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

BOLIVIA

PROJECT PAPER

BALANCE OF PAYMENTS
PAAD

AID/LAC/P-295

Loan Number: 511-K-601
Project Number: 511-0570

UNCLASSIFIED

CLASSIFICATION:

AID 1120-1 PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT
1. PAAD NO.	511-0570 511-K-601
2. COUNTRY	Bolivia
3. CATEGORY	Cash Transfer
4. DATE	January , 1986
5. TO:	AA/LAC, Dwight Ink
6. OYB CHANGE NO.	
7. FROM	LAC/DR, Terrence J. Brown
8. OYB INCREASE	
TO BE TAKEN FROM:	
9. APPROVAL REQUESTED FOR COMMITMENT OF:	$ 7,177,000
10. APPROPRIATION -	BPC: LESA-86-35511-KG31 (037-65-511-00-50-61)
11. TYPE FUNDING	☐ LOAN ☒ GRANT
12. LOCAL CURRENCY ARRANGEMENT	☐ INFORMAL ☒ FORMAL ☐ NONE
13. ESTIMATED DELIVERY PERIOD	FY 1986
14. TRANSACTION ELIGIBILITY DATE	Date of Authorization
15. COMMODITIES FINANCED	N/A

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: $7,177,000
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: $7,177,000	Other:

18. SUMMARY DESCRIPTION

The purpose of this Program is to provide balance-of-payments assistance to the Government of Bolivia (GOB) in support of its economic reforms. The ESF program is part of the package of assistance which also includes PL-480 Title I and Title III and the Agro-industrial Reactivation component of the FY 1985 Disaster Recovery project. This assistance has been conditioned on GOB taking broad economic reforms and on progress in coca control.

This $7,177,000 grant is the first tranche of a $14.355 million FY 1986 ESF program which will be obligated in two tranches. It will be disbursed as a cash transfer into a U.S. bank account of the GOB. Within six months after disbursement of the assistance, the GOB will deposit into a special account an equivalent amount of Bolivian pesos to be used for mutually agreed development purposes consistent with the general criteria of the Foreign Assistance Act, especially Sections 103-106.

The GOB will agree to make available an equivalent amount of dollars to the private sector for imports of raw materials and intermediate goods from the U.S. within twelve months following each disbursement.

19. CLEARANCES		DATE
LAC/SA:FAlmaguer		11/22/85
LAC/DR:ILevy		
LAC/DP:WWheeler		1/13/86
FM/PAD:CChristensen		1/15/86
GC/LAC:GDavidson		1/27/86
ARA/EC F.R Beckham		1/2/86
DAA/LAC:MButler		

20. ACTION

☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE — DATE

(Acting)
Assistant Administrator (LAC)

TITLE

CLASSIFICATION:

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CHARTS AND TABLES

ACCRONYMS

ADN	–	Acción Democrática Nacionalista (political party of General Banzer)
BCB	–	Central Bank of Bolivia
CBF	–	Corporación Boliviana de Fomento (State holding company)
COB	–	Central Obrera Boliviana (Bolivian Workers Confederation)
COMIBOL	–	Corporación Minera de Bolivia (State Mining Company)
ENTEL	–	Empresa Nacional de Telecomunicaciones (State Telecommunications Company)
GOB	–	Government of Bolivia
IDB	–	Inter-American Development Bank
LAB	–	Lloyd Aereo Boliviano (State airline)
MNR(H)	–	Movimiento Nacionalista Revolucionario (Histórico) (Political party of Paz Estenssoro)
OPIC	–	Overseas Private Investment Corporation
UDP	–	Unidad Democrática Popular (political coalition of ex-President Siles)
YPFB	–	Yacimientos Petrolíferos Fiscales Bolivianos (State petroleum company)

PAAD

I. SUMMARY AND RECOMMENDATIONS

On August 29, 1985, the newly elected Government of Victor Paz Estenssoro enacted far-reaching economic measures designed to halt Bolivia's hyperinflation, provide free-market incentives for the reactivation of domestic production, eliminate price distortions in the economy, restructure state enterprises, and provide the economic basis upon which the Government would be able to govern the country. The sweeping measures decreed by the GOB devalued the peso by 93.2% and implemented a flexible exchange rate mechanism to allow the peso to be adjusted in accordance with market forces, eliminated all price controls (except those on petroleum products - which were raised to world price levels - and utility services), froze public sector salaries, provided for free negotiation of private sector wages, eliminated interest rate controls, and provided for the decentralization of Bolivia's main state enterprises (COMIBOL - the state mining company, YPFB - the state petroleum company, and CBF - the state conglomerate).

