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

BOLIVIA

PROJECT PAPER

ECONOMIC STABILIZATION AND REACTIVATION

and

Amendment No. 1

AID/LAC/P-531

Project Number: 511-0575
Grant Number: 511-K-604
511-K-604A

UNCLASSIFIED

1. 8 89
89. ESF

CLASSIFICATION:

AID 1120-1 (6-68) PAAD	DEPARTMENT OF STATE AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO. 511-K-604 A (511 0575) 2. COUNTRY Bolivia 3. CATEGORY Cash Transfer 4. DATE March 5, 1990

5. TO: AAA/LAC:Frederick W. Schieck	6. OYB CHANGE NO. N/A
FROM: LAC/DR:Terrence J. Brown	8. OYB INCREASE N/A TO BE TAKEN FROM:
9. APPROVAL REQUESTED FOR COMMITMENT OF: $17,625,000	10. APPROPRIATION - ALLOTMENT 72-119/01037 LES9 90 35511 KG31 970-65-511-00-50-01

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

15. COMMODITIES FINANCED

N/A

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: 17,625,000
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: 17,625,000	Other:

18. SUMMARY DESCRIPTION

On January 6, 1989, $11.75 million in ESF was committed for Bolivia. The purpose of the current amendment is to increase the commitment of funds for Bolivia by $5.875 million to a total of $17,625,000 using FY 1989 funding. This is being done based on President Bush's March 1, 1990 certification called for by Section 481(h) of the Foreign Assistance Act of 1961, as amended by the Anti-Drug Abuse Act of 1986, the Anti-Drug Abuse Act of 1988 and the International Narcotics Control Act of 1989. The program remains unchanged from that approved on January 6, 1989, except for a reduction of the 1989-funded grant from $23.5 million to $17.625 million.

"I certify that the methods of payment and audit plan are in compliance with the Payment Verification Policy."

LAC/Controller

[signature]

19. CLEARANCES		DATE
LAC/DP:BSchouten	B.S.	3/5/90
GC/LAC:TGeiger	[initials]	3/8/90
LAC/SAM:RNelson	RN	3/6/90
LAC/CONT:CAdams	[initials]	3/6/90
PPC/PD:TBarker	PDB	3/6/90
STATE/ARA/ECP:DMarshall	[initials]	3/7/90
PFM/FM/PAFD:~~BOwens~~ PFM/FM/A	[signature]	3/9/90

20. ACTION

☒ APPROVED ☐ DISAPPROVED

Frederick W. Schieck 3/13/90

AUTHORIZED SIGNATURE DATE

Frederick W. Schieck

Acting Assistant Administrator, LAC

TITLE

PL

CLASSIFICATION:

CLASSIFICATION:

AID 1120-1 (8-86)

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT

PAAD

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO. 511-K-604
2. COUNTRY Bolivia
3. CATEGORY Cash Transfer
4. DATE December 14, 1988
5. TO: AAA/LAC:Frederick W. Schieck
6. OYB CHANGE NO. N/A
7. FROM: LAC/DR:Terrence J. Brown
8. OYB INCREASE N/A
TO BE TAKEN FROM:
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 11,750,000
10. APPROPRIATION – ALLOTMENT 72-119/01037 970-65-511-00-50-91
11. TYPE FUNDING ☐ LOAN ☒ GRANT
12. LOCAL CURRENCY ARRANGEMENT ☐ INFORMAL ☒ FORMAL ☐ NONE
13. ESTIMATED DELIVERY PERIOD
14. TRANSACTION ELIGIBILITY DATE
15. COMMODITIES FINANCED

N/A

16. PERMITTED SOURCE		17. ESTIMATED SOURCE	
U.S. only:		U.S.:	11,750,000
Limited F.W.:		Industrialized Countries:	
Free World:		Local:	
Cash:	11,750,000	Other:	

18. SUMMARY DESCRIPTION

The purpose of the proposed ESF program is to provide balance of payments assistance in support of the Government of Bolivia's (GOB's) economic stabilization and reactivation efforts. The dollars provided will 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 local currency counterpart to selected USAID and multilateral development organizations' projects.

The $23.5 million grant will involve two obligations of $11.75 million each and will be disbursed in four equal tranches. The four tranches will be consecutively disbursed upon meeting the conditions precedent identified in Section X, pages 45-46 of this document. No ESF assistance can be obligated for Bolivia in FY 1989 until the President issues the certification required by the Anti-Drug Abuse Act of 1988.

"I certify that the methods of payment and audit plan are in compliance with the Payment Verification Policy."

LAC Controller

19. CLEARANCES	DATE
LAC/DP:WWheeler	12/22/88
LAC/GC:TGeiger	12/21/88
LAC/SAM:CBuck	12/21/88
PPC/PB:EZallman (draft)	12/15/88
LAC/CONT:GByllesby	12/21/88
STATE/ARA/ECP:DMarshall	12/21/88
PFM/FM/PAFD:EOwens	12/20/88

20. ACTION

☒ APPROVED ☐ DISAPPROVED

Frederick W. Schieck — Jan. 6, 1989

AUTHORIZED SIGNATURE — DATE

Frederick W. Schieck

Acting Assistant Administrator, LAC

TITLE

CLASSIFICATION:

FY-1989 PAAD OUTLINE

Project No. 511-0575

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TABLES

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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 average rate of increase of the consumer price index was brought down from 11,750% in 1985 to 276% in 1986, 15% in 1987 and an estimated 20% in 1988. The rate of increase of the budget deficit of the consolidated public sector was brought down from 4,715% in 1985 to an estimated 105% in 1987. 1/ As a proportion of the GDP, the budget deficit of the consolidated public sector declined from 30% in 1984 to 13% in 1985, and to 4% in 1986. In 1987, it rose back to 7.5% mainly as a result of Argentina's failure to pay for Bolivia's past gas exports (2.5% of GDP) and payment of the remaining separation payments to the 23,000 dismissed COMIBOL miners (2% of GDP). The annual rate of bank credit expansion to the non-financial public sector which was 18,532% in 1985 declined to only 21% in 1987, and to an estimated 19% during the twelve-month period ending in June, 1988. As a result, the rate of increase of the money supply (M1) which was 5,900% in 1985 declined to 83% in 1986, 38% in 1987 and to an estimated 26% during the twelve-month period ending in June, 1988. 2/

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 in spite of a Paris rescheduling agreement in 1986. Officially recorded export earnings declined sharply - from $724 million in 1984 to $623 million in 1985, $550 million in 1986, to US$ 473 million in 1987, and to an estimated US$ 485 million in 1988 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 declined by 29% in 1987 (in addition to a decline of 12% in 1986) and is projected to drop by another 13% in 1988. The price of tin concentrate dropped by 52% between 1985 and 1986. On the other hand, substantial relief for Bolivia's 1986 balance of payments situation resulted from the debt renegotiation with the Paris Club that took place in June of that year. That relief amounted to some $324 million in refinanced interest and amortization payments falling due that year. It is expected that another round of negotiations will take place in mid-November, 1988. The GOB will try to renegotiate all of its bilateral debt on concessional terms (i.e. 30 to 40 years, at interest rates below the market).

1/ Source: Bolivia - Recent Economic Developments, Document of the IMF, Tables 12 and 40, Pg. 20 and 71, respectively, July 19, 1988.

2/ Source: Estadisticas Monetarias y Financieras, No. 38 and unpublished documents, Central Bank of Bolivia.

Agreement with the GOB for an Enhanced Structural Adjustment Facility loan was reached and a recommendation for SDR 136 million (about $188 million) to be disbursed over a three-year period, was submitted to, and subsequently approved by, the IMF Board. In addition, in May 1988, the World Bank approved an IDA financed SDR 50.6 million (equivalent of $70 million) Financial Sector Adjustment Credit to increase confidence in the banking system, mobilize savings, strengthen the financial condition of banks and reduce the high cost of credit.

In spite of the success of the stabilization program, Bolivia's balance of payments remains in serious disequilibrium. For 1988, the Central Bank has projected an overall balance of payments deficit (before debt rescheduling) of US$188 million. For 1989, the Mission, working with IMF and Central Bank data, projects an overall balance of payments deficit of US$ 200 million and a post debt rescheduling unfinanced gap (or decline in net international reserves) of US$89 million. To the extent that this gap remains unfinanced, imports will have to be cut back further, and the recovery and GDP growth targets for 1989 and beyond most likely will not be achieved.

The main task that presently confronts the Bolivian authorities is the reactivation of the economy. The real GDP is estimated to have declined by about 2.9% in real terms in 1986 and to have increased moderately--by 2.2%--in 1987. The GOB's growth target for 1988 is 2.5%. While there are indications that the government has succeeded in setting the basis for arresting and reversing the decline in economic activity, a number of factors are continuing to impede the recovery. These include credit tightness, high interest rates, the substantial difficulties faced by the mining industry, the multiplier effects of the sharp drop in export earnings, delays by Argentina in settling its arrears, and continuing uncertainties in the private sector with respect to the policies that future (post 1989) governments might adopt. The government is addressing various impediments to economic reactivation along with continuing implementation of the stabilization program. The text contains a detailed description of the measures the government has taken to stabilize and reactivate the economy (Sections III & IV), as well as an evaluation of their effectiveness to date (Section V).

The basic rationale for the proposed ESF balance of payments assistance program for FY 89 is as follows:

- 1. The ESF program will contribute some of the resources needed to finance economic reactivation by providing foreign exchange for the payment of official US bilateral debt and multilateral debt (i.e., World Bank, InterAmerican Development Bank, and International Monetary Fund), thereby freeing-up GOB dollar resources for other uses; and by generating local currency funds to be used to supply the counterpart funding required by key USAID and other donor projects.

1

- 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 will force a further cutback in imports and almost certainly impede economic recovery.

- 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. Close GOB-USG cooperation since 1986 resulted in the destruction of a substantial number of laboratories and processing facilities and the arrest of one of the most important narcotraffickers in Bolivia. More recently, substantial progress was made in the government's voluntary coca eradication program.

- 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. Bolivia is currently in an electoral process which merits U.S. support to consolidate the democratic process of the country.

The basic goals of USG policy in Bolivia are: (a) support for a stable and democratic government and institutionalization of the democratic process, (b) private sector led economic recovery and promotion of self-sustaining economic growth, and (c) narcotics control. The GOB's basic economic policies and priorities are fully in line with the recommendations of the USG, the IMF, the IBRD, 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. The survival of the democratic form of government and of the liberal economic model that the Paz government has instituted are likely to depend, in large measure, on the success of the economic policies currently being pursued.

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

8x

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 313% in 1983 to 2,345% in 1984 and 4,715% in 1985. (Table 2) 3/ As a proportion of the GDP, the overall deficit of the consolidated public sector increased from 16% in 1982 to 30% in 1984 4/ (See Table 2A). Net domestic financing equalled 85% of the overall public sector deficit in 1984 (Table 9).

These large deficits were financed, to a large extent, by Central Bank credit expansion. Total gross credit extended by the Central Bank to the public sector increased from $b 43.3 billion in 1981 to $b 13.1 trillion in 1984 and to $b 2,444 trillion in 1985 (Table 3) 5/. The annual rate of increase of gross bank credit expansion (excluding public sector deposits) to the non-financial public sector accelerated from 200% in 1983 to 1,707% in 1984 and to 18,532% in 1985 (see Table 3). However, credit to the public sector was not the only cause of the increase in money supply as bank credit expansion to the private sector increased at nearly equal rates during 1984 and 1985 (Table 3). As a result, the supply of currency plus demand deposits (M1) increased at a rate of 1,782% in 1984 and 5,929% in 1985 (Table 4). M2 (M1 + savings and time deposits) increased at rates comparable to M1 over this period (Table 4). Owing mainly to the "dedollarization" (explained at the end of this section) and to the hyperinflation, the dollar value of bank deposits declined drastically from US$ 556 million in 1980 to only US$45 million in 1984 and US$ 68 million in 1985 (Table 5).

Predictably, substantial deficits appeared in the current account of the balance of payments. These rose from $ 176 million in 1982 to $282 million in 1985 (Table 6). The overall balance of payments was consistently in deficit since 1980. However, net international reserves increased during 1983-86, in large part as a result of the substantial accumulation of arrears and debt rescheduling that occurred in 1983, the non-payment of interest and amortization in 1985 and 1986, and of the Paris Club debt and renegotiations of June, 1986.

3/ Source: IMF, Bolivia - Recent Economic Developments, Document of the IMF, Tables 12 and 40, Pg. 20 and 71, respectively, July 19, 1988.

4/ Ibid. Table 2

5/ Central Bank, Estadísticas Monetarias y Financieras, No. 38, Table No. 8 and Bank's unpublished documents.

Bolivia's balance of payments problem in recent years can be attributed to the following major causes:

1. Collapse in the prices of tin (which fell by 52% between 1985 and 1986) and natural gas (a 12% reduction in 1986 was followed by another 29% in 1987, with another drop of 13% is expected in 1988).

2. The disruption of narcotics exports (due to Operation Blast Furnace and follow-up efforts by the GOB) and the recent price decline of coca in the US market.

3. 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.

4. Faulty monetary-fiscal policies leading to a rapid increase of money supply and to substantial balance of payments deficits. The impact on the balance of payments was further aggravated by maintenance of a substantially overvalued exchange rate until August 1985, which heavily penalized exports (particularly of non-traditional products), and stimulated imports 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 1981 and 1986 declined by 14% (Table 16), while the real per capita GDP is estimated to have fallen by 25% over this period. 6/

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.

6/ Assuming a 2.8% average annual rate of population growth.

10A

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 coalition government, which lasted until August 1985, was weak and vacillating, particularly on the economic front. Siles was unable to implement a program involving the tough austerity measures that the situation required. The participants in the coalition government that he headed 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 and to check demands for wage increases (which contributed to large public sector deficits) or check the growth of communist influence within the government bureaucracy. 7/

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 another 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 $3.7 billion, approximately equal to 110% of the 1984 GNP (as estimated by the World Bank). Total accumulated arrears were $1.05 billion, of which $786 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 $609 million 8/, an amount equal to approximately 85% of Bolivia's estimated registered 1986 exports of goods and services in that year.

7/ Source: AID Mission to Bolivia PAAD, October 28, 1985, pages 5-6.

8/ Source: IMF, "Bolivia - Recent Economic Developments", Table 26, Page 48, July 19, 1988.

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 19% of GDP in 1981 to 27% in 1983) (Table 12), 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 Central Administration as a proportion of GDP declined from 11.8% in 1981 to only 3.2% in 1984, causing the Central Administration's overall deficit to increase from 7.4% to 20.5% of GDP, 9/ while the overall deficit of the Consolidated Public Sector increased from 16% to 30% (Table 10). This dismal revenue performance was due in large part to the distorting impact of the hyperinflation on the revenue collection system, 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 sold domestically to reflect its actual cost, 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 110% in 1983 to 1268% in 1984 and 15,514% in 1985 (See Table 3). 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 1,200%, interest rates on deposits were held to 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 and set the stage for the banking system's substantial difficulties (which persist to this day). From a level of $556 million in 1980 (US$ equivalent value), the dollar value of bank deposits declined to $45 million (as measured by the parallel market rate) by the end of 1984 10/ (Table 5), a factor that caused serious difficulties to Bolivia's commercial banking system. 11/

9/ Source: IMF, "Bolivia - Recent Economic Developments, Tables 11 and 12, Pg. 21 and 23, respectively, December 2, 1986.

10/ Source: Central Bank of Bolivia, Estadísticas Monetarias y Financieras No. 37, Table No. 3. The figures were calculated by taking the sum of demand, savings, time, and foreign exchange deposits.

