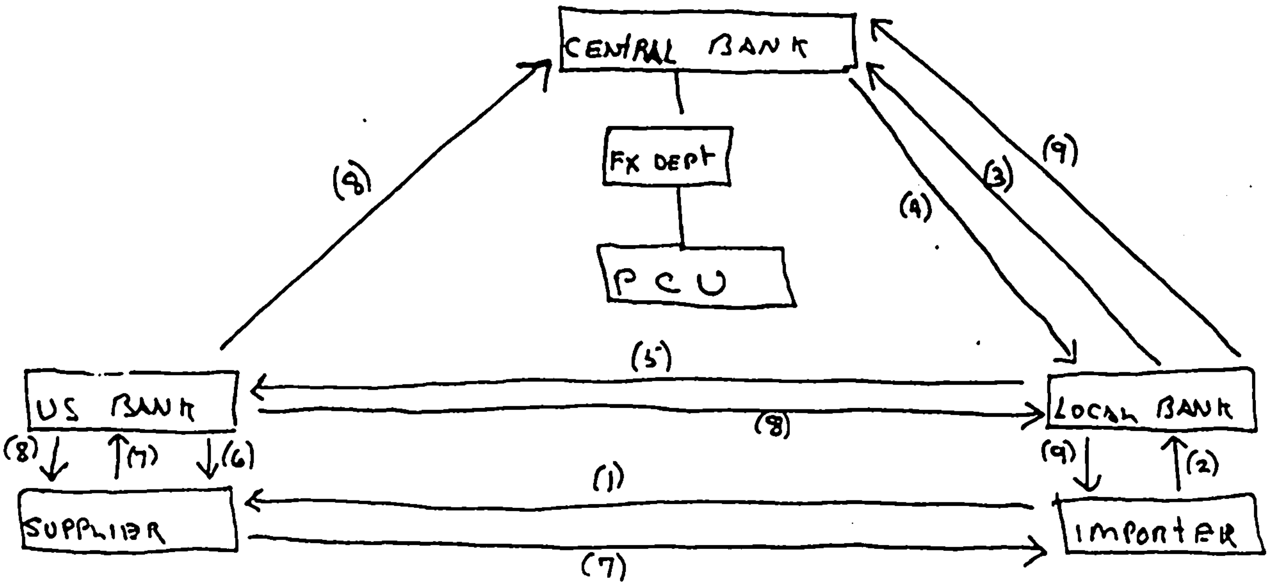
THE ESF DOLLAR SPECIAL ACCOUNT:
UTILIZATION AND ACCOUNTABILITY



(1) An importer in the host country places an order with an eligible supplier.

(2) The importer requests his local bank to open a letter of credit in favor of the supplier.

(3) The local bank sends the request to the central bank.

(4) The central bank, through its foreign exchange department and/or its price checking unit, verifies the request for eligible supplier, eligible commodity, and reasonable price, and if all is in order, forwards permission to the local bank to open the letter of credit designating the U.S. bank that will act as correspondent(the same bank in which the special account is held).

(5) The local bank opens the letter of credit and requests confirmation from the U.S. bank.

(6) The U.S. bank informs the supplier that the letter of credit has been confirmed.

(7) The supplier makes shipment and presents invoice and all relevant shipping documents to the U.S. bank.

(8) The U.S. bank makes payment to the supplier from the special account and informs the central bank and the local bank of its action.

(9) The local bank debits the account of the importer and applies to the central bank for reimbursement.

ANNEX I

Mr. David A Cohen
Director
USAID/Bolivia
La Paz

Dear Mr. Director:

Re.: GOB LETTER OF APPLICATION FOR ESF ASSISTANCE
(Original in Spanish)

Application is hereby made for US balance of payments assistance of $15 million for 1987. Bolivia's expected balance of payments gap in 1987, if projected on the assumption that economic reactivation will take place this year, is likely to be substantially larger than that.