The measures were bold, comprehensive, and farther reaching than had been expected or believed politically possible. The new stabilization program followed almost three years of chaotic conditions under the Government of Hernan Siles Zuazo, during which economic activity declined dramatically and Bolivia's experiment with democracy was severely threatened. By 1984, the fiscal deficit had increased to 28.1% of GDP. In the twelve months ending in August 1985, inflation had accelerated to a rate of more than 20,000 percent - the highest in the world. When Paz Estenssoro was sworn in as President, the survival of democracy in Bolivia depended on the willingness and ability of his Government to devise drastic economic measures and implement them tenaciously.

The Paz Administration has successfully begun implementing its stabilization program and reestablishing the political authority of the Government and the confidence of the Bolivian people. Although much remains to be done to implement the details of the stabilization program, USAID's analysis indicates that it will achieve a major reduction in the fiscal deficit, reduce the need for large scale monetary emissions and, consequently, lower the rate of inflation and stimulate recovery in the balance of payments. The program paves the way for a more rational allocation of domestic resources and more equitable growth through the activities of an unencumbered private sector and more efficient public enterprises. While it will reinforce the democratic process in Bolivia, the program does require painful adjustments in an economy which has been dominated by Government intervention.

The GOB's program is fully consistent with U.S. foreign policy interests in Bolivia, and it deserves full USG support. Without this support, the dangers of the stabilization program not succeeding, the Paz Government falling, and the democratic process in Bolivia being interrupted become substantial. If this were to happen, the prospects for meeting other USG policy objectives, such as coca control, would be severely compromised.

The grant ESF balance-of-payments assistance request in this PAAD is part of a package of additional assistance, including PL 480 Title I and Title III and an agro-industrial reactivation program, which USAID assembled during FY 1985 and conditioned on the taking of comprehensive economic measures and progress in coca control. This assistance package will provide critical USG support to the GOB's stabilization program, serve as a catalyst in attracting additional assistance from other bilateral and multilateral sources, and create the conditions under which USG policy objectives (the consolidation of Bolivian democracy, economic recovery,and narcotics control/coca reduction) can be attained.

Under the ESF program, two grant cash transfer tranches will be made to the GOB. $7.177 million will be authorized, obligated and disbursed as soon as possible in response to the GOB's August 29 economic measures.* The remaining portion of the FY 1986 ESF assistance will be authorized, obligated and disbursed when the GOB meets the coca reduction conditions established for FY 1986 by the U.S. Conngress. It is important that the requested ESF balance-of-payments assistance be provided in grant form given Bolvia's serious debt situation. Local currency generated under the program will be deposited in a special account for specific uses in support of the stabilization program to be agreed upon between the GOB and USAID/Bolivia.

USAID/Bolivia recommends that the $14,355,000 ESF balance-of-payments program requested herein be approved immediately, and that consideration be given to increasing ESF levels for Bolivia in FY 1986, (a) in response to the GOB's future performance in meeting mutually agreed upon coca control and reduction goals, and (b) in view of Bolivia's economic need and the contribution the GOB's stabilization program will make to the attainment of USG foreign policy goals in Bolivia. The purpose of this ESF program is to support the continuation of sound economic policies during the critical initial period of the Paz Administratoin. The ESF program will help Bolivia reduce its balance-of-payments gap, stimulate a higher rate of growth, encourage the Paz Government to maintain its market-led development policies, negotiate and conform to an IMF standby program, and help cushion the social and political disruptions and pressures that are expected as a result of the implementation of the economic package.

* The ESF level programmed for Bolivia in FY 1986 is $15,000,000. $14,355,000 is the amount potentially available for obligation after Gramm-Rudman-Hollings reductions have been taken into account. $7,177,000 is half of the amount potentially available.

In U.S. Mission discussions with Bolivia's leading political groups, it is clear that many of them will be looking to the USG for policy input and financial commitments that demonstrate our support for Bolivia's democratic process and its economic recovery program. If the USG is correctly positioned early on in the Paz Administration via the proposed ESF project, there will be important opportunities for breakthroughs in other areas of interest to the USG. The Mission therefore recommends the immediate approval of the proposed ESF program and the release of the first FY 1985 ESF disbursement.

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II. BACKGROUND

A. Recent Political History

Historically, Bolivia has been one of the world's most politically unstable countries. Since its independence in 1825, it has had 174 presidents, each with an average term of less than one year. Bolivia's chronic political instability has cultural and social roots. This instability is the primary reason why Bolivia, which is rich in natural resources and possesses impressive economic development potential, is the poorest country in South America.