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

12x

6. Other economic policies that exacerbated the economic difficulties included overvaluation of the exchange rate and the "dedollarization" 12/ of dollar deposits. Overvaluation of the exchange rate not only contributed significantly to the GOB 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. 13/ As a result, exports over a wide range of activities almost disappeared. Bolivia's non-traditional exports (other than tin, other metals, and natural gas) declined from $163 million in 1980 to only $38 million in 1985 (Table 7). 14/

The major impact of dedollarization 15/ was to: (1) reduce substantially the real value of savings of individuals and businesses that had left dollar deposits with domestic banks; (2) decapitalize such businesses; (3) further undermine confidence of the private sector in the government; (4) impair the credit standing of Bolivian banks with their foreign counterpart institutions; and (5) enrich individuals and institutions that had substantial net dollar obligations. 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 subsequently used a series of devices to avoid accepting such peso deposits in discharge of dollar denominated debt. This issue was finally decided in Supreme Decree 21660 (the Economic Reactivation Decree) discussed below, which provided that such obligations could be repaid at the current market value of the debt (about 11 cents on the dollar), a solution that obviously failed to satisfy the international banking community.

12/ Defined in the following paragraph.

13/ David Horowitz, Consultant to the World Bank, After Tin and Natural Gas, What?, August 1986, Page 151

14/ Ministry of Industry and Commerce, DICOMEX.

15/ "Dedollarization" refers to the government's decision to convert all US dollar or dollar denominated deposits held by Bolivians, Bolivian enterprises and banks into Bolivian Pesos at an overvalued official rate.

III. THE "NEW ECONOMIC POLICY"

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 initiates the GOB's New Economic Policy, the main features of which are summarized below in the following two sections. 16/

1. Decree No. 21060 ("The Stabilization Decree")

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 (daily auctions are conducted currently). While exporters still had to surrender all of their export proceeds to the Central Bank at the official rate, the system 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 $b1,078,000 to US$1 at one stroke, a 93% devaluation (Table 8). 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. As a result of the depreciation of the boliviano and the need to boost revenue collections the price of gasoline and all petroleum subproducts was tied to the depreciation of the boliviano, (this tie was broken in August 1988 to help dampen inflationary pressures).

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.

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

d. Monetary Reform: The program eliminated interest rate ceilings on all deposits and loans. Other provisions authorized commercial banks to 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, has 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, during 1982-85, most imports of consumer goods were 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 and is currently being reduced to achieve a flat 10% by January 1, 1990. 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 Policy: For the first time in recent history strict budget control was introduced, restricting expenditures to the level of revenues on a day-by-day basis. Furthermore, public investment was temporarily prohibited. These measures were followed up in 1986 with a major reform of the tax system (see Section III. 2.).

g. Wage and Labor Policy: Public sector wages were frozen between August and December 31, 1985, then permitted only 10% to 15% annual increases. 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. 17/ 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.

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

i. Improved Accounting by State Enterprises: The decree required all state enterprises to submit a set of accounts as of July 31,

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17/ 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 at the initiative of the employer (i.e. involuntary separation).

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 bank accounts outside the country. All legal monopolies were abolished.

j. State Enterprise Decentralization: The decree divided the state mining company, COMIBOL, into four regional enterprises and YPFB (the state petroleum company) into three. The Bolivian Development Corporation was dissolved and transferred all of its productive enterprises to the Regional Development Corporations, but with all debts exonerated or assumed by the Central Administration. Decentralization served 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.

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.

2. The Tax Reform (Law 843)

The fiscal measures dictated in Decree 21060 were not expected to be sufficient to restore tax revenues to levels prior to the hyperinflation. The existing system had nearly collapsed as current Central Administration revenues fell to less than 8% of current expenditures in 1984 (Table 11). Thus, in May 1986, a comprehensive tax reform law was enacted which abolished more than 500 taxes and introduced one temporary and six permanent taxes. The temporary measure was intended to regularize past tax dues, and was a one-time tax on property owned by enterprises and individuals. After payment of that tax, all prior obligations on taxes due up to December 31, 1985 would be forgiven. There are now only six sources of tax revenue: 1) a 10% value added tax (VAT) on sales of all goods (except real estate), services, and rent, with payments collected monthly; 2) a 10% income tax on salaries, rents, dividends, income from liberal professions, and income from royalties - against which VAT payments may be deducted; 3) a 1% transactions tax; and 4) a 30 to 50% excise taxes on luxury items such as alcohol, jewelry and tobacco; 5) a 2% tax on enterprises' net worth; and 6) a tax on personal property such as automobiles, dwellings and land holdings, at varying (progressive) rates.

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The new tax law also specifies major improvements in enforcement of tax obligations. Specific jail sentences have been introduced for tax evasion and tax debts are to be designated in US dollars to avoid incentives for late payment should inflation again accelerate. To expedite implementation and to improve tax collections, the government appointed a temporary Minister of Revenue Collections. The uniform rate of the customs tariff was raised to 20% in August 1986, but is scheduled to decline progressively (by one percentage point per quarter) to a uniform 10% rate by January, 1990.

3. The "Emergency Social Fund"

In addition, the GOB has established a temporary employment program financed by the "Emergency Social Fund" whose purpose is to alleviate the high level of unemployment through the implementation of labor intensive projects both in urban and rural areas. It is fed by donation from various donors, including allocations of local currency generations by USAID. Over the three years of its existence (1987-1989), the Emergency Social Fund will spend more than $100 million on road projects, health and sanitation, and school construction, through small-scale labor intensive projects.

4. IMF Negotiations with the GOB

In the spring of 1986, the GOB negotiated a stand-by agreement with the IMF for SDR 50 million (US$59 million) for a twelve-month period ending on June 30, 1987. The key element of the program was the reduction of the deficit of the non-financial public sector from an estimated 13% of GDP in 1985 to 6.5% in 1986 and to below 6% during the program period. Achievement of this target required pursuit of a tight wage policy and a substantial increase in revenue collections, including transfers from the state enterprises to raise the revenue/GDP ratio from about 8% of GDP in 1985 to 12% in 1986 through the following additional revenue measures: introduction of the 10% value added tax (which replaced the previous 5% selective sales tax), a 2% wealth or net worth tax, a substantial increase in the collection of import duties as a combined 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 adjustments of petroleum and other services sold by state enterprises 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.

An IMF team visited La Paz in December 1987, and again in February, 1988 to check on the situation. The result was the development

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of a set of policies to put the adjustment program back on track.

In May and June of 1988, IMF and IBRD teams visited La Paz to assist the GOB with the elaboration of a Policy Framework Paper (PFP) for the period 1988-91, which would serve as basis for requesting support under the Enhanced Structural Adjustment Facility (ESAF). The program aims at achieving a sustained increase in real per capita income, maintaining reasonable price stability, promoting the diversification of the economy, and strengthening the balance of payments on a permanent basis. Further structural reforms will be implemented with the aim of i) promoting private sector activity, particularly in exports and efficient import substitution (USAID/Bolivia supports directly this effort with its Export Promotion project), ii) improving the efficiency of state enterprises, iii) strengthening the Central Government Administration, iv) reducing the size of the public sector by divesting selected manufacturing enterprises (this task will be assisted by the financial and technical support provided under USAID/Bolivia's "Industrial Transition" project), and v) strengthening the financial system (to be assisted by USAID/Bolivia's "Strengthening Financial Markets" project). These reforms are to be pursued within a stable regulatory framework which includes a unified exchange rate system, a liberal trade and payments regime, a low and uniform import tariff, absence of price controls, and market-determined interest rates.

The detailed conditionality underlying this ESAF is included in the Staff Report for the 1988 Article IV Consultation. It contains limits on net international reserves, size of the deficit that can be incurred by the non-financial public sector, net domestic assets of the Central Bank, credit that may be granted by the Central Bank to the non-financial private sector, global amount of credit expansion, size of arrears on the external debt, and amount of new debt of less than 10 years maturity that the GOB can contract.

The Bolivian authorities obtained Fund support under the Enhanced Structural Adjustment Facility in an amount of SDR 136.05 million and the first annual arrangement thereunder. The objectives and policies that the authorities intend to pursue in the three-year program period that began April 1, 1988 and the targets and limits for 1988 were defined. The first disbursement of SDR 22.675 million was made in August, and the second disbursement for the same amount will be made in December, 1988, after observance of performance criteria for September, 1988, and completion of Executive Board Review. Furthermore, the GOB requested a purchase of SDR 45.3 million under the Compensatory Financing Facility, given to make up for temporary shortfalls in exports. The first tranche was already received in July, 1988. Full use of the requested support would increase fund credit to Bolivia to SDR 218.05 million at the end of the program period in March, 1991. In January, 1988, Bolivia incurred arrears in its financial obligations to the IMF, but became current on April 21, 1988.

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IV. DECREE No. 21660 (THE "ECONOMIC REACTIVATION DECREE")

The problems faced by the Bolivian economy turned out to be even more serious than anticipated at the time that Decree 21060 was enacted. In addition to the internal policy "shocks" administered by the stabilization program, Bolivia's two major exports suffered sharp reverses in market prospects within months of the reforms. These external shocks further depressed the GDP and boosted unemployment. As a consequence, the government came under political pressure to play a more activist role.

On July 10, 1987, the GOB issued Decree No. 21660, commonly known as the Economic Reactivation Decree. This decree was designed to play a key role in putting an end to the prolonged recession that the Bolivian economy has been suffering for about five years. The major provisions of this decree are summarized below.

1. Resource Availability. The total amount of external resources expected to become available over the three-year period (1987-1989) to finance all investment (public and private) was US$ 1,583 million. Most of this, however, consists of the pipeline of amounts obligated by the international agencies for various projects that will be disbursed very gradually, while the economy is in immediate need of a significant injection. Therefore, a special Economic Reactivation Fund of US$ 100 million was created, of which US$ 60 million was designed to meet the working capital requirements of the productive sector (manufacturing, agriculture, and mining) and US$ 40 million was earmarked for housing construction. The US$ 100 million were to be obtained by either selling or using as collateral part of the country's gold reserves, estimated to be worth about US$ 420 million, to bridge the resource gap arising from Argentina's failure to pay for Bolivia's gas deliveries. Unfortunately, only some $6.0 million of this fund were disbursed to date (as of October, 1988) in part owing to the Government's reluctance to sell or pledge any part of its gold reserve and in part owing to misuse of some funds by the banking system.

The interest rate to be paid by intermediate credit institutions (ICIs) for funds from this Special Reactivation Fund (as well as from funds from any official sources) will not exceed the LIBOR rate prevailing at that time. The interest rate charged on loans to final end-users made from these sources could not exceed LIBOR plus 5% (plus a "maintenance of value" clause to protect creditors against devaluation).

The decree announced a three-year public investment program for the period 1987 through 1990 (since revised), calling for total public investment spending of US$ 1,079 million, of which external financing would provide US$ 979 million. The major sectors to which this investment is directed include gas and oil (38%), transportation (34%), and agriculture (11%). An analysis of the revised investment program will be presented in Section V.2.B.

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2. Sectoral Restructuring. A National Council for Social Policy ("Consejo Nacional de Política Social") will be set up to develop a three-year plan outlining the government's policy in the social area. Its main functions will be to raise the level of employment and improve standards in the areas of health, training and education, welfare, and housing.

Plans for housing construction were developed by a newly established Housing Institute. To finance housing construction on a continuing basis, the decree provides for the establishment of a Special National Housing Fund to be financed by a 2% payroll tax to be contributed by employers and a 1% contribution from employees (this was put into effect). To encourage housing construction, the decree would establish a $40 million credit line under the Economic Reactivation Fund to be administered by the Central Bank of Bolivia (not in effect). The Banco Nacional de la Vivienda, S.A. (BANVI S.A.) was liquidated.

To promote export development, the decree set up a National Institute for the Promotion of Exports (INPEX) financed by the General Treasury as well as through contributions from the private sector. The institute will study all problems relating to the promotion of exports and will provide technical services to exporters. (is in effect).

The decree also authorizes the establishment of a free zone ("Zona Franca Industrial") in the national territory, which will be entitled to special treatment for imported products. (not in effect).

3. Reform of the Banking System: A substantial portion of the decree addresses the many prevailing weaknesses of the Bolivian banking system, and is designed to forestall the collapse of several banks. The decree contains the following provisions designed to curb prevailing weaknesses and abuses of the financial system:

- Establishment of a Superintendence of Banks to supervise compliance with all regulations governing the conduct of bank operations.

- Promulgation of a general rule calling on state banks to manage disbursements and provision of credit to state institutions only, while the activities of the private banks would be confined to receiving deposits from--and financing the operations of--the private sector.

- Changes in reserve requirements, lowering reserve requirements on demand deposits and raising reserve requirements on savings and dollar deposits, thus providing a uniform rate for all deposits.

- Banks will be required to comply with the rule governing the deposit/paid-in capital ratio (10 to 1) which was often allowed to rise 30 to 1. Furthermore, a bank's liabilities to the Central Bank cannot exceed five times the bank's paid-in capital, nor can it exceed 50 percent of its loan portfolio.

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- Banks must make adequate provision for loans in arrears.

- No financial institution can lend to a particular borrower an amount in excess of 20 percent of its net worth.

- Banks are required to report to the Superintendence of Banks on a monthly basis all information relevant to the exercise of the supervisory function.

4. Export Measures. The decree maintains the obligation for all exporters to sell 100 percent of their foreign exchange earnings to the Central Bank. To promote exports, the decree institutes the Certificado de Reintegro Arancelario (CRA) which is a refund for import duties (on imported inputs) paid by exporters. The certificate originally was for five percent of the value of "traditional" exports and ten percent for all others. Later, the certificate was limited to "non-traditional" products only. The certificate will be accepted in payment of all taxes.

5. Price Measures. On the subject of prices and utility rates, the decree reaffirmed the policy of permitting the free determination by market forces of prices for all goods and services, with the exception of petroleum and petroleum products, and rates charged for electricity and public transport. The decree substantially reduced both electricity and rail freight rates for the export sector.

With respect to air traffic rates, the Bolivian airline, Lloyd Aereo Boliviano (LAB), will set its rates in line with those of competing airlines, but will provide a preferential rate for Bolivian exports.

6. Debt Measures. The public debt owed to foreign commercial banks will be retired by buying it back at a fraction (i.e. 11 percent) of its original face value. No allowance will be made for interest due, either past or future. Moreover, the debt will not be repurchased with cash but with 25-year bonds that the central bank will issue for that purpose. 18/ The bonds eventually (in 25 years) will be redeemed at their present discounted market value. The GOB regards these bonds as constituting full payment for all debt owed to private foreign creditors. The purchasers of these bonds will be able to exchange them for shares of private banks, private enterprises or mixed companies in the productive sector, or to purchase the assets of state enterprises. If they do so, another 50 percent will be added to their redemption value.

18/ Since this decree was promulgated, a new scheme was developed with the assistance of the international community. A special fund was created to buy back this debt at a fraction of its original value with donations made by friendly governments. This special account is managed by the IMF. The GOB's goal was to collect about US$ 70 million for this purpose, though it was not able to raise more than about US$ 30 million. The GOB will negotiate with foreign creditor banks the settlement of the uncovered balance.

V. EVALUATION OF RECENT GOB ECONOMIC POLICY

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 economic policies is analyzed in terms of the behavior of the price level, the exchange rate, the monetary and fiscal aggregates, production, exports, credit utilization, the balance of payments, the external debt service, debt rescheduling and overall compliance with IMF performance targets.

1. Economic Stabilization

The New Economic Policy has been an unqualified success in eliminating hyperinflation (see Table 1). The GOB has virtually stabilized the economy with the implementation of conservative economic policies outlaid in Supreme Decree 21060 described in Section III. A combination of restrictive monetary and fiscal policies have resulted in the drastic reduction of inflation and the exchange rate gap between the official and parallel rates.

A. Price and Exchange Rate Stability.

The key indicator of the success of a stabilization program is the behavior of freely determined market prices. Within weeks of introducing the New Economic Policy, the rate of increase of the consumer price index declined precipitously. The general consumer price index presented in Table 1 shows that the annual average rate of increase of the consumer price index, which peaked at 11,750% in 1985, declined to 276% in 1986 and to 14.6% in 1987. The inflation rate declined to 10.7% between December 1986 and December 1987. However, the rate of inflation accelerated somewhat in 1988. 19/

19/ The main factors that explain this temporary upsurge in the consumer price index are: a) An excess money supply by the end of 1987: even though the nominal money supply declined between December, 1987 and June 1988, the real money supply was still above the level achieved during the period from April, 1987 through September 1987, during which the economy experienced relative price stability. Thus, the real money supply was in excess of the public's desire to hold money; b) inflationary pressure caused by the increase in the international price of cereals, especially wheat, in the world markets. It is estimated that the price of wheat increased by close to 45% as a result of the drought in the U.S.; and c) the rise in the dollar/boliviano exchange rate and the indexing of the price of gasoline beginning in April, 1988. In August, 1988, the GOB stopped indexing gasoline prices.