The Government of Bolivia has already taken a number of far reaching actions to stabilize the economy. These will be continued. The major measures taken include a freeze of the wages of public sector employees, followed by an increase of only 10%; a substantial reduction in the budget deficit, with its ratio to the GDP declining from 28% in 1984 to less than 4% in 1986; an increase in tax revenue collections from 4.8% of GDP in 1984 to over 19% in 1986, largely as a result of devaluation and substantial increases in the internal price of petroleum products; a tax reform bill that overhauls the whole tax system; a substantial devaluation of the exchange rate followed by its nearly complete stabilization since January 1986; the freeing of almost all prices and substantial increases in the prices of goods and services provided by the public sector; and generally, tight monetary - fiscal management.

The stabilization measures have had the intended effect and the Government plans to continue its stabilization program. The present goal is to hold the increase of the consumer price index to 10% in 1987, down from 66% between December 1985 and December 1986. Investment is to rise from about 4% of GDP in 1985 to 12% in 1987 and 14% in 1988, while the deficit of the consolidated non-financial public sector is expected to be about 6% in both 1987 and 1988, down from 28% in 1984 and 12% in 1985. Total revenue collections of the non-financial public sector have already increased from 5% in 1984 to 19% in 1986 and are expected to maintain that ratio in 1987 and 1988.

A number of structural changes have been initiated during the past year that will be consolidated and expanded over 1987-88. Measures already taken include adoption of a comprehensive program of tax reform substituting taxes easy to administer for those that are hard to collect, and introducing a new value added tax; a tariff reform assessing almost all imports at a uniform 20% rate; the closing of a number of tin mines that could not be operated profitably; significantly reducing the payroll of the public sector; and

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freeing the economy of price, import and exchange controls. Structural reforms under way include measures designed to improve the efficiency of a number of state owned financial institutions as well as private commercial banks; identification of enterprises to be transferred to the private sector and actions required to permit these to operate profitably; the reorganization and decentralization of various state enterprises; and measures to improve investment incentives.

Major attention is being given to improving the public sector investment program, both with respect to the execution of projects already under way and to the development of a sound medium-term public investment program. The Ministry of Planning is currently analyzing the factors that are delaying or impeding project execution. The study under way will recommend specific measures to remove such impediments in order to speed project implementation and accelerate the rate of disbursement of external loans. For the medium-term, government analysts are preparing a sector by sector development strategy, which will include the development of specific sector goals, major policies to be pursued and new projects to be submitted for financing to the international agencies. It is expected that the public investment plan and development strategy will be completed by the last quarter of 1987.

Sincerely yours,

(signed)
Gonzalo Sanchez de Lozada
Ministro de Planeamiento y Coordinación

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ANNEX I

Presidencia de la República
MINISTERIO DE PLANEAMIENTO
Y COORDINACION
BOLIVIA

SUBCOORD Nº 09/87 831

RECEIVED
USAID
19 MAR. 1987
LA PAZ

La Paz, 18 MAR. 1987

FILE		
DIV	ACTION	INFO
DIR		✓
DD		
ECON	✓	
DP		✓
PD&I		✓
CONT		✓
PRD		
HHR		
Reply due 3/27		
Action tkn		

Señor
David A. Cohen
DIRECTOR USAID/BOLIVIA
Presente.-

Estimado señor Director:

Mediante la presente, me permito presentar a usted la solicitud del Gobierno de Bolivia por asistencia para la balanza de pagos en un monto de US$ 15.000.000 para 1987. La brecha que se proyecta en la balanza de pagos de Bolivia para 1987 (suponiendo una reactivación económica) será considerablemente mayor a dicho monto

El Gobierno de Bolivia ya ha iniciado una serie de acciones de largo alcance para estabilizar la economía. Dichas acciones continuarán. Las principales medidas tomadas incluyen un congelamiento de los salarios de los empelados del sector público, seguido de un incremento de sólo el 10%; una reducción substancial del déficit presupuestario, con su relación respecto al PIB disminuyendo del 28% en 1984 a menos del 4% en 1986; un aumento de las recaudaciones impositivas del 4.8% del PIB en 1984 a más del 19% en 1986, resultante principalmente de la devaluación y aumentos substanciales del precio interno de los derivados del petróleo; una ley de reforma tributaria que reorganiza todo el sistema tributario; una devaluación substancial del tipo de cambio, seguida de su casi total estabilización desde enero de 1986; la liberación de casi todos los precios y aumentos substanciales de los precios de bienes y servicios suministrados por el sector público y, en general, una política monetaria y fiscal muy estricta.