The Revolution of 1952 brought significant changes to Bolivian society and paved the way for a more democratic society through the institution of universal sufferage and agrarian reform. Unfortunately, the Revolution's promise of a more prosperous society has yet to be realized. Two basic reasons for this are (a) the nationalization of much of the country's productive enterprises and (b) the failure of the Bolivian populace and its political leaders to develop truly democratic practices and institutions necessary to the functioning of a modern state and improving the standard of living.

Despite these basic obstacles, Bolivia prospered during much of the 1970's. Relative political stability was provided during the 1971-78 military rule of General Hugo Banzer Suarez. World prices for Bolivia's mineral exports, primarily tin, were high. Higher petroleum prices fostered interest in oil exploration, and private international banks were very willing to lend Bolivia money. Unfortunately, much of this borrowed money was used to finance current government expenditures and investment in new state enterprises, which were not well run. By the late 1970's, fiscal reforms had not been enacted, bloated state enterprises were operating with growing deficits, petroleum exploration had been less successful than anticipated, export earnings had declined, and Bolivia's debt service burden had grown considerably.

In an attempt to return the country to democracy, elections were held in 1979, but none of the candidates obtained a clear majority. In the elections of 1980, Hernan Siles Zuazo and his Popular Democratic Union (UDP) coalition won a plurality of votes. Siles would have been elected president by Congress but for the military coup led by General Luis García Meza Tejada in July 1980.

The García Meza coup was harsh. Congress was suspended; political party activities were outlawed; and unions were brutally shut down. The García Meza Government openly engaged in cocaine trafficking, and relations with it were sharply restricted by the United States and other western democracies. During the 1980-81 period, the economy began to deteriorate more rapidly. Already 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. Nothing was done to adjust the over-valued peso. Contraband imports flourished, damaging domestic producers and wasting valuable foreign exchange.

García Meza resigned in August 1981. He was followed by two somewhat more benign military presidents who began to concentrate on Bolivia's economic problems. These regimes improved relations with the western democracies, but could not command public support for the economic measures they tried to take. Public reaction to the set of rather comprehensive and generally appropriate measures announced by the Vildoso Government in June 1982 was so hostile that the military reconvened the 1980 Congress and turned over rule to a civilian government headed by Hernán Siles Zuazo, who took office on October 10, 1982.

The Siles Government, which lasted until August 1985, was characterized by weakness and vacillation, especially on the economic front. Three factors contributed to its inability to come to terms with the politically sensitive economic problems facing the country. The first was political divisiveness within Siles' coalition and indecisive leadership by Siles himself. The party leaders participating in the coalition Government ranged from dedicated communists to slightly left-of-center, western-oriented liberals. Siles' leadership style of hoping passively for consensus to evolve never worked and led to eight major cabinet shuffles during his term.

The second factor was the political instability resulting from difficulties involved in the transition from dictatorial to democratic rule. The executive branch continued to rule by decree. A productive institutional role had not been, and is only beginning to be, established for the Congress, and its operations during the Siles Presidency suffered due to the absence of political cooperation among its members. Given this imperfect system, individuals, political parties, economic interest groups and unions sought to exert their influence through disruptive means (threats, strikes, blockades, boycotts, etc.) focused on narrow self interest rather than the country's welfare.

The third factor contributing to the Siles Government's inability to tackle the country's economic problems was Siles' practice of routinely conceding to the demands of almost any pressure group - most notably the Bolivian Workers Confederation (COB), whose leaders were intent on bringing down the Siles Government. Capitulation typically led to increased demands and to an unwillingness among interest groups to make the sacrifices necessary to make any economic measures effective.

The result of Siles' weak leadership was a state of virtual political and economic anarchy. In the absence of presidential leadership and coherent government policies, the economic measures the Siles Government announced were ad hoc, incomplete and poorly implemented. Six economic packages were adopted, the most comprehensive of which were in April 1984 and February 1985, but none of them was followed by consistently applied follow-up measures. Accordingly, the economy continued its rapid deterioration, and the political situation worsened. Extreme leftist elements in the Government took advantage of the absence of leadership and the political weakness of President Siles to foment chaos in an attempt to destroy the country's weak democracy. Labor leaders intimidated and controlled the executives of the state enterprises, government ministries and other organizations (most notably the Central Bank) with work stoppages and the de facto "veto authority" given them by the Siles Government. Official government decisions and policies were ignored when they conflicted with the personal or political interests of these union leaders. Staffs and payrolls were padded, and financial control over government and state enterprise operations was lost.