The official exchange rate which, prior to 1985, had long been allowed to lag significantly behind the decline in 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 remained quite stable at about \$b 1.9 million to \$1 through 1986 and within the narrow range of \$b 2.0 million - \$b 2.2 million to US\$1 throughout 1987 (Table 8). The spread between the official and parallel market rates is rarely more than a percentage point. However, there are indications that the boliviano may still be somewhat overvalued. These include the substantial loss of reserves during 1987 (around US\$ 78 million), the slowdown in the repatriation of capital held by private Bolivians abroad, the infusion of an unknown but reportedly substantial amount of "coca-dollars" into the economy (without which the current exchange rate could not have been maintained), and the stagnation of non-traditional exports between 1986 and 1988.

The GOB has committed itself to the IMF to allow the bolivian peso to depreciate in nominal terms in relation to the dollar so as to maintain a constant real exchange rate. In practice, during 1987, the GOB has allowed the external value of the peso to decline slightly more rapidly than its internal purchasing power, thus permitting some decline in the real value of the peso. Thus the dollar/boliviano exchange rate rose by about 13% versus a 10.7% increase in the consumer price index between December 1986 and December 1987. The GOB seems to be pursuing a crawling peg policy, cautiously trying to keep the devaluation ahead of inflation, but not enough to trigger a major inflationary impulse. This policy was suspended in mid 1988 (hopefully only temporarily) in response to the acceleration of inflationary pressures this year.

B. Credit Expansion

The main cause of the hyperinflation was rapid credit expansion to both the public and private sectors. To stabilize the price level, the present government has reduced drastically the rate of (gross) bank credit expansion to the consolidated public sector from 18,500% in 1985 to 9% in 1986, 21% in 1987 and 19% from June 1987 to June 1988 (see Table 3). The rate of credit expansion to the private sector has also showed drastic declines from 15,500% in 1985 to 131% in 1986, 50% in 1987 and 23% from June 1987 to June 1988 (Table 3). The deceleration in the rate of increase of bank credit over 1985-1988 predictably resulted in a sharp reduction in the rate of expansion of money supply.

C. Money Supply and Bank Deposits

The annual rate of increase of M1 (currency plus demand deposits) is estimated to have declined from 5,900% in 1985 to 83% in 1986, 38% in 1987 and 26% from June 1987 to June 1988 (see Table 4).

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This reduction clearly shows the efforts of the GOB to control inflation and stabilize the currency. As discussed above in more detail (footnote 19), the rise in the rate of inflation experienced during the second quarter of 1988 was mainly the result of an excess of money supply generated in the second half of 1987. In fact, M1 was reduced by 2% during the first half of 1988, reflecting a serious commitment by the GOB to avoid rekindling the inflationary spiral. Similarly, the rate of increase of M2 (M1 plus time, savings and foreign exchange deposits) declined from 7,200% in 1985, to 182% in 1986, 48% in 1987 and 24% from June 1987 to June 1988 (see Table 4). Furthermore, it is important to note that the banking system has increasingly performed its main function of credit intermediation. It has increasingly "created" secondary money, from 44 cents for every boliviano in currency in 1985, to Bs 1.37 in 1987 and Bs 1.77 in June 1988.

As a result of the stabilization process, the economy should start a period of "remonetization". Especially since 1984, the economy has "demonetized" drastically as a result of the hyperinflation. As a percentage of GDP, M1 has declined from 15.3% in 1984 to only 3.4% in 1986 and 3.9% in 1987. Similarly, M2 has declined from 18.5% of GDP in 1984 to 7.8% in 1986 and 9.5% in 1987. This behavior shows that Bolivia's financial system has reversed the reduction in the money supply to GDP ratios owing partly to high positive interest rates, and partly to a partial restoration of confidence, which resulted in a steady recovery of the deposit base. Nevertheless, the ratios are still low in comparison with 1981; their continued recovery can be expected as economic reactivation takes place.

--Total Bank Deposits: Mainly as a result of the "dedollarization" and the hyperinflation, bank deposits and the overall savings of the population have contracted drastically. As of December 1984, deposits in the banking system amounted to only an equivalent of US$ 45 million, down from US$ 556 million at the end of 1980 (see Table 5). As of June 1988, total deposits increased to US$ 400 million, albeit most of it in foreign exchange deposits or boliviano denominated deposits with a maintenance of value clause (i.e. indexed to the dollar). As shown in Table 5, time deposits in foreign exchange (including boliviano deposits with maintenance of value) account for approximately 74% of total deposits. Nevertheless, the increase in deposits has been steady and should continue to be so as the economy reactivates and public confidence in the financial system recovers.

D. Net International Reserves.

Hyperinflation and overvaluation of the exchange rate during 1980-1985 put heavy pressure on the balance of payments and international reserves. Net international reserves were consistently negative during 1980-1983, owing mainly to the huge increase in internal credit that drained the country's "inexpensive" foreign exchange holdings (See Table 13). This trend was reversed in 1984, when the net

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international reserves of the Central Bank increased from a negative US$ 40 million in 1983 to US$ 107 million in 1984, as a result of a US$ 188 million repayment of arrears by Argentina. In 1986, total reserves recovered to US$ 194 million as a result of an improved financial situation, produced by tight fiscal and monetary policies and a much more realistic exchange rate. In 1987, net international reserves declined as a consequence of the buildup of US$ 96 million of arrears by Argentina that were financed by a drain in Bolivia's reserves and the easing of monetary policy compared with previous years. Net international reserves of the Central Bank declined by US$ 78 million, and those of the banking system as a whole by US$ 62 million.

E. Fiscal Performance

The major policy instrument behind price stabilization has been a conservative fiscal stance since the New Economic Policy was implemented.

--The Consolidated National Budget: In 1980, the consolidated fiscal deficit of the consolidated public sector was approximately 11,162 billions of pesos bolivianos, or 9.0% of GDP, of which 44% was financed by domestic credit (See Table 9). The period of hyperinflation (1982-1985) dismantled the tax base and gave way to inefficiency, corruption, and nearly complete loss of control of the state's finances. As a result, the fiscal deficit increased to 30% of GDP in 1984 (see Table 10). This deficit was 85% internally financed as a result of international community reluctance to disburse significant amounts to a country in such chaotic situation. In 1985, the fiscal deficit was reduced to 12.7% of the GDP, as a result of the New Economic Policy initiated in the last quarter. Still, two-thirds of this deficit had to be financed with internal credit. In 1986, the fiscal situation improved dramatically. The deficit was reduced to only 4.3% of the GDP (Table 10). However, 1987 preliminary figures show an increase of the deficit to 7.5% of the GDP, owing mainly to the unexpected failure by Argentina to pay for Bolivian gas exports (2.5% of GDP) and payment of the remaining separation payments to the 23,000 dismissed COMIBOL miners (2% of the GDP). Internal financing covered 43% of this deficit. In 1988, the planned budget shows a deficit equal to 6.7% of GDP, totally financed with external funds (Table 10). Preliminary estimates of actual performance during the first half of 1988 reveal an annualized deficit equivalent to 4.7% of the GDP, well below the IMF (and budgeted) target of 6.7%.

--Central Administration Operations: Low revenue collections coupled with high expenditures during the past years resulted in Central Administration deficits throughout the decade, with 1986 being the exception (see Table 11). In 1981, the deficit in the Central Administration's budget as a percentage of GDP was 7.4%. This proportion increased dramatically to 18.3% in 1983, and again to a disturbing 20.5% in 1984 (Table 12). In 1986 and 1987, the current government's tight fiscal and monetary policies resulted in smaller deficits of 2.9% and 5.1% of GDP, respectively (Table 12).

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Central Administration revenues as a percentage of GDP hit their lowest level in 1984, a mere 3.2% (Table 12). Under the present government, revenues improved dramatically, starting in the last quarter of 1985. Revenues have been constantly increasing. In 1987, they reached 14% of GDP and are estimated to increase to 14.6% in 1988. Nevertheless, their composition has changed drastically. The importance of internal revenue and customs collections declined from 55% of current revenues in 1980 to 41% in 1987 (Table 11). On the other hand, revenues from gas and petroleum (taxes on domestic sales and exports) increased from only 16% of total current revenues in 1980 to 49% in 1987.

Central Administration expenditures increased from 19% of the GDP in 1981 to 27% in 1983 (Table 12). Even though wages and salaries did not increase significantly in relation to GDP, transfers to the rest of the public sector increased from less than 1% of the GDP in 1980 to 26.3% in 1984 and 28.2% in 1985. Obviously, subsidies, especially to the state enterprises, were the main cause for increased expenditures, and thus, for Central Administration deficits. Current expenditures were slashed in 1986 to just 17.7% of the GDP (Table 12), the lowest of the decade, through reductions of wages and salaries to 4.4% of the GDP and zero transfers to the public sector. Subsidies to state enterprises were stopped. In 1987, expenditures remained 17.7% of the GDP, wages and salaries increased to 6% of the GDP, and transfers were kept to less than 1% of the GDP.

2. Economic Reactivation

The reactivation of the Bolivian economy is currently the major task that confronts the Bolivian authorities. There are indications that the downward trend in GDP has been reversed as the economy began its long-awaited recovery in 1987, albeit still feeble. The following paragraphs will examine the performance in the last two years of the GDP, investment, exports and credit.

A. The Gross Domestic Product

According to the GOB, preliminary indicators suggest an overall positive rate of growth in 1987 (about 2.2%), the first in the decade. The most rapidly growing sectors were: manufacturing (+ 7.2%), commerce (+ 7.1%), transportation and communications (+ 6.0%), construction (+ 5.6%), public administration (+ 2.8%), hydrocarbons (+ 2.3%), finance, insurance and real estate (+ 1.4%). Declines occurred in the following sectors: mining (- 21.4%), electricity, gas and water (- 0.6%), services (- 0.5%), and agriculture (- 0.2%) (See Table 18).

Preliminary information show that the economy will experience a positive growth rate in 1988. During the first semester, industrial production increased by 12.1%, raising its production index (1978=100) from 54 during the first semester of 1987 to 60 in June, 1988 (See Table 14). This performance becomes a good indicator of the recovery

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of the industrial sector, continuing the 7% recovery that occurred in 1987. Between the first semester of 1987 and the first semester of 1988, agroindustry grew by 25% and manufacturing by 8.1%. The industries that experienced the highest rate of growth during the first semester of 1988 are: non-metallic industries by 163.5%, tool manufacturing by 116.8%, and glass manufacturing by 63.3% (Table 14). GOB sources have preliminarily projected a 2.2% growth for 1988 still below the population growth rate of 2.8% per annum.

B. Investment

Investment since 1981 declined much faster than the GDP. Economic and political instability were clearly the main causes of this deterioration. Investment declined from 14.1% of GDP in 1980 to a negative rate of 0.8% in 1985 (owing both to low fixed investment and a large decline in stocks). In 1987, investment rose back to 9.5% of GDP, still far too low to support recovery and growth.

The GOB's planned public investment program for 1987 was US$572.3 million, or 14.1% of GDP. Of that amount, only US$250.7 million, or 6.2% of GDP, was actually executed (See Table 15). Domestic private sector investment was US$76 million, only 45% of the GOB target of US$ 168 million.

The shortage of GOB counterpart funds had the effect of slowing external disbursements. The reorganization of the central bank in early 1987 is thought to have contributed to slowing down the processing of external funds for a few months. Cumbersome procurements regulations and other weaknesses in public administration also slowed implementation. To some extent, the shortfalls in execution reflect the deficient institutional framework. In mining, only 8.9% of programmed funds were actually spent in 1987, owing to the drastic restructuring of COMIBOL (see Table 15). Agriculture is the other major productive sector which showed a very low rate of project execution (36.5% of programmed funds were spent). This was partly due to institutional weaknesses in the Ministry of Agriculture, which prior to 1985 had a reputation of inefficiency and excessive political influence. The present government is reorganizing this ministry, which will hopefully promote increased investment in the future. Education also achieved a very low rate of execution (only 9.2% of budgeted funds were spent) (Table 15).

By contrast, the energy and hydrocarbons sectors achieved a relatively high rate of execution (71.9% and 58.2%, respectively) (See Table 15). Work has gone forward in the integration of the two major energy grids serving the country. Exploration for new energy sources and construction of small gas pipelines have proceeded at a regular pace. The largest sector, transportation, executed 46.8% of planned investment. Some roads were intended to be financed by Regional Development Corporations which found themselves with insufficient funds, and obtaining imported materials proved to be a slower process than anticipated.

The GOB proposes an investment program of US$350 million for 1988, or 8% of GDP (see Table 15). This program includes ongoing projects and those already prepared, largely with identified sources of financing. This is essentially the pipeline of projects inherited from previous years. This program is 40% greater than the executed public investment plan of 1987 and only 61% of what was planned in that year.

The contribution of private investment is crucial to achieving the projected growth rates; the GOB will need to make every effort to maintain the stable macroeconomic environment of the past three years. It must also ensure that the private sector has access to the private pool of savings and is not crowded out by the need to finance the public sector deficit.

C. Exports

Bolivia's exports have been subject to severe shocks in recent years. First, international tin prices declined by 52% between 1985 and 1986. Second, Argentina, Bolivia's only export market for natural gas, was able to negotiate a much lower price than the GOB had anticipated, which translated into a 12% reduction in 1986, followed by another 29% in 1987 (this is due both to the discovery and exploitation of natural gas fields in Argentina and to the worldwide price decline of petroleum). Finally, the unit prices of a whole range of minor exports declined over the 1981-1986 period, including the prices of tungsten, lead, zinc, soybeans, coffee and timber.

As a result of these factors, the total value of Bolivia's registered exports of goods plunged from $912 million in 1981 to $473 million in 1987, a decline of 48% (see Table 6). Much of this reduction is undoubtedly due to the drop in tin exports (the decline in volume paralleled the fall in price) as well as to the drop in the price of gas sold to Argentina. Total mineral exports fell from $640 million in 1980 to only $264 million in 1985 and to $121 million in 1987, though some recovery is expected in 1988.

Preliminary information show that the export sector will recover some ground and reverse the downward trend since 1981. The first semester of 1988 shows a 17% increase compared with the first half of 1987 (as reported by the GOB and the National Chamber of Exports). The most significant increase was recorded in mineral exports (up by 68%), reaching an export value of about US$78 million. The most important minerals are: tin (concentrated and metallic) US$ 25.2 million; zinc, US$19.4 million; silver, US$ 17.6 million; and gold, US$ 16.0 million. Gas exported to Argentina during the first half of 1988 were US$113.4 million, about the same value as in the first half of 1987, with non-traditional exports showing a 6% increase to US$49.1 million. It appears that total exports for the year will surpass the 1987 value by about 17%, with hydrocarbons remaining the main source of export earnings.

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Given Bolivia's dependency on natural gas and the depressed state of the mining export industry, it is important to diversify the export sector of the economy for which the non-traditional products offer the best perspective. While non-traditional exports recovered substantially in 1987, its level was still 33% below 1980. Recovery of non-traditional exports to the 1980 level is not expected before 1990 (See Table 9). Non-traditional exports are believed to have great potential and could provide important relief to Bolivia's foreign exchange stringency. The Mission is contributing to this endeavor by providing credit and technical assistance through its Export Promotion Project.

In sum: Private sector representatives are more optimistic now than a year ago. The fact that inflation has been arrested, the exchange rate stabilized, the economy liberalized, and the downward trend of GDP arrested last year, has led to a restoration of confidence in the present government and in its economic policies.