Estas medidas han logrado el efecto deseado y el Gobierno tiene planes de continuar con su programa de estabilización. La meta actual es mantener el aumento del índice de precios al consumidor en 10% para 1987, bajándolo del 66% registrado entre diciembre de 1985 a diciembre de 1986. Se espera que las inversiones suban de alrededor del 4% del PIB en 1985 al 12% en 1987 y al 14% en 1988, mientras que el déficit consolidado del sector público no financiero será de alrededor del 6% en 1987 como en 1988, bajando del 28% de 1984 y del 12% de 1985. El total de recaudaciones del sector público no financiero ya han subido del 5% en 1984 al 19% en 1986, y se espera que mantengan la misma relación en 1987 y 1988.

Se ha iniciado una serie de cambios estructurales durante el año pasado que serán consolidados y ampliados en 1987-1988. Las medidas que ya han sido tomadas incluyen la adopción de un programa global de reforma tributaria sustituyendo los impuestos fáciles de

Presidencia de la República
MINISTERIO DE PLANEAMIENTO
Y COORDINACION
BOLIVIA

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administrar por aquellos que son difíciles de recaudar e introduciendo un nuevo impuesto al valor agregado; una reforma arancelaria valorizando casi todas las importaciones con una tasa uniforme del 20%; el cierre de cierto número de minas de estaño que no podían ser operadas rentablemente; la reducción significativa de las planillas del sector público y la liberación de la economía de controles sobre precios, importaciones y tipo de cambio. Las reformas estructurales emprendidas incluyen medidas diseñadas para mejorar la eficiencia de una serie de instituciones financieras estatales así como de la banca privada comercial; la identificación de empresas estatales que podrían ser transferidas al sector privado y las acciones requeridas para permitir que éstas operen rentablemente; la reorganización y decentralización de varias empresas estatales, y las medidas para mejorar los incentivos a las inversiones.

Además, estamos dedicados al mejoramiento del programa de inversiones del sector público, tanto con respecto a la ejecución de proyectos que ya están en marcha como al desarrollo de un programa sólido de inversiones públicas a mediano plazo. El Ministerio de Planeamiento se encuentra analizando actualmente los factores que demoran o impiden la ejecución de los proyectos. El estudio emprendido hará recomendaciones concretas para suprimir tales impedimentos a fin de agilizar la implementación de proyectos y acelerar el ritmo de desembolsos de los préstamos externos. A mediano plazo, los analistas del Gobierno estan preparando una estrategia de desarrollo sectorial, la cual incluirá metas específicas por sector, las políticas principales que se seguirán y nuevos proyectos a ser presentados para su financiamiento a las agencias internacionales. Se espera que el plan de inversiones públicas y la estrategia de desarrollo estarán terminados en el último trimestre de 1987.

Con este motivo, saludo a usted con las seguridades de mi consideración más distinguida.

GONZALO SANCHEZ DE LOZADA
MINISTRO DE PLANEAMIENTO Y COORDINACION

ANNEX II

FY 1986 ESF LOCAL CURRENCY PROGRAM

The table on page 2 of this Annex presents the status of the FY 1986 ESF local currency program.