By late 1984, at a time when the COB had decreed a general strike in reaction to the November 1984 economic measures, President Siles was forced to recognize that he would have great difficulty remaining in power through the scheduled end of his term in August 1986. Through an agreement worked out under the auspices of the Bolivian Episcopal Conference, Siles asked Congress to advance national elections to mid-1985 and agreed to turn over the government to the winning presidential candidate on August 6, 1985.

The decision to advance elections in order to maintain democratic government was widely praised. In March 1985, after the announcement of a relatively strong economic package, the COB leadership made a final attempt to topple Siles and undermine the upcoming elections. A national strike was declared and miners were brought to the capital for massive demonstrations. At the time, there was doubt that the Siles Government could survive and that elections could be held. For once, Siles did stand firm, however, and called out the Army to end the strike (peacefully).

During the presidential campaign, it was uncertain that the election would actually take place. Polls showed the right-of-center ADN party of ex-President Banzer in the lead, and President Siles tried unsuccessfully to persuade Congress to delay the balloting. The Electoral Court also had great difficulty organizing the election. The assistance it requested from A.I.D. in voter registration and vote tabulation was ultimately turned down by the Siles Government for political reasons. In addition, the Court had great difficulty obtaining timely disbursements of GOB funds for the election's logistical costs.

After the balloting finally did take place on July 14, 1985, it took several weeks to complete the official vote count. General Banzer received the most votes (28.57%), while Victor Paz Estenssoro, the MNR(H) leader, received 26.42%. The fact that neither leading candidate received a majority of the votes meant that the new Congress, in which the MNR(H) was dominant would have to select the President. After two Congressional ballots, Paz Estenssoro was selected to be President on August 5 and sworn in the next day. Banzer, understandably displeased with having his narrow plurality in the popular vote overturned by the Constitutional requirement that the presidential selection be made by Congress, ultimately accepted the decision of the Congress in the context of sustaining the democratic process in Bolivia.

B. Bolivia's Economic Crisis

During the past five years, economic conditions in Bolivia have deteriorated drastically. Inflation has accelerated to a rate of more than 20,000 percent in the 12 months ending August 1985. The external accounts have worsened steadily. Exports dropped from $942 million in 1980 to an estimated $556 million in 1985. As a consequence of the deterioration in exports, imports have been seriously constrained; merchandise imports fell from $707 million in 1980 to $477 million in 1984. As a result of import constriction and the effects of rampant inflation on the financial system, real GDP has declined 20.1 percent in the past five years. On a per capita basis, real GDP and income have fallen 32 percent over this period, in a country which, after Haiti, is the poorest in the Western Hemisphere. This precipitous decline in production, income, and employment, when combined with the wealth transfers produced by rampant inflation, has exacerbated social tensions to the breaking point.

The origins of this economic disaster are to be found in a steadily increasing fiscal deficit exacerbated by a series of ineffective and often counter-productive ad hoc measures which successive governments adopted to deal with the inflation and the resultant balance-of-payments problems. The deficit of the consolidated public sector deteriorated steadily in the late 1970s, reaching 9.1 percent of GDP by 1980. Despite large amounts of external financing, a substantial portion of this deficit (4.0 percent in 1980) was financed through the domestic financial system. The resulting monetary emission produced an increase in domestic prices which, combined with a fixed and extremely overvalued exchange rate, put steadily increasing pressure on the balance of payments. By 1981, the balance-of-payments deficit reached $178.3 million, despite some success by the then government in reducing the fiscal deficit to 7.8 percent of GDP. During 1982, the GOB enacted import controls and carried out a series of exchange rate adjustments. While these measures limited the balance of payments deficit in 1982 to $93 million, import controls produced a serious decline in the revenues from import duties (because of the decline in the legal importation of consumer goods which were heavily taxed) and the tax on foreign exchange transactions. Import duties, which were 2.0 percent of GDP in 1981, dropped to 1.2 percent in 1982 and 0.6 percent in 1983. Similarly, receipts from the tax on foreign exchange transactions dropped by half by 1983, reflecting the decreasing volume of official foreign exchange being made available to the private sector. In addition, the insistence of the GOB on maintaining a fixed exchange rate (after a brief experiment with floating rates in 1982) significantly reduced the revenues received from export taxes and from the export sales of the state enterprises. Lastly, control of central government current expenditures deteriorated even further after the change of government in October 1982. Current expenditures increased from 17.9 percent of GDP in 1981 to 21.6 percent in 1982, and reached 26.8 percent by 1984. Much of this increase was the result of additions of personnel to the central government payroll.