On the other hand, the pace of the economic reactivation is still slow. Recovery has been impeded by a number of factors, of which the most important ones include the continued extreme shortage of working capital and credit except at very high interest rates and on very short terms (30 to 90 days), reflecting a continuing lack of confidence in long-term political and economic stability. In particular, there are doubts as to whether the next government will follow the same liberal economic model, with heavy emphasis on stabilization, free markets and private sector initiative. Other negative factors include the relatively depressed state of the mining industry (with some 35,000 to 40,000 miners laid off), the negative income multiplier effect resulting from the sharp drop in export earnings, and continuing delays by Argentina in settling its debt for past gas deliveries. While an agreement with Argentina on a formula for settling the price of natural gas and for payment of past debt owed to Bolivia was reached in late 1987, Argentina continues to fall behind in its payments for gas deliveries. As of June 1988, Argentina was behind by some $107.5 million in its payments.

3. The External Debt

Bolivia suffers from one of the largest debt burdens in Latin America resulting in great pressure on both the GOB budget and the balance of payments. Not only does Bolivia have a large external debt overhang relative to the size of its economy, but the country is also facing growing problems with arrears in its debt servicing which creates tensions with its external creditors. Bolivia has no alternative but to press for relief through debt renegotiation. Paris Club I (held in June 1986) has provided significant relief. Paris Club II (scheduled for November, 1988) is expected to do so again.

A. Debt Service

Bolivia's total debt outstanding in 1987 totalled US$ 4.1 billion, almost equal to its GDP and 6.8 times its exports in that year. 20/ Note that the total debt service payments theoretically due are very considerable - US$ 437 million in 1988 and US$ 462 million in 1989 (Table 16). These figures include both the amounts already rescheduled at the 1986 Paris Club debt renegotiation sessions (Paris I) and the amount it plans to rescheduled this year (Paris II). Debt service theoretically due (before rescheduling) in 1987 was 89% of exports of goods and services (see Table 16). For 1988 and 1989, the debt service to be paid actually declines significantly owing mainly to the Paris I renegotiation. Note that even if we just concentrate on the interest and amortization payments that were made or must be made (mostly to the multilateral agencies), we still come up with very substantial sums: US$ 295 million for 1988 and US$ 351 million for 1989 (Table 16). To put these debt service obligations into perspective, note that the "Total Debt Service to be Paid" in 1989 (US$ 351 million) constitutes about half of total projected legitimate export earnings in that year (US$ 685 million), obviously an unmanageable burden in the country's foreign exchange resources. Even "Interest Paid or to be Paid" alone in 1989 (US$ 259 million) constitutes 38% of total legal export earnings in that year.

B. Debt Rescheduling

Since 1985, the GOB's debt strategy has been to keep reasonably current on its debt to multilateral entities and to reschedule or renegotiate official bilateral and commercial debt.

Regarding the multilateral debt situation, Bolivia has largely maintained payments following promulgation of the New Economic Program. Payments have been facilitated through positive net transfers from the multilateral agencies. Since 1988, however, repayments to multilateral agencies as a whole have slowed, owing partly to the lack of funds due to the nonpayment by Argentina of its arrears on Bolivian gas exports. In turn, new disbursements and commitments from some multilateral agencies have also been halted temporarily. Bolivia is making every effort to improve this situation since it is in the country's own interest.

To date, the major concessions have come from the Paris Club. In June, 1986, Bolivia's creditors in the Paris Club agreed to a rescheduling of some US$ 450 million of Bolivia's bilateral debt service, a package which included postponement of interest payments and

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20/ IMF, Bolivia - Recent Economic Developments, July 19, 1988, Table 26, Pg. 48.

rescheduled all amortizations and arrears. The terms obtained in the Paris 1986 debt renegotiations 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 was exempted from all payments on either amortization or interest until July 1, 1987, and then only for interest payments on the renegotiated terms.

Bolivia expects to return to the Paris Club in November, 1988, and is expected to ask for the renegotiation of all bilateral debt on concessional terms (i.e. 30 to 40 years, at interest below market rate).

Argentina is Bolivia's most important bilateral creditor. Bolivia's outstanding debt to Argentina is approximately US$ 689 million. This debt has been rescheduled outside Paris I as part of an overall agreement with Argentina (negotiated in September, 1987) that also dealt with Bolivia's gas exports. This agreement rescheduled Bolivia's debt, including arrears, to 30 years, with a 15 year grace period, at 8% interest. While amortization payments have been postponed for 15 years, interest payments on this debt amounts to about US$ 55 million per year, representing more than a fifth of Bolivia's export receipts for gas deliveries to Argentina.

Commercial debt has not been serviced since 1984 and the country has not attracted any new loans since then. The GOB's debt-buyback proposal calls for Bolivia to buy back its debt at 11 cents of face value from foreign commercial banks, without acknowledging any interest accrued, using funds donated specifically for this purpose by donor governments. To date, Bolivia has signed an agreement which includes the repurchase of US$ 306 million (for about US$ 34 million) out of a total debt with a face value of about US$ 670 million. The remaining US$ 364 million will be renegotiated with each bank.

In addition to its relations with the commercial banks, official creditors and multilateral agencies, Bolivia owes about US$ 160 million to two foreign oil companies, Tesoro and Occidental.

4. <u>The Balance of Payments</u>

The evolution of Bolivia's balance of payments during the period 1980-88, with projections for 1989, is presented in Table 17. We shall first discuss major trends over 1980-88, then analyze the USAID and IMF projections for 1989.

A. Trends over 1980-88

1. Merchandise Trade: Exports declined by nearly 50% between 1980 and 1988, from $942 million to only $485 million. This drastic decline is due mostly to sharp drops in tin and natural gas prices, though exports of non-traditional products suffered also, particularly during 1983-85. Imports declined sharply between 1980 and 1984 (by 27%), then recovered to $745 million in 1988. They are now only some 10% (in current dollars) above the 1980 level, which means a reduction in real terms.

As a result of these trends, the balance of trade moved from a positive $264 million in 1980 to a negative $260 million in 1988 (Table 17), a turnaround of $524 million over this eight-year period.

2. Total interest payments falling due (prior to rescheduling) rose from $281 million to a peak of around $400 million over the period 1980 to 1985, then declined to $287 million in 1988 (Line I-3-ii of Table 17).

3. The disbursement of international donor loans declined from $265 million in 1980 to less than $100 million in 1983, but have now risen back to the 1980 level as a result of stepped up donor assistance over 1986-88 (Line II-B-i) of Table 17).

4. Amortization payments (paid and unpaid) declined by $163 million between 1986 and 1988 as a result of the Paris I (in mid-1986) debt rescheduling (II-B-i).

5. The sum of "errors and omissions" and "net short-term capital" include earnings from the informal sector, consisting mostly of earnings from coca exports that found their way into the banking system or resulted in legitimate imports. Such earnings amounted to about $200 million in 1985 and 1986, but declined to about $140 million in 1987 and to an estimated $84 to $100 million a year over 1988-89 (Line II-B-ii plus line III). This decline is related to the drop in the international coca price and to the success of coca eradication and interdiction efforts.

6. The overall balance of payments deficit (in line IV) showed a substantial deficit every year over 1980-88, though the amounts vary considerably from year to year. Note the 49% decline that occurred in the overall deficit between 1987 and 1988 (down from $367 million to $188 million), which is due to three factors: 1) the Paris I Debt Rescheduling Agreement (of 1986), which substantially reduced amortization payments falling due on the medium and long-term external public debt; 2) a $43 million improvement in the balance of trade in 1988 resulting from the slight increase in exports and an absolute decline in the level of imports; and 3) a US$ 63 million increase in the rate of official loan disbursements in 1988.

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B. 1989 Projections

Two alternative projections for 1989 are presented in Table 17. One was done by the IMF last May. The other is a revised projection jointly undertaken in October of 1988 by the Mission and the Balance of Payments Department of the Central Bank. The USAID/Central Bank revision was necessary as the IMF's 1989 projection appears to greatly overstate both exports and imports, mostly owing to the fact that data on first semester 1988 performance was not available to the IMF team at the time it made its projections last May. Both exports and imports during the first semester of 1988 were substantially below earlier expectations. Since the adjustments we have made to the IMF projections are offsetting to a substantial degree, the overall results with regard to the size of the balance of payments deficit and the drop in net international reserves are not significantly different. Thus, the IMF projected an overall balance of payments deficit of $176 million in 1989, while our projection shows a deficit of $200 million. Similarly, the IMF projected a decline in net international reserves of $65 million, compared with our anticipated loss of $89 million (Line IV of Table 17).

The difference between the overall balance of payments deficit (on Line IV of Table 17) and the loss in net international reserves (on Line IV-C) is the "Extraordinary Financing", consisting mostly of potential debt relief on debt that was not rescheduled under Paris I, but that may be rescheduled under Paris II or subsequently. This item represents a possible, but by no means an assured, source of deficit financing.

The detailed methodology underlying the projections, as well as the various sources of data, are presented in the footnotes to Table 17.

If the balance of payments gap projected for 1989 cannot be covered, the GOB would face the following alternatives:

1. Permit a further drawdown in net international reserves. These were already drawn down by some $78 million in 1987 and stood at $165 million at the end of September, 1988 (equal to 2.7 months of imports). Further drawdowns would violate the IMF agreement and is not a viable option for the GOB.

2. The GOB could sell part of its gold reserve, officially valued at only $40 an ounce in calculating net reserves, but actually worth $350 to $400 an ounce in the international market. The country's gold reserve may be worth $375 million to US$400 million at current market prices. The sale or use as loan collateral of part of the gold reserve is theoretically a viable option, but has run into very strong political opposition.

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3. Secure additional fast-disbursing assistance from donors: stepped up assistance from international donors has been obtained at the recent Consultative Group meetings in Paris, and a faster rate of disbursement already is reflected in the 1989 loan disbursement projection (Line II-B-i). However, most of international donor assistance takes the form of long-term development projects that cannot be disbursed rapidly. What is needed is fast disbursing non-projectized assistance, such as the one requested under this PAAD.

4. Reduce imports and other foreign exchange expenditures: our import projection for 1989 allows for only a 10% increase of imports in current dollars, which probably translates into no more than a 5% increase in real terms. A significant cutback from this level would almost certainly interfere with economic reactivation and the recovery of per capita GDP, which has declined by some 25% since 1981.

5. Meeting the IMF's Performance Targets

On December 15, 1986, the IMF concluded the mid-year review of the stand-by arrangement and found the GOB in full compliance with all the targets set in the SDR 50 million that had been approved on June 19, 1986, except for the reduction of arrears to private suppliers, a deficiency that was remedied by mid-July, 1986. The final purchase under that arrangement could not be made because certain performance criteria for March 1987 were not observed (particularly those related to the public sector deficit) and the arrangement expired on July 20, 1987. Progress in meeting the structural benchmarks was broadly satisfactory.

In December, 1986, the IMF also approved Bolivia's request for arrangements under the Structural Adjustment Facility and for a purchase of SDR 64.1 million under the Compensatory Financing Facility.

The program for 1987-88 called for cautious fiscal and monetary policies which, together with a flexible exchange rate policy, were to protect the balance of payments. In particular, the overall public sector deficit was to be limited to 6.1% of GDP and net official international reserves were not to decline by more than US$18.5 million. Difficulties with the implementation of these policies were experienced during the first quarter of 1988. It appears that some key public enterprises, notably the state mining complex COMIBOL and the state oil monopoly (YPFB), as well as some ministries, exceeded their spending allocations. The GOB has since taken some far-reaching measures to reduce expenditures and introduce controls to prevent such occurrences. The GOB's financial difficulties were exacerbated by the failure of Argentina to make timely payments for its purchase of Bolivia's gas. Partly as a result of this factor, the public sector deficit expanded from 4.3% of GDP in 1986 to 9.8% of GDP in 1987, while net international reserves declined by US$ 139 million. 21/ After making allowance for the delay in Argentina's payments, the overall deficit was scaled down to 7.5% of the GDP, while the 1987 reserve loss was estimated at US$ 78 million.

VI. MAJOR REMAINING PROBLEMS AND GOB PRIORITIES

1. Reactivation of the economy: Now that the GOB has successfully implemented a stabilization program, economic reactivation and the reduction of unemployment become the first priority. The private sector has identified a number of obstacles to increase economic activity that need to be addressed. These include the acute shortage of working capital (which the Government's Reactivation Plan seeks to relieve), the very high interest rates charged by banks (25 to 30 percent on dollar loans), a fragmented, decapitalized and inefficient financial system, the need for stronger export incentives, including the possible expansion of the tax rebate provided by the export certificate (which involves a 10% return to exporters of non-traditional exports of the gross value of the exports), tighter controls on smuggling, continuing adjustment of the exchange rate, and the simplification of bureaucratic procedures that currently impede exports, imports, the obtention of credit and even the payment of taxes. Most of these points are receiving serious consideration by the government.

2. Restructuring the Economy: Some restructuring of the economy appears 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 areas described below constitute major obstacles to growth and should be among the prime targets of the restructuring program. Several of these are long-term problems that the GOB will not be able to address without substantial international donor assistance over a period of several years.

a. Expansion and diversification of exports: These include continued adjustment of the exchange rate, provision of pre-embarkation and production credit for non-traditional exports, 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 royalty payments to regional administrations on such products as timber, rubber, livestock and Brazil nuts.

21/ The reserve loss for 1987 recorded in the accounts of the Central Bank was US$ 78 million because US$ 61 million of the Central Bank's reserve liabilities were assumed by the Central Government as long-term obligations as part of a comprehensive debt restructuring agreement with Argentina.

b. Reduce 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 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 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, tax collections and police. In assessing the impact of salary adjustments on public sector finances, account must be taken of the potential impact of such adjustments on increased revenue collections, as well as their obvious impact on the increase in 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.

c. Increase Investment: Bolivia needs to raise investment levels substantially to replace and expand its capital stock. The investment/GDP ratio dropped from 14.1% in 1980 to 9.5% in 1987. While the government is determined to encourage private sector development and reduce the role of the state in the economy, private enterprises need to increase their investment, especially that directed to the export sector or to efficient import substitution industries. Public sector investment will have to play a critical role in improving and expanding the country's very deficient physical and social infrastructure. The deficient transportation system (lack of a national paved highway system, very poor road maintenance and an adequate railroad system) constitutes a serious bottleneck which results in high transport costs that discourages export-oriented activities, especially in the agricultural sector.

d. Reduce the substantial disequilibrium in the balance of payments (discussed in Section V-7 above). The government confronts a major dilemma: while the projected $89 million decline in net international reserves in 1989 must be avoided, additional foreign exchange resources are not available. Yet, a further decline in imports is inconsistent with implementation of the reactivation program.

e. Deal with the country's chronic unemployment and under-employment problem: This problem has been further exacerbated since 1985 by the depression in the tin mining industry which resulted in the discharge of some 35,000 to 40,000 miners. There is no solution in sight. The long-term outlook is rendered more dismal by the high (2.8%) rate of population growth and GOB resistence to adoption of a population policy that encourages family planning.

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

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f. Renegotiation of Bolivia's public sector debt: We have noted that the GOB has acted unilaterally to resolve its debt situation with foreign commercial banks by buying back that debt at the going market rate (about 11 cents to the dollar), with cash contributed by donor governments. Bolivia's debt with bilateral donor governments - mostly South American governments and Paris Club members - is being renegotiated at successive Paris Club meetings. However, the debt to the multilateral agencies cannot be handled as easily as such debt is not renegotiable. The outstanding debt, as of December, 1987, to the multilateral organizations alone is approximately US$ 1,126 million, with debt servicing (in 1988) of about US$ 124 million. We have noted that total interest and amortization payments falling due in 1988 that must be paid is approximately US$ 295 million. 23/ The balance of payments analysis presented above clearly shows that Bolivia will be unable to service its debt to both bilateral donors and the multilateral credit organizations, leaving the GOB no alternative but to seek another Paris Club rescheduling agreement with bilateral donors. The meeting was held in November, 1988, and agreement was reached to reschedule Bolivia's bilateral debt.