FY 1986 ESF Program Operational Letter No.6, dated October 1, 1986, explains the procedures for approval and disbursement of local currencies generated under the FY 1986 ESF program. Copies of that letter are available in AID/W. A change has been made regarding approval of employment-generating activities since that Operational Letter was sent. Given that all activities under this component are designed by AID staff in cooperation with private voluntary agencies, USAID has obtained GOB agreement to send activity proposals directly to the PL-480 Secretariat for its technical and financial review. Following approval by the Secretariat, funds are disbursed by the Secretariat to the implementing agencies involved.

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Annex II

FY 1986 ESF LOCAL CURRENCY PROGRAM
(as of March 12, 1987)

		Programmed		Committed
1.	Cost associated with reducing size of public sector	1,550,000	1,171,830.11	a) Relocation of COMIBOL miners
			38,248.77	b) Severance payments to Cochabamba municipality employees
			53,861.19	c) Severance payments to Pando Development Corp. employees
			1,263,940.07	
2.	Cost associated with strengthening and improving public administration	700,000	300,000.00	a) Salary supplements for selected GOB personnel
			75,000.00	b) Development of GOB Financial Administration and Control System
			375,000.00	
3.	Employment-generating activities	2,029,300	15,000.00	a) Construction of two bridges, Taquiña-Tiquipaya Road
			356,676.00	b) Building of basic housing and school classrooms
			200,000.00	c) Construction of Laca-Laca-Fruitillani Road
			500,000.00	d) Construction of La Paz peripheric road
			350,000.00	e) Construction of Socara-Caripuyo Road, Potosi
			26,700.00	f) Food production centers, Potosi
			14,145.00	g) Resettling of Bolivar miners in Yungas
			1,462,521.00	
4.	Development and narcotics awareness activities contributing to GOB narcotics control efforts	2,180,000	300,000.00	a) Financing narcotics awareness activities by USAID/B
			3,600.00	b) Travel expenses for GOB Officials to US Department of Justice narcotics conference
			303,600.00	
5.	USAID trust fund	717,700	717,700.00	a) Support administrative costs
	TOTALS	7,177,000	4,122,761.07	

COUNTRY CHECKLIST

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FAA Sec. (481). Has it been determined that the government of the recipient country has failed to take adequate steps to prevent narcotic drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully?	No.
2. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government?	No.

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3. FAA Sec. 620(e) (1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities? — No

4. FAA Sec 532(c), 620 (a), 620 (f), 620D; FY 1982 Appropriation Act Secs. 512 and 513. Is recipient country a Communist country? Will assistance be provided to Angola, Cambodia, Cuba, Laos, Vietnam, Syria, Libya, Iraq, or South Yemen? Will assistance be provided to Afghanistan or Mozambique without a waiver? — No

5. ISDCA of 1981 Secs. 724, 727 and 730. For specific restrictions on assistance to Nicaragua, see Sec. 724 of the ISDCA of 1981. For specific restrictions on assistance to El Salvador, see Secs. 727 and 730 of the ISDCA of 1981. — N/A

6. FAA SEC. 620 (j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action of U.S. property? — No

7. FAA Sec. 620 (l). Has the country failed to enter into an agreement with OPIC?	No.
8. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters?	N/A
(b) If so, has any deduction required by the Fishermen's Protection Act been made?	-
9. FAA Sec. 620 (q); FY 1982 Appropriation Act. Sec. 517, (a) Has the government of the recipient country been in default for more than six months on interest or principal of any AID loan to the country? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan, under a program for which the appropriation bill appropriates funds?	620(q) problems have been dealt with successfully as they have arisen.
10. FAA Sec. 620 (s). If contemplated assistance is development loan or from Economic Support Fund, has the Administrator taken into account the amount of foreign exchange or other resources which the country has spent on military equipment? (Reference may be made to the annual "Taking into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)	He will

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11. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

No.

12. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget? (Reference may be made to the Taking into Consideration memo.)

No arrearages to Mission's knowledge.

13. FAA Sec. 620 A; FY 1982 Appropriation Act Sec. 520. Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism? Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed a war crime?

No.

14. FAA Sec. 666. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?

No.

15. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device, after August 3, 1977? (FAA Sec.620E permits a special waiver of Sec. 669 for Pakistan.)

No.

16. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Session of the General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.)

Bolivia was represented at the Meeting of Ministers by the Torrelio Government. It did not formally disassociate itself from the communique issued.

17. ISDCA of 1981 Sec. 721. See special requirements for assistance to Haiti.

N/A

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria.

a. FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

N/A (but no)

SH 1X

2. Economic Support Fund Country Criteria

a. FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest? — No

b. ISDCA of 1981, Sec. 725(b) If ESF is to be furnished to Argentina, has the President certified that (1) the Govt. of Argentina has made significant progress in human rights; and (2) that the provision of such assistance is in the national interest of the U.S.? — N/A

c. ISDCA of 1981, Sec. 726(b).

If ESF assistance is to be furnished to Chile, has the President certified that 1) the Govt. of Chile has made significant progress in human rights; (2) it is in the national interest of the U.S.; and (3) the Govt. of Chile is not aiding international terrorism and has taken steps to bring to justice those indicted in connection with the murder of Orlando Letelier? — N/A

NONPROJECT ASSISTANCE CHECKLIST

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. App. Unnumbered; FAA Sec 653(b)

(a) Describe how Committees on Appropriations of Senate and House have been or will be notified concerning the nonproject assistance; — C.N.

(b) is assistance within (Operational Year Budget) country or international organization allocation reported to the Congress (or not more than $1 million over that figure plus 10%)? — Yes

2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance? — N/A

3. FAA Sec. 209, 619. Is assistance more efficiently and effectively given through regional or multilateral organizations? If so why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs. If assistance is for newly independent country, is it furnished through multilateral organizations or in accordance with multilateral plans to the maximum extent appropriate? — No.

4. FAA Sec. 601(a); (and Sec. 201(f) for development loans). Information and conclusions whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions. — Will encourage a, b, d, and e indirectly through support for GOB stabilization program and import financing.

5. FAA Sec. 601(b). Information and conclusion on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Most of all ESF dollars will finance imports from the U.S.

6. FAA Sec.612(b); Sec. 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services.

N/A

7. FAA Sec. 612(d). Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?.

No.

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for ESF

a. FAA Sec. 531. How will this assistance support promote economic or political stability?

By reinforcing a well reasoned and market-led economic stabilization program.

2. Nonproject Criteria for Development Assistance

N/A

3. Nonproject Criteria for Development Assistance (Loans only)

N/A

a. FAA Sec. 201(b)(1). Information and conclusion on availability of financing from other free-world sources, including private sources within the United States.

b. FAA Sec. 201(b)(2); 201(d) Information and conclusion on (1) capacity of the country to repay the loan, including reasonableness of repayment prospects, and (2) reasonableness and legality (under laws of country and United States) of lending and relending terms of the loan.

2 c. FAA Sec. 201(e). If loan is not made pursuant to a multilateral plan, and the amount of the loan exceeds $100,000, has country submitted to AID an application for such funds together with assurances to indicate that funds will be used in an economically and technically sound manner?

d) FAA Sec. 202(a). Total amount of money under loan which is going directly to private enterprise, is going to intermediate credit institutions or other borrowers for use by private enterprise, is being used to finance imports from private sources, or is otherwise being used to finance procurements from private sources?

4. Additional Criteria for Alliance for Progress

a. FAA Sec. 251 (b)(1)-(8). Does assistance take into account principles of the Act of Bogota and Charter of Punta del Este; and to what extent will the activity contribute to the economic or political integration of Latin America? — Yes. It will not.

b. FAA Sec. 251(b)(8); 251(h). For loans, has there been into account the effort made by recipient nation to repatriate capital invested in other countries by their own citizens? Is loan consistent with the findings and recommendations of the Inter-American Committee for the Alliance for Progress (now "CEPCIES," the Permanent Executive Committee of the OAS) in its annual review of national development activities? — N/A