The 1983 El Niño natural disasters of drought in the highlands and flooding in the eastern lowlands severely aggravated the country's economic decline. The disasters resulted in large production losses and heavy financial requirements for repairs to roads, bridges and water systems, and for food imports. International assistance was forthcoming, but was not enough to make up for significant production losses, from which the country has only recently begun to recover fully.

The combination of declining revenues, increased current expenditures, and declining external borrowing led to substantial monetary emissions by the Central Bank. The domestically financed portion of the fiscal deficit increased from 3.0 percent of GDP in 1981 to 16.6 percent in 1982, 21.1 percent in 1983, and 25.8 percent in 1984.

Serious as the inflationary consequences of these monetary emissions were, they were made far worse by a GOB policy of interest rate ceilings which lagged far behind current rates of inflation. For example, during 1984, when inflation accelerated to over 2000 percent, deposit interest rates were held to less than 140 percent. As a result, holdings of deposits in the domestic banking system declined steadily in real terms. From a level equal to $781 million in 1980, the value of currency and bank deposits declined to $117 million (measured at the parallel market rate) by the end of 1984. Thus, the monetary emissions associated with the domestic financing of the public sector deficit were being forced onto a steadily shrinking real monetary base.

On March 1, 1985, the GOB enacted measures to liberalize the interest rate regime. Lending rates were freed from controls, while deposit rates were subjected to a minimum interest rate of 20 percent per month (raised in June to 25 percent). Interest rates continued to remain far below inflation, apparently as a result of a lack of loan demand in a highly uncertain political environment. Nonetheless, the real value of currency and deposits began to expand after the liberalization.

Finally, overall social and political tensions were aggravated by the corruption and speculative profits made possible by the government's exchange rate, interest rate, and pricing policies, which enriched certain individuals, while the incomes of the overwhelming majority of Bolivians were falling precipitously.

The situation faced by the new government, which took office August 6, called for drastic measures to restore public confidence and bring about economic stabilization and recovery; i.e. reduction of the fiscal deficit, adjustment of the exchange rate in line with inflation, and expansion of real resource mobilization by the financial system. To be in a position to implement the required economic measures, the Paz Government knew that it would have to regain the political power the central government had lost under Siles, to exert its authority over the union leaders who had gained control of the state enterprises, government ministries, and the Central Bank, and to confront the COB.

The sweeping economic measures described in Section II C were decreed by the Paz Government on August 29, just four weeks after taking power. President Paz made it clear that he believed his Government would have only one chance to begin implementing a coherent economic stabilization program and gain control politically, thereby preserving Bolivia's democracy.

The general public welcomed the unexpectedly far-reaching and comprehensive measures decreed on August 29the, because most people were weary of the lack of governmental leadership and very concerned with the country's economic decline. The reaction of the union leaders -- who had grown accustomed to intimidating President Siles and who realized the real threat the Government's measures posed to their priviledged positions -- was predictable and swift. An indefinite national strike was declared. The Government responded by intervening in key public sector organizations, such as the petroleum company, to prevent excessive behavior on the part of strikers and ensure the continuation of critical government services.