VII. BASIC RATIONALE FOR ESF ASSISTANCE

The basic rationale for the proposed ESF Assistance Program for FY-88 is as follows:

1. The ESF program will contribute resources to finance the Economic Reactivation Program by providing (a) foreign exchange for the payment of official US bilateral debt and multilateral debt (i.e., World Bank, InterAmerican Development Bank, and International Monetary Fund), thereby freeing-up GOB dollar resources for other uses; and (b) for generating local currency funds to be used to meet the counterpart requirements for projects financed by USAID and the multilateral development banks, particularly the IBRD and the IDB. The GOB estimates that every one dollar of counterpart funding provided could release about $4 in foreign exchange disbursements from donors as the shortage of GOB counterpart currently constitutes the major bottleneck to the disbursement of international donor assistance. Examples of USAID projects for which with counterpart financing would be provided by the ESF Program include the Chapare Regional Development Project, Strengthening Financial Markets, Promotion of Non-traditional Exports, the Industrial Transition (Privatization) Project, and the Micro and Small Enterprise Project.

23/ Bilateral debt servicing consists of US$ 79 million in interest and US$ 7.4 million in amortization; payments to the commercial banks are around US$7.2 million in interest and US$4.9 million in amortizations; and the remaining US$72.5 million accounts for interest to be paid to regional development institutions such as ALADI (Asociaciôn Latinoamericana de Integraciôn) and interest on contracted and undisbursed debt, and obligations to the IMF.

2. The program will provide balance of payments support and thus help reduce the unfinanced balance of payments gap. The balance of payments analysis presented above indicates a likely overall balance of payments deficit of about $200 million in 1989, of which $111 million might be covered through non-payment of interest and amortization (associated with debt rescheduling), while another $89 million would be covered by a decline in net international reserves. The IMF points out that Bolivia cannot afford to lose $89 million in net international reserves. Hence, the most likely alternative to obtaining foreign exchange resources to finance the gap would be to contract imports, a policy that almost certainly would further delay implementation of the economic reactivation program. 24/

3. The case for balance of payments assistance is further strengthened by the determined efforts that the GOB and the USG are undertaking to curb the country's coca growing and narcotics export industry. While the contribution that narcotics exports is making to foreign exchange earnings that benefit the economy cannot be reliably estimated, these are estimated to fall within the range of US$ 200 million to US$ 300 million a year. The ESF program has been, and will continue to be, an important USG instrument for encouraging continued GOB cooperation in the area of narcotics control. US and Bolivian negotiators have developed a plan for GOB narcotics control actions on several fronts. Continued ESF assistance is an important element in that plan. Close GOB-USG cooperation since mid-1986 (starting with Operation Blast Furnace) resulted in the destruction of a significant number of laboratories, processing facilities and airstrips, the confiscation of a number of private aircraft, the arrest of one of the most important narcotraffickers, as well as in other forms of interdiction. In addition, the Narcotics Control Law (Ley de Sustancias Controladas y Regimen de la Coca) promulgated in August 1988, set up annual targets to coca eradication. Significant declines in the price of coca leaves sold by farmers are observed when coca interdiction efforts are stepped up. Substantial progress in the Government's voluntary coca eradication program has occurred over the past twelve months.

4. Finally and perhaps most importantly, there is a strong case for continued US Government 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 controls, establish a much more favorable environment for the private sector, and undertake a determined campaign to eliminate narcotics trafficking. The preservation of a democratic, private sector-oriented form of government is by no means assured. Failure to reactivate the

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24/ The major alternatives to filling the balance of payments gap with fast disbursing non-projectized resources are discussed in Section V.4.

economy, to reduce the magnitude of the unemployment problem and to raise per capita income (that has been significantly eroded since 1980) could well generate such discontent as to produce a major political upheaval.

VIII. DONOR COORDINATION

In the past, donor coordination was close but informal, except for consultations on projects which took place whenever needed to avoid duplication and ensure complementarity, particularly in the case of projects involving joint funding. A case in point is AID's Strengthening Financial Markets project where the IBRD is assuming responsibility for strengthening public sector institutions (i.e. reorganizing the central bank, providing technical assistance and budget support to the Superintendency of Banks, implementing the tax reform program and improving the auditing system at the Contraloría), while USAID is working with the private sector by providing training for the staffs of commercial banks to improve their efficiency. In addition, visiting IBRD and IMF teams generally debrief Mission officials on their findings before leaving the country.

Beginning in January of this year, the AID Director invited representatives of all bilateral donor governments and international agencies to a meeting at which all donors were invited to present a summary of their programs and to discuss any problems, project ideas and programs of mutual interest. The Minister of Planning was also present at the meeting. The consensus was that these meetings should be held on a regular monthly basis. In addition, special sectoral meetings would also be held at which problems and projects of particular sectors would be discussed in depth. At the first meeting, GOB officials made a presentation of the National Budget for 1988 and its investment priorities. The second meeting (sponsored by USAID) dealt with agriculture. The third, also under USAID sponsorship, dealt with a USAID proposal to create a local currency fund to provide short-term credit to the "productive" private sector to meet its requirement for working capital, thus contributing to the reactivation of the economy. At the fourth meeting, sponsored by the IBRD representative, a presentation was made by the GOB of the work being done in preparation for the Consultative Group meeting held in Paris in July, 1988, which dealt with Bolivia's Ten-Year Development Strategy Plan. The last meeting was devoted to the analysis of the role that micro and small enterprises can play in the process of economic reactivation and growth. It is thus expected that donor coordination, always good, will be even closer in the future. The fact that the USAID Mission, the IDB and the World Bank all have their offices in the same building substantially facilitates donor coordination in La Paz.

Contributions to balance of payments support by major donors are as follows:

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The IMF: Resources made available to Bolivia by the IMF in recent years include a one-year Stand-By for SDR $50 million approved in June, 1986; a three-year Structural Adjustment Arrangement for SDR $42.6 million approved in November, 1986; and an SDR $64.1 million loan from the Compensatory Financing Facility that was fully disbursed in November, 1986. Moreover, the IMF Board authorized an Enhanced Structural Adjustment Facility in an amount of SDR 136.05 million in July, 1988, while the first tranche was disbursed on August, 1988. Additionally, the IMF approved a purchase of SDR 45.3 million under the Compensatory Financing Facility. Full use of the authorized agreements would increase fund credit to Bolivia to SDR 218.05 million at the end of the program period in March, 1991.

The IBRD: The IBRD has provided two "Reconstruction Import Credits", one in June, 1986, and the second in July, 1987. The undisbursed amount of these two loans combined is US$79 million (as of March 1988). These credits can be used to import equipment, spare parts and intermediate goods for both the private and public sectors. Additionally, the GOB has obtained US$ 70 million under the IBRD's Financial Sector Adjustment Credit, of which the dollar amount will be utilized to import capital and inputs and intermediate goods by the productive sector of the economy, while the local currency will be used primarily to refinance private sector debt to the banking system. The projected disbursements for 1989 for all three lines of credit were included in the $310 million official loan disbursement projection of Table 12 (item II-B-1), and is therefore not available to finance the remaining balance of payments gap.

The Corporación Andina de Fomento (CAF): The CAF has provided $20 million in a rotating fund to finance exports of non-traditional products of which some $14 million have already been utilized (as of July 1988). The CAF will disburse the remaining $6 million during 1988. No additional CAF funds for this purpose are expected in 1989.

The Swiss Government (COTESU): The Swiss Government has provided Bolivia with a credit line of $7.1 million, all of which is still undisbursed, for the purchase of essential imports by both the public and private sectors for the purpose of expanding the country's productive capacity. Most of this credit line is for the importation of equipment and spare parts. The GOB estimated that US$ 5 million of Swiss aid funds will be disbursed in 1989.

Great Britain: The British government has provided Bolivia with a credit line of $9 million (still undisbursed) beginning in 1987 to finance imports of intermediate and capital goods for both the public and private sector from Great Britain (imports are tied to that country). The British Embassy does not think this amount will be disbursed in 1989, nor has the Central Bank included it in its projections.

In sum: Of the amounts described above, all amounts were included "above the line" in the $310 million official loan disbursements of the balance of payments projections for CY 1989.

IX. ESF DOLLAR AND LOCAL CURRENCY PROGRAM AND DISTRIBUTION PROCEDURES

US dollar funds will be provided to the GOB in two equal obligations to finance the payment of official multilateral debt (i.e., World Bank, InterAmerican Development Bank, and International Monetary Fund) and US bilateral debt, thereby freeing-up GOB dollar resources for other uses. The GOB will commit itself to providing an amount equal to the US dollar grant in local currency (bolivianos) to finance the cost of counterpart requirements of AID and multilateral development organizations' projects. The procedures which will apply to the programming, use, and control of the US dollar and boliviano funds are described below.

A.I.D. will obligate the funds with Bolivia in two equal obligations of $11,750,000 each. Once the certification requirement contained in the Anti-Drug Abuse Act of 1988 for Bolivia with respect to implementing narcotics legislation is made, the first obligation of ESF funds will be made. The FAA further requires that only 50% of the OYB can be made available prior to Presidential certification to Congress that Bolivia has complied with anti-narcotics measures. Each of the two equal obligations will be made available in two equal disbursements, upon compliance with the conditions described in Section X of this PAAD. Each tranche of US dollars made available to Bolivia under the agreement will be disbursed to a Separate Account established by the Central Bank of Bolivia (B.C.B.) in a U.S. bank, at the written request of the authorized representative(s) by means of a "Financing Request." Section X describes these conditions.

1. Programming, Use, and Control of the US Dollars

Prior to the disbursement of the US dollar funds, the B.C.B. will be required to provide the Mission with the eligibility criteria for selection of the debt to paid and the procedures describing how the dollars will be used for the payment of debt and the tracking and reporting mechanisms. The requirements for these procedures will be set out in the Agreement and more fully detailed in the Operational Letter No. 1. The intent of the procedures will be to assure that the use of the dollars can be determined and that the reporting requirements will allow for complete and timely reporting on their uses. The Mission experienced much difficulty in working out the procedures with the Central Bank for the 1987 and 1988 programs, which produced correspondingly lengthy delays in the use of the dollars. The approval by the DAEC to use the FY-89 ESF dollars for the payment of official multilateral debt (i.e., World Bank, InterAmerican Development Bank, and International Monetary Fund) and US bilateral debt, thereby freeing-up GOB dollar resources for other uses, will greatly facilitate the rapid use of the FY-89 dollars. Subsequent to the DAEC review, the Mission and the B.C.B. agreed at the working level to a draft set of procedures which the B.C.B. will shortly present to the Mission. The Mission expects that these procedures should present no problems for the implementation of the FY-89 program.

These draft procedures will provide that the B.C.B. will submit to USAID the proposed list of debt to be cancelled along with the payment dates. Once approved by the Mission, the B.C.B. will disburse dollars from the Separate Account directly to the approved debtor on the approved date and, at least once a quarter, present documentary evidence to USAID to support the disbursements made. USAID will review the documentation provided and formally notify the B.C.B. of its concurrence or non-concurrence with each disbursement made. In the case of non-concurrence, the Agreement will provide for reimbursement to the Separate Account of the amount in question.

2. <u>Programming, Use, and Control of the Bolivianos Counterpart Funds</u>

With regard to the programming, use, and control of the boliviano counterpart funds to be provided under the agreement, discussed above, Operational letter No. 1 will contain the following procedures and provisions: 1) Within seven days from the date on which the initial U.S. dollar deposit of the grant is made to the account of the grantee, the grantee will establish a Special Account in the B.C.B. and begin deposits in bolivianos according to the schedule provided. Initial deposits will be made to the USAID Trust Fund to finance the operational costs of the USAID Mission in Bolivia; and 2) Subsequent boliviano deposits into the Special Account, also in accord with the schedule provided, will be made for use as counterpart to USAID and multilateral organizations' projects.

Per the agreement, all boliviano deposits made by the grantee into the Special Account will be calculated at the highest rate of exchange which is not unlawful in Bolivia in effect on the day the deposit is made.

The bolivianos made available by the GOB pursuant to the agreement and subsequent Operational Letters, including any interest earned, shall be used for counterpart contributions to A.I.D. and multilateral development organizations' projects and for purposes of the USAID Trust Fund Account.

The B.C.B. will be required to inform the Ministry of Planning and Coordination and A.I.D. of all counterpart deposits made available under the Agreement and will submit any financial information that A.I.D. might reasonably request.

The Mission has established a Local Currency Management Committee to review, track, and recommend approval of the uses of the ESF local currency for counterpart to A.I.D. and multilateral development organizations' projects. It is this Committee's responsibility to recommend approval to the Director of the proposed uses of the local currency, monitor the use of the local currency on a regular basis, and review these uses and the GOB's compliance with the agreed upon uses.

The Committee will include representatives of the various Mission Offices, including: the Controller's Office, which will have the responsibility for maintaining the financial reporting on these local currency uses; the Project Development and Implementation Office, which will have responsibility for monitoring the use of these funds; and the Development Planning Office, which will chair the local currency committee and review the programmatic use of the funds. With regard to the OE Trust Fund (the only other approved use of the local currency), the Controller's Office will maintain the normal accounting records for these funds.

Prior to the first disbursement of counterpart funds, except for disbursements to the Trust Account, the Grantee will, submit to A.I.D., for A.I.D. review and approval, the Grantee's proposed plan for the use of counterpart funds. This will be reviewed by the Mission's Local Currency Use Committee and, as necessary, modified after consultation with the Ministry of Planning (MOP), and then approved by A.I.D. and the MOP via countersigned operational letter.

3. Reports

The ProAg will require that the Grantee shall furnish to A.I.D. on a quarterly basis, in form and substance satisfactory to A.I.D., such information and reports indicating that the funds deposited in the Separate and Special Accounts pursuant to the ProAg were used for agreed upon purposes, as described more fully by Program Operational Letters. Specific reporting and tracking procedures are listed below.

A. Separate Account

In order to fulfill this requirement, the Grantee shall submit quarterly reports to support the disbursements made for each payment of debt (principal or interest). The following documentary evidence to A.I.D. which describes the specific uses financed with dollar funds, shall be provided: (1) copies of B.C.B. authorizations to the U.S. bank, in the which the Separate Account has been established, authorizing the payment to the approved debtor and the telexed confirmations of the paymen; of from the correspondent U.S. bank; (2) the name of the debtor which has received the foreign exchange; and (3) the amount involved

The Grantee shall provide these reports on a quarterly basis to A.I.D. The first report shall be submitted at the end of the calendar quarter in which the ProAg is signed and, thereafter, at the end of each calendar quarter. Records to support the reports shall be kept available in the Central Bank for A.I.D. audit for three years after the last disbursement of dollars and counterpart funds by A.I.D. and the B.C.B., respectively. The Grantee shall also furnish additional reports regarding the use of dollar funds as A.I.D. shall reasonably request in Operational Letters to the Grantee.

B. Special Account

In order to fulfill this requirement, the Grantee shall provide a report to A.I.D. each quarter. The first report shall be submitted at the end of the calendar quarter in which the ProAg is signed and, thereafter, at the end of each calendar quarter. The report will describe the specific uses and activities financed with counterpart funds, and the amount of counterpart funds disbursed or utilized for activities and programs, related to the agreed upon program of Local Currency uses. The Grantee shall also furnish such additional information or reports regarding the use of counterpart funds as A.I.D. shall request in Operational Letters to the Grantee.

C. Records and Audits

The ProAg will provide that the Grantee be required to maintain or cause to be maintained, in accordance with generally accepted accounting principles and practices consistently applied, books, records, and documentation relating to the Separate and Special Accounts under the Agreement. Such books, records, and documentation will be audited regularly, in accordance with generally accepted auditing standards, and maintained for three years after the last disbursement of dollars and counterpart funds by A.I.D. and B.C.B., respectively. The Grantee will also be required to afford authorized representatives of USAID the opportunity at all reasonable times to inspect all activities financed with both the dollar and boliviano proceeds, and all books, records, and documentation and other documents relating to this Agreement.

The audits will be conducted as follows, at the end of 1989:

1. The Mission will request RIG/A/T to perform the audit. If this is not possible due to RIG/A/T's workload, the Mission will a) use the IQC services of Price Waterhouse and Co., or b) contract the services of another approved local firm affiliated with a U/S/ auditing firm.

2. If the audit is carried out locally, payment will be made in Bolivianos form the local currency proceeds of the program. The approximate cost of the annual audit will be programmed and defined with the GOB (estimated cost $50,000).

4. Experience Under the FY-87 Program

A. U.S. Dollars

The U.S. dollars were disbursed in two tranches upon meeting the conditions precedent, in September and December, 1987. These funds are available for financing of private sector imports by the B.C.B. under the Reactivation Program announced by the GOB in August of 1987. On September 25, 1987, USAID issued Project Operational Letter No. 2

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notifying the B.C.B. that the regulations proposed by the Bank met the requirements of AID's tracking and monitoring program. Those regulations provided for the use of these funds by the ICIs under the Reactivation Credit Line and under two other developmental lines. It had been expected that disbursement would begin promptly, as there was a critical shortage of available foreign exchange. However, as of the writing of this PAAD, no disbursements of dollars from the Separate Account have been made.

By December 1987, the Mission was aware that there were several problems which were preventing the line of credit from being accessed by the ICIs. The foremost of these was bureaucratic incompetence at the Central Bank, still suffering the effects of an almost complete turnover of personnel in 1986 and a resulting major reorganization in early 1987. This resulted in the regulations describing the procedures for the use of the dollar resources not being distributed to the ICIs, and, therefore, in failure to implement the program. Since the B.C.B. could offer no adequate explanation as to why the program could not be implemented as established, the Mission continued to push the B.C.B. to implement the regulations and begin operation of the program. By April 1988 however, when the program was still not operational, the Mission decided that other implementation procedures had to be adopted. Following a series of meetings with GOB and B.C.B. officers, the Mission decided to accept the B.C.B.'s alternate proposal that imports which would have been eligible under the program be selected to account for the $7.16 million ESF program, plus interest. There are precedents in Ecuador and Uruguay supporting this procedure, which was considered acceptable by the RLA, Mr. Alex D. Newton. However after discussions with the RIG on this issue, it was concluded that the Mission would consult with the LAC Bureau on this procedure. This issue was, therefore, discussed at the PAAD review. The LAC Bureau concluded that the proposed procedure complied with Agency guidance and was, thus acceptable. This is reflected in the Bureau's approval of the PAAD and the authorization of the program.

Once agreement was reached on these procedures, the B.C.B. reviewed the 1987 import documentation and tentatively selected over 170 import transactions totalling $9.4 million at CIF prices. The supporting documentation (U.S. vendors' invoices, bills of lading and import policies) was reviewed by the Controllers Office. Ineligible items were eliminated and sufficient acceptable transactions were identified to justify disbursement of the $7.16 million dollars, plus interest, in the Separate Account. The B.C.B. will now make formal submission of the acceptable transactions to the Mission. Upon agreement of the Mission, these funds will be disbursed from the Separate Account to the GOB.

Bureaucratic delays in the B.C.B. in implementing the regulations for the proposed credit lines were the principal factor that held up disbursement of the dollars from the Separate Account. Steps to overcome the problem have been taken: (i) eligible transactions have been selected; and (ii) a POL approving the transactions and authorizing disbursement will be issued now that review of the procedures by AID/W has been completed. The Mission, therefore, believes that the dollars should be disbursed shortly after review of the PAAD. It was not advocated that the use of the 1987 dollars be delayed until the procedures for the 1988 program are approved, in order to avoid further delay in the use of the 1987 resources.

B. Local Currency

The Mission and the Ministry of Planning completed a review of the proposed uses of the local currency and an operational letter No. 4 was issued on February 24, 1988, giving A.I.D.'s agreement to these uses. The Minister of Planning countersigned this letter also indicating his agreement to the uses. Disbursements of these funds has begun and will continue over into CY 1989. The GOB's deposit of the local currency to the Special Account for the first tranche of $3.0 million was substantially in accord with the schedule provided via operational letter. Deposits of the local currency for the second tranche of $4.32 million have been delayed, although in most cases the availability of local currency has still been adequate to carry out the agreed upon activities. The B.C.B. has now proposed a new deposit schedule for the second tranche, which is under review by the Mission.

The delay in the deposits of the local currency corresponding to the second tranche of funding is related to the non-use of the dollar funds. As these dollar funds were not disbursed as anticipated, in order to make the local currency deposits, the Central Bank provided credit to finance the local currency deposits. The Bank, however, wished to minimize this financing to the government and the possible inflationary effects of these disbursements, therefore, local currency deposits were made to the Special Account only as required by the projects. While this procedure is not in accord with the Mission's original instructions to the Bank, once we were made aware of the problem the Mission understood the rationale for it and, to the extent that it did not overly delay implementation of the agreed upon projects, did not object to it. Now that procedures for reimbursing the dollar costs of import transactions have been agreed upon with the B.C.B. and disbursement of the dollars is to take place, agreement on a revised schedule for the deposit of the remaining local currency corresponding to the full amount of the second tranche has been formalized.

5. Experience Under the FY-88 Program

A. U.S. Dollars

As of the writing of this PAAD, the U.S. dollars have not been disbursed. The agreement provides that they be disbursed in two tranches: the first, upon meeting the initial conditions precedent (substantially the same conditions as described in this document for the 1989 agreement); and, the second, upon meeting the eradication target of 1800 hectares. The GOB had met all of the conditions, including the eradication target, but had failed to submit adequate procedures for the use, disbursement, and tracking of the dollar funds.

Simultaneously, while working out the problems regarding the FY-87 program, the Mission also began review of completely new procedures for FY-88. After detailed discussions with the B.C.B., at the writing of the PAAD, the B.C.B. had drafted a set of proposals which it was expected would be presented to the Mission shortly. These procedures provided for the financing of eligible imports from the U.S. Importers would access the line of credit through their own banks, the banks in turn applying to the B.C.B. for a letter of credit. After reviewing these procedures in detail at the working level, the Mission requested a meeting with the senior management of the B.C.B. and the Ministry of Finance in order to determine if, in fact, the proposal representated a workable set of procedures. Our concern was that these procedures represented substantially the same procedures as those proposed for the FY-87 program, and we wanted to be clear on why the B.C.B. personnel thought that these would work for the FY-88 program when they had not for the FY-87 program.

The meeting served to confirm our suspicion that the proposed procedures were not workable for the same reasons as in 1987, i.e., the generation of the local currency would be delayed due to the extended pay-back period proposed by the B.C.B. for the dollar funds. The B.C.B. president and the Undersecretary of Treasury of the Ministry of Finance proposed that we consider the following alternatives for the use of the dollars:

Financing of public sector imports;

Reimbursement for private sector imports, as in the FY-87 program; or

Payment of multi-lateral debt.

We agreed that we would present these alternatives at the PAAD review.

As mentioned above, the discussion at the PAAD review confirmed that reimbursement of eligible imports was an appropiate procedure for FY-87 and this was also approved as the Bureau's preferred use of the FY-88 funds.

B. Local Currency

Since the dollars have not yet been disbursed, no deposits of local currency have been made. However, the Mission and the Ministry of Planning have begun a review of the proposed uses of the local currency, and it is expected that an operational letter will be issued during this quarter giving A.I.D.'s agreement to these uses. The disbursements will be made according to a schedule which provides for deposits over a seven month period, which guarantees availability of the local currency as needed.

X. COVENANTS AND CONDITIONS PRECEDENT

Before presenting the Covenants and Conditions Precedent for the present FY 1989 PAAD, we will briefly discuss GOB compliance with the covenants in the FY 1988 PAAD.

1. Implementation of Covenants in the FY 1988 PAAD

The text of the Covenants in the FY 1988 PAAD, and action taken by the GOB, are as follows:

a) The GOB agrees to give priority to the continuing implementation of its stabilization and reactivation program. The Grantee agrees to consult on a quarterly basis and provide data to AID on the progress of the stabilization/recovery program, particularly with regard to performance of the consolidated public sector.

This covenant is fully in line with the GOB's own policies and priorities. With regard to stabilization, there has been some acceleration in the rate of inflation in 1988, which is due, in large part, to the significant increases in the money supply that occurred in 1986 and 1987. In these years, M1 increased by 83% and 38%, respectively. The price level increased at much lesser rates than money supply during 1986-87, but caught up in 1988 (the price level increased by 18.5% during the first three quarters of 1988) even though the GOB has followed a much more conservative monetary-fiscal policy this year. Between December 31, 1987 and June 30, 1988, the money supply (M1) actually declined by 2.1%. As a percent of the GDP, the deficit of the consolidated public sector is projected to decline from 7.5% in 1987 to 6.7% in 1988.

With regard to data to be provided to AID, the Mission has been able to obtain the information it required on all economic developments, including public finance, from both the Central Bank, the Ministry of Finance and UDAPE (the economic policy research unit in the Ministry of Planning). The detailed data summarized in the 18 tables of this PAAD support this conclusion.

b) The GOB will agree to maintain a flexible nominal exchange rate so as to prevent any appreciation in the real value of the boliviano in relation to the dollar during the course of CY 1988.

The data summarized below show that the GOB has performed well on this score during 1987, but not during the first nine months of 1988. In 1987, the consumer price index increased by 10.7%, while the dollar was permitted to appreciate by almost 15%, thus

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increasing the competitiveness of the boliviano. However, this ground was lost during the first nine months of 1988 when the consumer price index increased by 18.5% while the boliviano was allowed to appreciate by only 8.6%.

	Consumer Price Index	Dollar/Boliviano Exchange Rate
Dec. 86 - Dec. 87	10.7%	14.9%
Dec. 87 - June 88	10.9%	8.1%
June 88 - Sep. 88	6.8%	0.4%
Dec. 87 - Sep. 88	18.5%	8.6%

The explanation for the poor 1988 performance so far appears to be twofold: i) the acceleration of the inflation rate in 1988 caused the government to look at all sources of the problem, including the slippage of the boliviano in the auction market, which had an immediate impact on the price level owing to the agreed IMF policy of linking the domestic price of gasoline to the exchange rate; ii) this being an election year, the ex-Minister of Planning (who is also the present government's candidate for President) has a particular stake in maintaining price stability.

c) In the area of financial reform, the GOB will agree to continue implementation of the financial reform measures and regulations incorporated in the Economic Reactivation Decree No. 21660 (including a number of rules governing the ratio of deposit liabilities to paid-in capital, the filing of monthly reports with the Superintendency of Banks, provision of adequate reserves against loans in arrears, increasing the bank's capital requirements, and prohibiting banks from lending an amount exceeding 20% of their net worth to any particular borrower).

Supervisory machinery to enforce these rules was set up in the July 1987 Economic Reactivation Decree. It consisted mainly of a Superintendency of Banks to which the World Bank is providing technical assistance and operational support. The Superintendency started operations in March 1988. It has immediately requested an outside audit (by foreign firms) of all banks. This audit was carried out by Coopers & Lybrand, Price Waterhouse and Horwath & Horwath. This audit was completed at the end of October, 1988. It was found that most banks were not in full compliance with the various banking rules specified in the Economic Reactivation Decree. In particular, the requirement to increase the bank's capitalization was met in most cases through a unilateral revaluation of fixed assets, a procedure the Superintendence is most likely to reject. However, it should be borne in mind that deficiencies in commercial bank operations have been going on for many years and were seriously aggravated by the recent hyperinflation and concurrent depression. These deficiencies cannot be remedied in a few months.

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In sum: while the GOB is doing its best to remedy the deficiencies of the financial system, progress to date is limited. The problem will take some time to correct.

The USAID Mission has a $10 million project to help the deficiencies of the financial system, to improve their procedures and performance. AID's Strengthening Financial Markets Project provides funds to train bank staffs through seminars and technical assistance. While the USAID Mission concentrates on the private sector, the World Bank provides training, technical assistance and operating funds to the public sector. In addition, the USAID Mission will be monitoring periodically progress of the banks' performance and review audits and bank statements to determine which banks are sound enough to participate in Mission projects.

2. Covenants and Conditions Precedent for FY 1989

No quantitative targets for macroeconomic performance will be proposed here since a number of targets already were set in the Agreement negotiated with the IMF this summer and constitute the basis for the three-year SDR 136 million Enhanced Structural Adjustment Facility. In addition, the GOB has already adopted a number of policies designed to promote economic stabilization and set the basis for economic growth. The macroeconomic requirements included here call for maintaining a flexible exchange rate, as this policy is considered essential to the success of the Mission's export promotion project, for periodic GOB consultation (as needed) with the Mission on the status of the GOB stabilization /recovery program and provision of the macroeconomic guidelines the GOB will observe in implementing its economic program as well as a demonstration that they are in substantial compliance with those guidelines.

The conditionality set forth below assumes that $23.5 million will become available under this PAAD in FY-1989. It is anticipated that this amount will be made available in four equal tranches of $5.875 million each. The $23.5 million will be provided under two obligations of $11.75 million each, the first in December 1988; the second prior to July 31, 1989. The second obligation will be made only after the certification requirements of the FAA and Anti-Drug Abuse Act of 1988 are completed.

A. Conditions Precedent

1. First Tranche

Prior to the disbursement of the first tranche, the GOB will comply with the standard Conditions Precedent (legal opinion and authorized representatives), as well as with the following conditions: (1) establishment of a Separate Account and a Special Account for the deposit of the US dollar and boliviano proceeds of the grant, respectively; (2) provision of the procedures governing how the dollars and Bolivianos will be handled; (3) an amendment to the Trust Account Agreement dated June 6, 1986, as amended, providing that the equivalent of $2,500,000 in bolivianos and 10% of any subsequent obligations in

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excess of $23.5 million, will be made available by the GOB to the Trust Account to finance USAID's OE expenses, according to a deposit schedule provided by the Mission; and (4) provision to the USAID of a policy matrix, including the credit, fiscal policy, and international reserve guidelines that the GOB will seek to observe over the life of the agreement in implementing its stabilization and economic recovery program.

2. <u>Second Tranche</u>

Prior to disbursement of the second tranche, tentatively scheduled to be effected by April 30, 1989, the GOB will have eradicated 1,300 hectares of coca (counting from January 1, 1989). In addition, the total amount of ESF balance of payments assistance provided with FY-1987 and 1988 funds will have been disbursed by the Central Bank.

3. <u>Third Tranche</u>

Prior to disbursement of the third tranche to be effected on or before August 31, 1989, the GOB will have completed eradication of 3,000 hectares since January 1, 1989; and demonstrated that it is in substantial compliance with the guidelines for implementation of the GOB's economic program established prior to the first Tranche disbursement.

4. <u>Fourth Tranche</u>

Prior to disbursement of the fourth tranche, anticipated by or before December 31, 1989, the GOB will have eradicated the full 5,000 hectares projected for the first year following promulgation of Narcotics Control Law (Ley de Substancias Controladas y Regimen de la Coca); and will have fully disbursed the first tranche provided under this FY 1989 ESF Agreement.

B. <u>Covenants</u>

The following covenants will be contained in the agreement:

The Grantee shall give priority to the continuing implementation of its stabilization and reactivation program. The Grantee agreees to consult periodically and provide data to AID on the progress of the stabilization /recovery program, particularly with regard to the fiscal performance of the consolidated public sector.

The GOB will agree to maintain a flexible exchange rate: at a minimum the real value of the boliviano will not be allowed to increase in relation to the dollar during the period December 31, 1987 through December 31, 1989.

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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	47,742,011.0	276.3
87	54,702,174.8	14.6
88 */	61,500,000.0	19.7

		Annualized Quarterly Rate of Increase
Jun 85	6,023,641.8	
Sep 85	26,098,526.4	1,333.1
Dec 85	30,873,311.6	73.2
Mar 86	44,343,478.3	174.5
Jun 86	48,357,088.1	36.2
Sep 86	50,661,830.1	19.1
Dec 86	51,238,413.0	4.5
Mar 87	53,508,884.8	17.5
Jun 87	54,426,923.6	6.8
Sep 87	55,255,270.8	6.1
Dec 87	56,701,504.2	10.4
Mar 88	58,027,000.0	9.3
Jun 88	62,902,000.0	33.6
Sep 88	67,229,504.8	27.5

*/ USAID estimate.

Source: Instituto Nacional de Estadistica, Boletín Nacional, January 1988.

Table 2

BUDGET DEFICIT OF THE CONSOLIDATED PUBLIC SECTOR
(In Billions of Bolivian Pesos)

		Annual Rate of Increase
1982	57.2	
83	236.0	312.6
84	5,771.0	2,345.3
85	277,900.0	4,715.4
86	313,400.0	12.8
87 (Prel.)	643,600.0	105.4
88 (Prog.)	682,029.0	6.0

TABLE 2A

BUDGET DEFICIT OF CONSOLIDATED PUBLIC SECTOR AS % OF GDP

82	16.0
83	18.3
84	29.9
85	12.7
86	4.3
87	7.5 */
88	6.7 **/

*/ Preliminary.