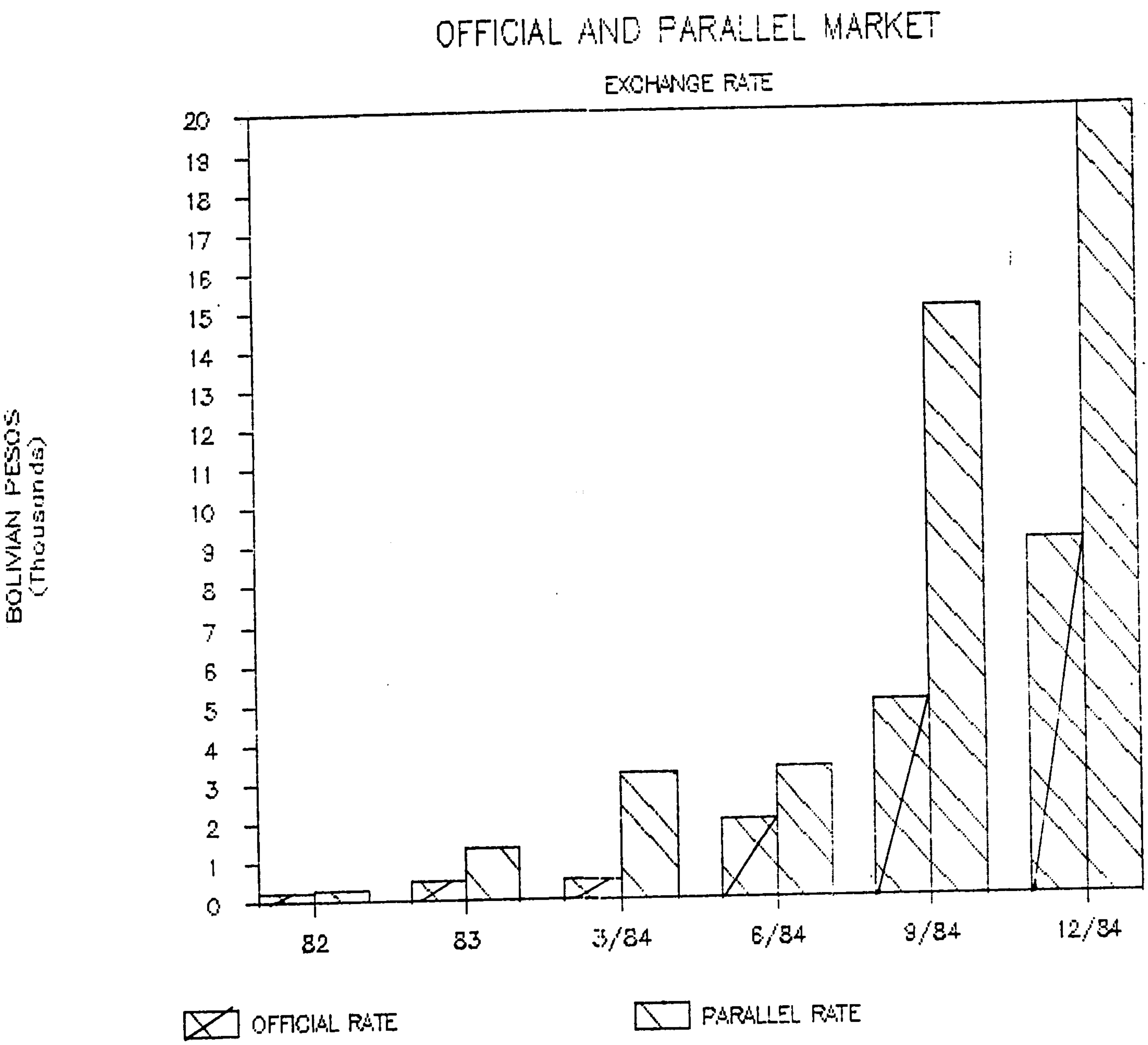
When campesino support for the COB never materialized and it appeared that the Government would continue to stand its ground, hunger strikes were declared. The GOB-COB confrontation culminated in the declaration of a constitutional state of siege by the Government and the temporary confinement of union leaders. An attempt by the leftist parties in Congress to censure the Paz Government for declaring the state of siege was thwarted when the ADN supported the Government, and the democratically elected Congress formally voted to uphold the state of siege in accordance with the Constitution. By the beginning of October, it was clear that the Paz Government had successfully regained the political power necessary to continue to implement its stabilization program. At this point, the GOB released the union leaders. Later, on October 16, General Banzer and President Paz Estenssoro signed an historic "Pact for Democracy," under which the MNR and ADN parties, which together hold a significant majority in Congress, agreed to cooperate in areas of mutual interest (the most notable of the areas mentioned at the signing ceremony were economic recovery and coca control), for the good of the country. This pact provides the potential for the Paz Government to achieve its policy objectives in a democratic framework unprecedented in Bolivia's recent history.

C. The August 29 Measures

Annex I summarizes the complete August 29 decree which constitutes the basis of the GOB economic program.