**/ Projected IMF estimate.

Sources: IMF, IMF report on Bolivia - Recent Economic Developments July 19, 1988, Tables 12 and 40, P. 20 and 71, respectively.

Table 3

PUBLIC AND PRIVATE CREDIT OF THE FINANCIAL SYSTEM
(Balance Outstanding)
(Mill of $b.)

	CREDIT TO THE PUBLIC SECTOR (1)	RATE OF GROWTH	CREDIT TO THE PRIVATE SECTOR	RATE OF GROWTH	TOTAL CREDIT	RATE OF GROWTH
1981	43,297		23,358		66,655	
1982	241,541	457.9%	91,192	290.4%	332,733	399.2%
1983	725,583	200.4%	191,788	110.3%	917,371	175.7%
1984	13,115,122	1707.5%	2,624,024	1268.2%	15,739,146	1615.7%
1985	2,443,624,611	18532.1%	409,714,472	15514.0%	2,853,339,083	18028.9%
1986	2,673,092,600	9.4%	947,524,015	131.3%	3,620,616,615	26.9%
1987	3,239,026,683	21.2%	1,423,094,849	50.2%	4,662,121,532	28.8%
JUN87	2,951,859,158		1,274,636,494		4,226,495,652	
JUN88	3,500,375,418	18.6%	1,569,582,800	23.1%	5,069,958,218	20.0%

(1) On a gross basis - i.e. without deducting government deposits whose value was distorted by the devaluation.

SOURCE: Estadisticas Monetarias y Financieras No. 38 and unpublished documents, Central Bank of Bolivia.
SUMMARIZED BY: ECON/USAID
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Table 4

TOTAL LIQUIDITY AND ITS COMPONENTS

	1981	1982	1983	1984	1985	1986	1987	JUN1987	JUN1988
In nominal terms (In mill.of $b)									
M1	17,153	56,555	175,125	3,295,516	198,678,345	363,303,693	502,510,532	389,706,698	491,674,945
Currency	10,852	38,897	124,757	2,870,909	173,819,231	294,372,647	396,874,215	301,947,557	368,302,915
Demand Deposits	6,301	17,658	50,368	424,607	24,659,114	68,931,046	105,636,317	87,759,141	123,372,030
Rate of Growth M1		229.7%	209.7%	1781.8%	5928.7%	82.9%	38.3%		26.2%
Quasi-Money	14,466	42,612	92,282	708,184	94,390,948	463,495,279	719,420,736	676,300,512	829,695,003
Local Currency	9,141	40,544	90,060	679,801	57,299,821	168,915,736	152,005,466	154,544,431	119,748,209
Foreign Exchange(1)	5,325	2,068	2,222	28,383	37,091,127	294,579,543	567,415,270	521,756,081	709,946,794
M2=Total Liquidity	31,619	99,167	267,407	4,003,700	293,069,293	826,798,972	1,221,931,266	1,066,007,210	1,321,369,948
Rate of Growth M2		213.6%	169.7%	1397.2%	7220.0%	182.1%	47.8%		24.0%
In real terms (In $b)(2)									
M1	18,581,550	14,783,147	10,683,291	8,828,218	6,435,278	7,090,456	8,862,307	7,160,172	7,816,523
Currency	11,755,785	10,167,449	7,610,652	7,690,756	5,630,081	5,745,155	6,999,298	5,547,753	5,855,166
Demand Deposits	6,825,765	4,615,698	3,072,640	1,137,462	805,198	1,345,300	1,863,009	1,612,419	1,961,337
Rate of Growth M1		-20.4%	-27.7%	-17.4%	-27.1%	10.2%	25.0%		9.2
Quasi-money	15,670,417	11,138,538	5,629,527	1,897,124	3,057,364	9,045,855	12,687,749	12,425,827	13,190,28
Local Currency	9,902,288	10,597,965	5,494,003	1,821,090	1,855,966	3,296,662	2,680,778	2,839,481	1,903,72
Foreign Exchange(1)	5,768,129	540,573	135,524	76,034	1,201,398	5,749,193	10,006,971	9,586,347	11,286,55
M2=Total Liquidity	34,251,967	25,921,665	16,312,818	10,725,341	9,492,642	16,136,311	21,550,056	19,586,000	21,006,80
Rate of Growth M2		-24.3%	-37.1%	-34.3%	-11.5%	70.0%	33.6%		7.

(1)Adjusted official data by dividing through the official exchange rate
and multiplying it by the parallel exchange rate of the corresponding year or month.
(2)Deflated by the CPI for the month of December (June for 1988).

SOURCE: Estadisticas Monetarias y Financieras No. 37, Central Bank of Bolivia, and unpublished documents.
SUMMARIZED BY: ECON/USAID

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Table 5

DOLLAR VALUE OF DEPOSITS IN THE BANKING SYSTEM (1)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	JUN87	JUN88
TOTAL DEPOSITS	180.00	296.62	395.83	428.09	388.17	556.14	453.87	210.70	113.61	45.48	67.90	268.58	362.80	366.00	400.33
Demand Deposits (Local Curr.)	78.68	118.87	140.78	138.68	118.93	194.90	152.75	62.39	40.49	17.32	14.49	35.08	46.74	42.04	51.82
Time Deposits	101.32	177.75	255.05	289.41	269.24	361.24	301.12	148.31	73.12	28.16	53.41	233.50	316.06	323.96	348.51
-Local Currency	78.28	134.22	179.61	166.96	150.92	245.25	221.60	143.24	72.40	27.73	33.39	85.96	67.26	74.03	50.30
-Foreign Exchange	23.04	43.53	75.44	102.45	118.32	115.99	79.52	5.07	0.72	0.43	20.01	147.54	248.80	249.93	298.21
Rate of Growth (Tot.Dep.)		64.8%	33.4%	8.1%	-9.3%	43.3%	-18.4%	-53.6%	-46.1%	-60.0%	49.3%	295.6%	35.1%		9.4%

(1) As adjusted by the parallel exchange rate for the month of December (June for 1988).

SOURCE: Estadisticas Monetarias y Financieras, No. 38, BCB, unpublished documents.
SUMMARIZED BY: ECON/USAID
Loldeph

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Table 6

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

	Exports (FOB)	Imports (CIF)	Deficit on Current Account	Overall BOP Deficits
1982	828	578	176	- 456
83	755	589	- 138	- 491
84	724	492	- 128	- 128
85	623	552	- 282	- 312
86	550	674	- 349	- 236
87	473	776	- 444	- 367
88(e)	485	745	- 412	- 188
89(e)	556	819	- 437	- 200

Source: Central Bank of Bolivia, Boletín Estadístico No. 259 and unpublished documents.

Table 7

NON-TRADITIONAL EXPORTS
(Mill US$)

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986(1)	1987	PROJECTED 1986	1989(2)	1990(2)	1991(2)
Timber	8.21	7.69	9.58	16.90	23.85	12.74	9.92	4.93	3.14	4.35	15.08	22.90	15.00	20.00	25.00	30.00
Wood Products	1.70	0.99	2.92	4.36	8.83	5.52	4.71	2.29	2.92	1.44	5.11	8.22	8.50	12.00	14.00	16.00
Livestock	2.40	2.15	2.91	3.16	1.31	0.95	0.59	1.25	1.58	1.17	13.42	6.75	2.00	5.00	7.00	10.00
Coffee	13.12	17.18	16.71	19.82	20.64	15.82	15.77	13.07	6.56	13.94	13.28	11.48	15.00	18.00	20.00	22.00
Soybeans & Subproducts	0.00	0.00	0.00	2.80	6.91	5.33	8.02	4.69	2.29	5.33	19.45	18.29	15.00	20.00	24.00	27.50
Sugar & Subproducts	42.13	25.99	15.05	30.17	50.51	5.40	8.85	12.42	6.55	1.75	4.85	8.57	7.00	8.00	8.50	9.00
Brazil Nuts	2.58	2.68	5.16	2.81	2.77	2.72	2.90	1.65	2.22	1.47	3.54	6.88	5.00	6.00	7.50	9.50
Cacao & Subproducts	0.55	1.26	1.75	1.73	1.76	0.68	0.46	0.41	0.28	0.99	3.56	0.99	2.00	3.00	3.50	5.00
Leather & Subproducts	0.99	2.83	4.86	7.99	4.88	3.08	2.08	0.65	0.82	1.33	6.77	8.53	16.00	14.00	17.00	20.00
Rubber & Subproducts	2.35	2.23	2.08	1.06	4.79	3.44	4.12	2.73	0.73	0.52	3.76	1.85	2.00	3.00	4.00	5.00
Cotton & Subproducts	12.50	13.75	14.70	10.58	0.95	2.95	5.07	2.48	0.51	0.71	4.68	6.79	4.00	6.50	8.00	9.00
Trioxide Alloys	0.00	1.85	0.00	12.72	16.64	13.09	8.50	7.73	4.32	4.18	3.83	1.76	2.50	5.00	6.50	8.00
Others	3.86	10.43	20.48	12.83	19.39	27.37	16.58	2.82	1.91	0.96	6.55	7.06	7.00	10.00	12.00	15.00
TOTAL	90.39	89.03	96.20	126.93	163.23	99.09	87.57	57.57	33.83	38.16	103.88	110.07	101.00	130.50	156.50	186.00

(1) The sharp decline over 1981-85, followed by dramatic recovery in 1986, reflects the disruption caused by the hyperinflation in combination with a highly overvalued exchange rate, which all but eliminated all profit from legal exports during 1982-1985.

(2) Mission estimates, assuming the GOB executes economic policies favorable to the promotion of exports including a flexible real exchange rate, an effective tariff refund certificate (CRA) on inputs used by export industries, credit, and technical assistance for the export sector.

SOURCE: DICOMEX, Ministry of Industry and Commerce.
SUMMARIZED BY: USAID/B
expntra2

Table 8

Official and Parallel Exchange Rates

Year/Months	Official */ Exchange Rate (b/US)	Parallel */ Exchange Rate (b/US)
1980	24.51	24.51
1981	24.51	31.49
1982	129.61	178.00
1983	247.00	695.00
1984	2,791.67	8,203.00
Mar 85	50,000.00	126,451.00
Jun 85	75,000.00	470,330.00
Sep 85	1,077,887.00	1,065,166.00
Dec 85	1,588,613.00	1,724,193.00
Mar 86	1,866,762.00	1,965,484.00
Jun 86	1,904,857.00	1,944,300.00
Sep 86	1,915,090.00	1,924,067.00
Dec 86	1,924,000.00	1,952,903.00
Mar 87**/	2,000,600.00	1,993,200.00
Jun 87	2,070,000.00	2,087,600.00
Sep 87	2,110,000.00	2,133,000.00
Dec 87	2,210,000.00	2,226,800.00
Mar 88	2,290,000.00	2,283,500.00
Jun 88	2,390,000.00	2,380,700.00
Sep 88	2,400,000.00	2,410,000.00
Dec 88		

*/ 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.

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Table 9

CONSOLIDATED NATIONAL BUDGET

(In Thousands of Bs)

	1980	1984	1985	1986	1987(pr)	1988(pl)
CURRENT ACCOUNT SURPLUS (DEFICIT)	(2.731)	(4,933.0)	(204,500.0)	(51,800.0)	(213,900.0)	10,179.5
Capital Revenues	0.428	58.0	6,400.0	87,000.0	85,200.0	101,795.4
Capital Expenditures	8.859	896.0	79,800.0	348,600.0	514,900.0	794,004.2
CAPITAL ACCOUNT SURPLUS (DEFICIT)	(8.431)	(838.0)	(73,400.0)	(261,600.0)	(429,700.0)	(692,208.8)
TOTAL SURPLUS (DEFICIT)	(11.162)	(5,771.0)	(277,900.0)	(313,400.0)	(643,600.0)	(682,029.3)
Financing	11.162	5,771.0	277,900.0	313,400.0	643,600.0	682,029.3
External (net)	6.040	867.0	90,400.0	399,700.0	368,100.0	794,004.2
Internal (net)	4.867	4,904.0	187,500.0	(86,300.0)	275,500.0	(111,974.9)
Banking System (net)	-	4,904.0	187,600.0	(248,600.0)	142,200.0	n.a.
Other (net)	-	-	(100.0)	162,300.0	133,300.0	n.a.
Short-Term External Credit	0.255	0.0	0.0	0.0	0.0	n.a.

n.a. Not Available
(pr) preliminary
(pl) planned

SOURCE: For 1980, Ministry of Finance. For 1984-88, IMF, Recent Economic Developments, July 19,1988, Table 40 and other IMF unpublished documents.
SUMMARIZED BY: ECON/USAID
cobu8088

Table 10

CONSOLIDATED NATIONAL BUDGET (As % of GDP)	1980	1984	1985	1986	1987(pr)	1988(pl)
CURRENT ACCOUNT SURPLUS (DEFICIT)	-2.2	-25.6	-10.1	-0.7	-3.1	0.1
Capital Revenues	0.3	0.3	0.3	1.1	1.0	1.0
Capital Expenditures	7.1	4.6	3.5	4.8	6.1	7.8
CAPITAL ACCOUNT SURPLUS (DEFICIT)	-6.8	-4.3	-3.2	-3.7	-5.1	-6.8
TOTAL SURPLUS (DEFICIT)	-9.0	-29.9	-12.7	-4.3	-7.5	-6.7
Financing	9.0	29.9	12.7	4.3	7.5	6.7
External (net)	5.0	4.5	4.1	5.5	4.3	7.8
Internal (net)	4.0	25.4	8.6	-1.2	3.2	-1.1

(pr) preliminary
(pl) planned

SOURCE: For 1980, Ministry of Finance. For 1984-88, IMF, Recent Economic Developments, July 19,1988, Table 40 and other IMF unpublished documents.
SUMMARIZED BY: ECON/USAID
cobu8088

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Table 11

CENTRAL ADMINISTRATION OPERATIONS*
(Mill of $b.)

	1980	1984	85/84	1985	86/85	1986	87/86	1987	88/87	1988(pl)
CURRENT REVENUE	11,669	559,865	36652.6%	205,764,731	310.4%	844,536,839	21.6%	1,026,877,865	44.7%	1,485,523,174
Internal Revenue	3,843	149,187		22,146,488		137,111,764		274,747,295		508,145,000 (5)
Customs Revenue	2,564	122,881		22,676,488		101,224,558		145,982,664		179,652,500
Hidrocarbons Royalty Tax	1,854	78,501		140,462,248		522,153,369		505,520,837		707,896,244
Public Sector Transfers	-	-		-		-		56,594,892		28,560,000
Other Revenue	3,408	209,296 (1)		20,479,507 (2)		84,047,148 (3)		44,032,177 (4)		61,269,430
CURRENT EXPENDITURES	19,691	7,142,466	19274.3%	1.383,805,490	-50.2%	688.461,962	53.7%	1,058,366,029	40.4%	1,485,523,174
Wages and Salaries	9,230	1,723,466		144,772,921		324,138,195		511,489,133		654,178,521
Purchases of Goods & Services	3,611	380,253		216,843,572		186,813,327		233,095,527		301,039,448
Payment of Debt Owed to Reg. Governments	1,768	80,905		13,255,132		16.393,459		6,996,881		34,820,971
External Debt Service	2,607	479,943		439,414,277		96,130,336		137,451,243		207,423,461 (6)
Transfers to Pub.Sector Enterprises	493	4,464,301		566,513,515		244,721		70,639,066		123,801,140
Other Expenditures (7)	1,982	13,598		1,006,073		64,741,924		98,694,179		164,259,633
CURRENT ACCOUNT SURPLUS (DEFICIT)	(8,022)	(6,582,601)		(1,178,040,759)		156,074,877		(31,488,164)		0

* On a cash basis.
(pl)Planned budget.