1. Exchange Rate Adjustment Mechanism

One of the major causes of Bolivia's balance of payments deterioration was the insistence of previous governments on maintaining a fixed exchange rate in the context of rapidly worsening inflationary environment. With monthly rates of price increases of 30 to 100 percent and more, the official exchange rate was chronically overvalued, often one-seventh to one-tenth the estimated purchasing power parity rate. (See following chart.) This imposing differential seriously hampered exports, since legal exporters were forced to deposit hard currency earnings in the Central Bank to be credited at the official exchange rate. Moreover, since import duties were a major source of central government revenue and export sales of YPFB and COMIBOL (the state petroleum and mining companies, respectively) were major sources of consolidated public sector revenue, the overvalued exchange rate was a major contributor to the fiscal deficit.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(Thousands)
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18
17
16
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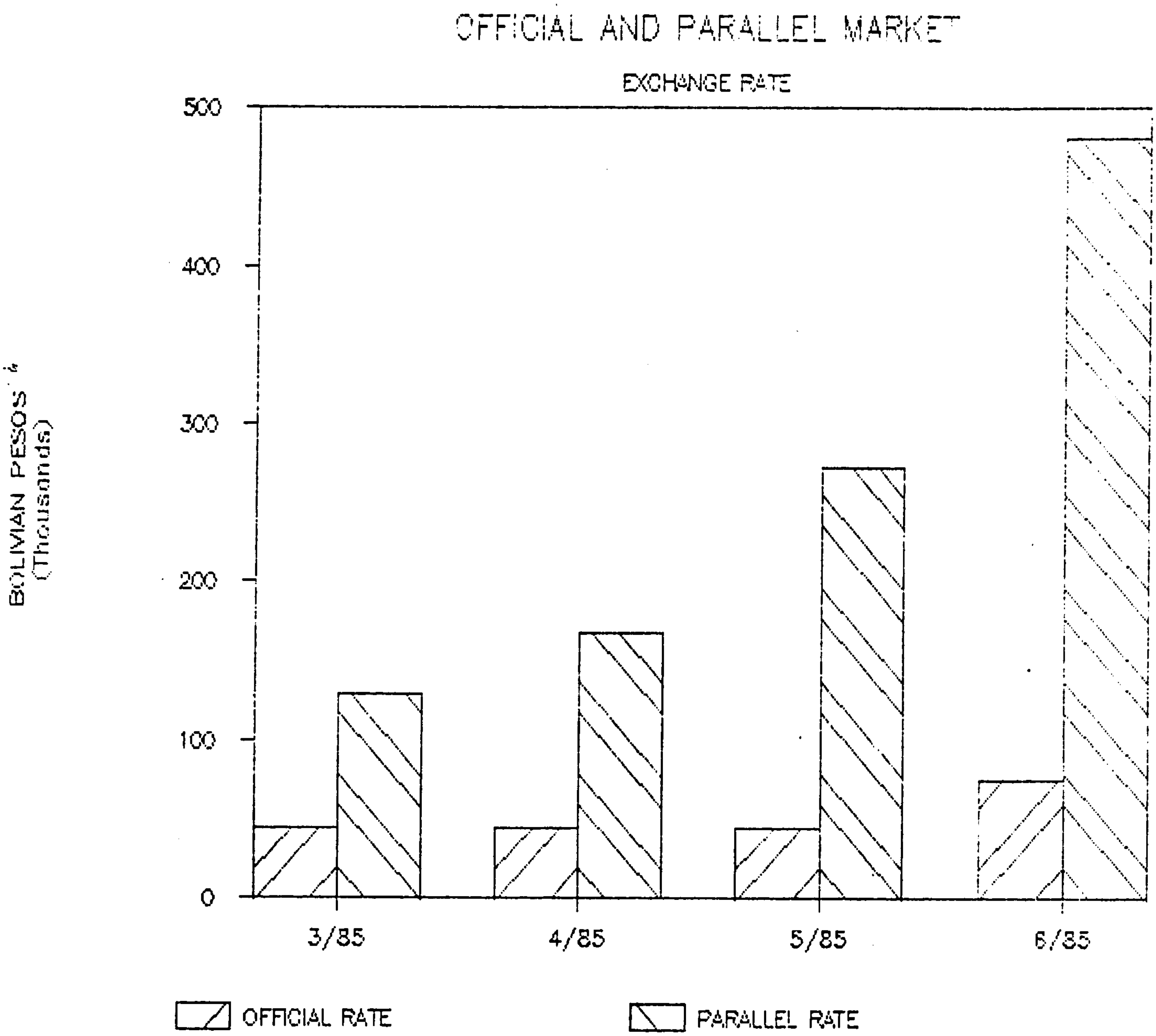
14
13
12
11
10
9
8
7
6
5
4
3
2
1
0
82
83
3/84
6/84
9/84
12/84
OFFICIAL RATE
PARALLEL RATE