(1) Includes mainly mining royalty tax revenue and revenue taxes from the sale of foreign exchange.
(2) Includes mainly mining royalty tax revenue.
(3) Includes mainly an extraordinary one-time tax on all net worth, business ans personal and asset revaluations.
(4) Includes the implementation of the new "value added tax" since April.
(5) Estimate higher collections owing mainly to a full year application of the "value added tax" and the new sales tax on gasoline.
(6) Includes state enterprises' subrogated debt transfered to the Central Goverment by decree 21660.
(7) Includes pensions.

SOURCE: Ministry of Finance and UDAPE.
SUMMARIZED BY ECON/USAID
tgn8488

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Table 12

CENTRAL ADMINISTRATION OPERATIONS*
(AS % OF GDP)

	1981	1982	1983	1984	1985	1986	1987 (pr)
TOTAL REVENUE	11.8	6.2	8.3	3.2	9.0	14.8	14.2
Current Revenue	11.8	5.7	3.7	3.1	8.9	14.8	14.2
Tax Revenue	8.9	4.9	2.8	2.9	8.6	14.4	14.0
Nontax Revenue	2.8	0.8	0.8	0.2	0.3	0.4	0.2
Capital Revenue and Grants	-	0.5	4.6	0.1	0.1	-	-
TOTAL EXPENDITURE	19.2	21.3	26.6	23.7	17.7	17.7	19.3
Current Expenditure	16.1	19.4	24.7	22.3	15.8	16.6	18.6
Capital Expenditure	3.1	1.9	1.9	1.4	1.9	1.1	0.7
OVERALL SURPLUS OR DEFICIT (-)	-7.4	-15.2	-19.3	-20.5	-8.8	-2.9	-5.1
FINANCING	7.4	15.2	18.3	20.5	8.8	2.9	5.1
External	4.1	0.7	0.1	0.1	2.8	5.2	3.5
Internal	3.3	14.5	18.2	20.4	6.0	-2.3	1.6

* On an obligation basis.
pr = preliminary

SOURCE: Bolivia - Recent Economic Developments, Document of the IMF, Table 12, Pg. 23, December 2, 1986 and Table 13, Pg. 21, July 19, 1988.
tgngdp87

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Table 13

NET INTERNATIONAL RESERVES OF THE BANKING SYSTEM (In Millions of US$)	1980	1981	1982	1983	1984	1985	1986	1987 (pr)
Central Bank	-96.5	-255.3	-328.5	-40.0	107.5	136.2	246.6	168.4
Deposit Money Bank	-29.1	-52.9	-72.1	-50.8	-62.9	-63.6	-54.7	-39.9
Specialized Banks	-2.1	-2.2	-1.6	-9.0	5.0	5.8	2.5	4.2
Banking System	-127.7	-310.4	-402.2	-99.8	49.6	78.4	194.4	132.7

pr = preliminary

SOURCE: Bolivia - Recent Economic Developments, Document of the IMF, Table 45, Pg. 96, December 2, 1986 and Table 25, Pg. 46, July 19, 1988.
nirbk887

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Table 14

PRELIMINARY ECONOMIC GROWTH INDICATORS FOR 1988

	JAN-APR 1987	JAN-APR 1988	PERCENT CHANGE
Manufacturing (1) (Base 1978=100)	54	60	11.1%
Petroleum (Thou. barrels)	2217	2295	3.5%
Natural Gas (Thou. cubic feet)	53597	54692	2.0%
Energy (Thou. KWH)	462	514	11.3%
Cement Prod. (Thou. M.T.)	79	91	15.2%

(1) Data for the first semester of 1987 and 1988.

SOURCES: Instituto Nacional de Estadisticas.
UDAPE, based on information provided by (the state oil company), DINE (the state electricity company and the IMF.

gro88

Table 15

PUBLIC INVESTMENT PROGRAM 1987-1992

(Mill of US$)

	A Prog. 1987	B Actual 1987	C Actual/ Prog.	Preliminary(1) D Prog. 1988	E Prog. 1989	F Prog. 1990
Transportation	178.7	83.7	46.8%	100.8	138.5	86.0
Hydrocarbons	151.0	87.9	58.2%	106.4	160.4	152.3
Agriculture	70.5	25.7	36.5%	21.3	49.6	28.2
Communication	34.6	14.6	42.2%	13.5	14.9	14.2
Sanitation	29.3	8.6	29.4%	13.3	13.8	9.3
Energy	17.8	12.8	71.9%	45.1	20.7	6.3
Mining	15.7	1.4	8.9%	15.5	4.2	1.3
Education	13.0	1.2	9.2%	0.4	0.5	0.4
Health	10.3	5.3	51.5%	4.5	2.0	0.5
Industry	9.1	3.0	33.0%	0.1	8.5	1.0
Others	42.0	6.5	15.5%	32.7	18.6	13.9
	572.0	250.7	43.8%	353.6	431.7	313.4

(1) From 1988-1990, programmed investment includes only projects with assured financing.

SOURCE: World Bank, Bolivia: A Review of the Public Investment Program and Financing Requierements, 1987-1990, June 1, 1988.

puin8890

Table 16

DEBT SERVICE PAYMENTS IN 1987, 1988 AND 1989

(In millions of US Dollars)

	1987	1988	1989
Interest Paid or to be Paid	133.1	229.9	258.6
Interest not Paid (1)	119.9	45.7	33.4
Total Interest	253.0	275.6	292.0
Amortization Paid or to be Paid	76.6	64.9	92.0
Amortization not Paid (1)	203.9	96.3	78.0
Total Amortization	280.5	161.2	170.0
Total Debt Service to be Paid	209.7	294.8	350.6
Total Debt Service that was (& hopefully) will be rescheduled	323.8	142.0	111.4
Total Debt Service Theoretically Due	533.5	436.8	462
Exports of Goods and Services	601.9	615.7	685.0
Total Debt Service as % of exports of goods and services			
Before Rescheduling	88.6%	70.9%	67.4%
After Rescheduling	34.8%	47.9%	51.2%

(1) Includes amounts previously rescheduled at Paris Club meetings as well as those that the GOB hopes to reschedule in 1988 and 1989.

SOURCE: USAID/Bolivia estimates based on Central Bank of Bolivia data.
debtserv

Table 17

BOLIVIA: SUMMARY OF BALANCE OF PAYMENTS FOR 1980 - 1989
(In millions of US$.)

	1980	1981	1982	1983	1984	1985(p)	1986(p)	1987(p)	1988(e)	1989 USAID(e)	1989 IMF(f)
I. CURRENT ACCOUNT (A+B)	-7.3	-465.7	-175.8	-138.1	-127.8	-281.9	-349.5	-444.4	-412.3	-437.1	-487.0
A. Goods, Services, and Interest (1+2+3)	-66.8	-505.3	-221.3	-244.3	-216.3	-361.9	-448.5	-570.1	-548.9	-575.1	-625.0
1. Merchandise	263.8	-63.0	250.2	166.0	232.9	71.5	-124.1	-303.4	-259.7	-263.2	-307.0
Exports FOB	942.2	912.4	827.7	755.1	724.5	623.4	549.9	472.6	485.0 (1)	556.0 (2)	621.0
Imports CIF	-678.4	-975.4	-577.5	-589.1	-491.6	-551.9	-674.0	-776.0	-744.7	-819.2 (3)	-928.0
2. Services	-63.8	-78.9	-57.7	-48.0	-80.2	-60.0	-10.3	-18.1	-18.0	-16.1	0.0
Exports	89.3	94.2	83.5	104.5	95.0	98.0	156.1	129.3	130.7	129.0	n.a.
Imports	-153.1	-173.1	-141.2	-152.5	-175.2	-158.0	-166.4	-147.4	-148.7	-145.1	n.a.
3. Earnings from Interest	-266.8	-363.4	-413.8	-362.3	-369.0	-373.4	-314.1	-248.6	-271.2	-295.8	-318.0 (4)
i) Received	14.2	15.0	7.2	39.4	28.5	16.0	23.4	18.5	15.8	18.2	n.a.
ii) Due	-281.0	-378.4	-421.0	-401.7	-397.5	-389.4	-337.5	-267.1	-287.0 (5)	-314.0 (5)	n.a.
- Interest Paid on Medium and Long Term External Public Debt	-163.8	-186.2	-177.3	-228.5	-189.6	-68.8	-65.0	-85.6	-172.8 (5)	-155.6 (5)	n.a.
- Other Interest Paid	-97.7	-145.0	-135.6	-87.8	-102.5	-73.8	-62.9	-47.5	-57.1	-103.0	n.a.
- Interest not Paid	-4.5	-17.2	-84.6	-25.6	-69.2	-174.0	-170.4	-119.9	-45.7 (5)	-33.4 (5)	n.a.
- Other Income	-15.0	-30.0	-23.5	-59.8	-36.2	-52.8	-39.2	-14.1	-11.4	-22.0	n.a.
B. Unilateral Transfers	59.5	39.6	45.5	106.2	88.5	80.0	99.0	125.7	136.6 (6)	138.0 (6)	138.0 (6)
II. CAPITAL ACCOUNT	47.6	55.0	-324.0	-469.2	5.2	-210.3	1.5	17.4	154.0	237.0	311.0
A. Direct Investment	43.9	75.6	31.0	6.9	7.0	10.0	12.6	22.0	35.0	35.0	35.0
B. Other Capital	3.7	-20.6	-355.0	-476.1	-1.8	-220.3	-11.1	-4.6	119.0	202.0	276.0
i) Medium and Long-Term Capital	48.9	68.3	-207.5	-362.2	-182.3	-244.8	-118.4	-83.6	89.0	118.0	192.0
- Disbursements on Medium and Long-Term External Public Debt	265.3	326.9	210.9	97.9	159.8	108.7	230.1	207.9	270.0 (1)	310.0 (7)	321.0
- Amortizations Paid on Medium and Long-Term External Public Debt	-126.3	-108.8	-121.0	-101.4	-141.9	-159.3	-120.2	-76.6	-64.9 (8)	-92.0	-127.0
- Amortizations not Paid	-59.4	-140.4	-267.8	-353.1	-192.4	-184.7	-204.1	-203.9	-96.3 (8)	-78.0	
- Other Capital (Net)	-30.7	-9.4	-29.6	-5.6	-7.8	-9.5	-24.2	-11.0	-19.8	-22.0	-2.0
ii) Short-Term Capital (Net)(9)	-45.2	-88.9	-147.5	-113.9	180.5	24.5	107.3	79.0	30.0	84.0	84.0
III. ERRORS AND OMISSIONS(9)	-404.5	-196.4	43.4	116.7	-5.1	180.5	112.0	60.3	67.8		
IV. TOTAL CURRENT TRANSACTIONS AND CAPITAL MOVEMENT (I+II+III)	-364.2	-607.1	-456.4	-490.6	-127.7	-311.7	-236.0	-366.7	-188.5	-200.1	-176.0

BOLIVIA: SUMMARY OF BALANCE OF PAYMENTS FOR 1980 - 1989
(In millions of US$.)

	1980	1981	1982	1983	1984	1985(p)	1986(p)	1967(p)	1988(e)	1989 USAID(e)	1989 IMF(f)
A. COUNTERPART ITEMS	8.6	9.1	1.9	0.9	0.9	9.9	0.0	0.0	0.0	0.0	0.0
B. EXTRAORDINARY FINANCING	388.9	425.7	352.4	788.4	261.6	358.7	346.4 (10	288.5	162.0 (11)	111.0 (12	111.0 (12)
C. NET INTERNATIONAL RESERVES (Increase = -)	-33.3	172.3	102.1	-298.7	-134.8	-56.9	-110.4	78.2	26.5	89.1	65.0

n.a. Not Available
(p) Preliminary.
(e) Estimated by Central Bank and USAID.
(f) Estimated by the IMF.

(1) Based on Central Bank's estimate. Exports for 1988 were adjusted based on first semester performance.
(2) USAID/Bolivia and Central Bank estimate based on independent projections for minerals, natural gas and non-traditional exports.
(3) USAID/Bolivia and Central Bank estimate based on a 5% annual world inflation rate and an expected 4-5% real economic growth.
(4) As estimated by the IMF. Assumes that bank claims that remain outstanding after the buyback are rescheduled on terms similar to the buyback.
(5) Includes all interest payments falling due, including those that were rescheduled in Paris I.
(6) Excludes ESF balance of payments assistance for 1988, 1989 and 1990.
(7) USAID/Bolivia and Central Bank estimate based on recent GOB performance on absorbing capital inflows.
(8) Includes only Paris I renegotiation which reduced amortizations due (both paid and unpaid).
(9) Includes and informal sector earnings.
(10) Includes US$ 100 million credit from FAR (Fondo Andino de Reservas).
(11) Includes expected Paris I and Paris II debt rescheduling and net arrearage payments from Argentina. From an estimated gross payment from Argentina of approximately US$ 70 million, only US$ 34.6 million are included as an inflow as the remainder is transferred directly to Occidental and Tesoro to settle the GOB's debt to these companies.
(12) Includes potential debt relief on debt not previously rescheduled and assuming terms similar to those of the 1986 Paris Club rescheduling.

SOURCE: For 1980-1987, Central Bank of Bolivia.
For 1988 and 1989, Central Bank of Bolivia and USAID own estimates.
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Table 18

GROSS DOMESTIC PRODUCT BY ECONOMIC ACTIVITY
(In Millions of Constant 19 0 Bolivian Pesos)

ECONOMIC ACTIVITY	1980	1981	1982	1983(p)	1984(p)	1985(p)	1986(p)	1987(e)
A. INDUSTRIES	106,050	106,450	103,133	94,971	94,420	93,161	90,600	91,979
1. Agriculture, Forestry & Fishing	22,563	22,354	23,900	19,981	24,552	26,789	25,534	25,489
-Agricultural Products	15,727	17,257	18,408	14,506	19,101	21,088	20,031	19,874
-Animal Products	5,893	4,216	4,850	4,814	4,796	5,046	4,829	4,925
-Forestry & Fishing	943	881	642	661	655	655	674	690
2. Mining & Quarry Production	19,407	20,139	19,526	18,614	16,335	14,284	12,062	11,013
-Crude Oil & Natural Gas	6,728	7,072	7,476	6,838	6,869	6,735	6,468	6,618
-Metallic & Non-Metallic Minerals	12,679	13,067	12,050	11,776	9,466	7,549	5,594	4,395
3. Manufacturing	17,974	16,581	14,531	13,863	11,925	10,815	11,038	11,837
4. Electricity, Gas & Water	806	907	930	938	938	948	987	981
5. Construction & Public Works	4,521	4,058	3,698	3,639	3,555	3,168	2,918	3,080
6. Commerce	13,261	14,418	13,464	11,796	11,652	12,110	12,895	13,805
7. Transportation, Storage & Communications	7,321	8,174	7,799	7,059	7,204	7,337	7,557	8,008
8. Financial Establishments, Insurance, Real Estate, & Services to Companies	17,248	16,829	16,308	15,964	15,454	15,102	14,972	15,179
-Financial Services to Companies	7,189	6,704	6,126	5,629	5,068	4,716	4,480	4,584
-Housing	10,059	10,125	10,182	10,335	10,386	10,326	10,492	10,595
9. Social & Personal Services	4,881	4,857	4,710	4,710	4,239	3,942	3,904	3,883
-Banking Services (Imputed)	(1,932)	(1,867)	(1,733)	(1,593)	(1,434)	(1,334)	(1,267)	(1,296)
B. PUBLIC ADMINISTRATION SERVICES	12,940	13,193	13,749	14,836	15,149	15,643	14,646	15,056
C. DOMESTIC SERVICES	668	687	702	709	710	714	719	726
TOTAL: At Producer Prices	119,658	120,330	117,584	110,516	110,279	109,518	105,965	107,761
Indirect Taxes on Imports	3,288	3,753	1,090	427	332	927	1,246	1,763
TOTAL: At Prices to End Users	122,946	124,083	118,674	110,943	110,611	110,445	107,211	109,524
GDP % GROWTH RATE		0.9%	-4.4%	-6.5%	-0.3%	-0.2%	-2.9%	2.2%

(p) Preliminary.
(e) Estimated.

SOURCE: 1980-1982: Central Bank of Bolivia, National Accounts Department.
1983-1987: National Institute of Statistics.