15


OFFICIAL AND PARALLEL MARKET
EXCHANGE RATE
BOLIVIAN PESOS
(Thousands)
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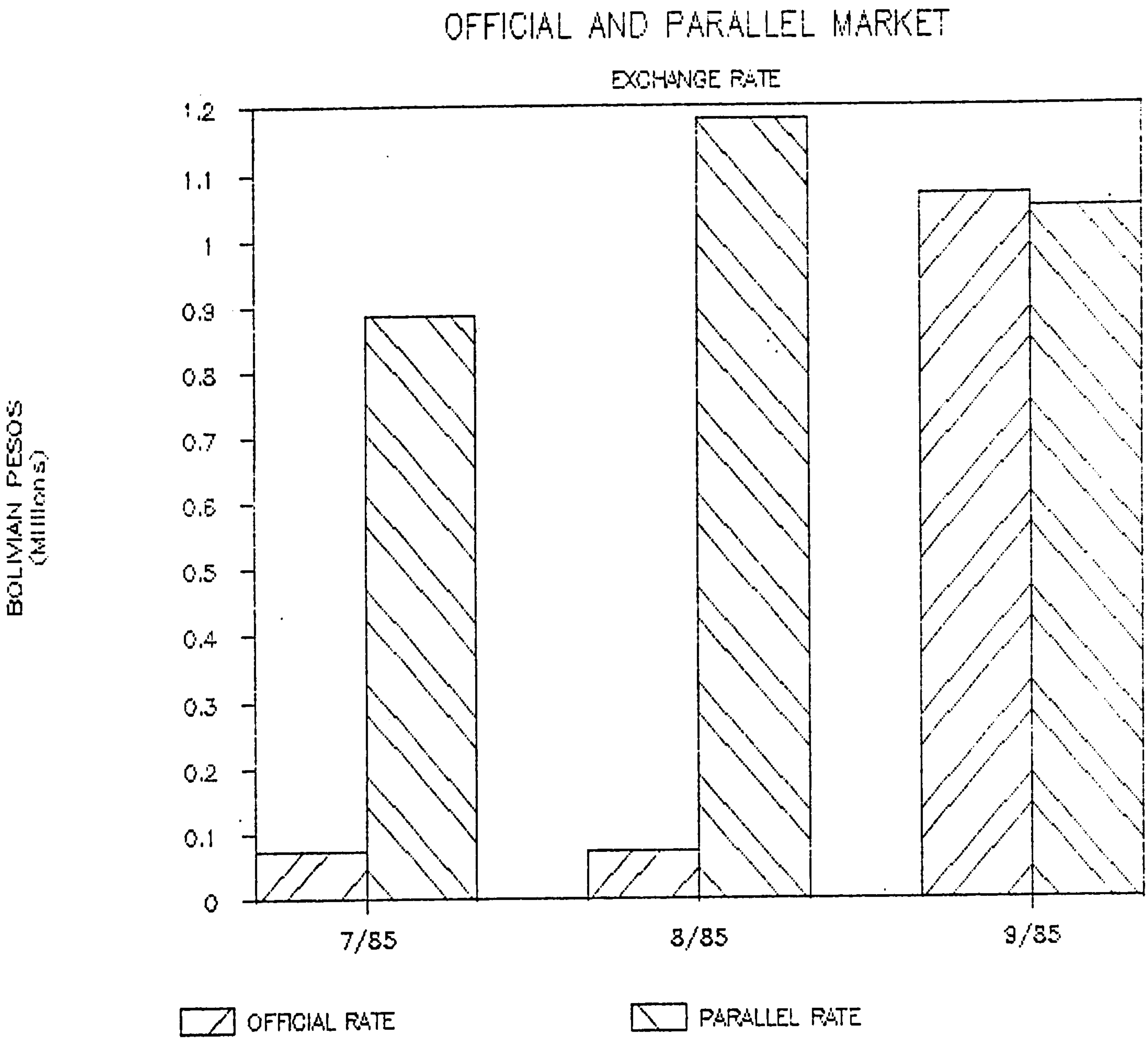
400
300
200
100
0
3/85
4/85
5/85
6/85
OFFICIAL RATE
PARALLEL RATE



OFFICIAL AND PARALLEL MARKET
EXCHANGE RATE
BOLIVIAN PESOS
(Millions)
1.2
1.1
1
0.9
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0
7/85
8/85
9/85
OFFICIAL RATE
PARALLEL RATE

Under the new exchange system announced by the GOB on August 29, the official rate is to be adjusted at least twice weekly. The Central Bank conducts an auction twice a week at which it offers foreign exchange for sale. Sealed bids are accepted in increments of $5,000. The official exchange rate is the weighted average of accepted bids and prevails until the next auction. (In an attempt to prevent small groups of traders from manipulating the market on light trading days, the Central Bank sets an unannounced "floor" at each auction below which it does not accept bids. The effect of this is create a slight upward bias in the exchange rate system, which should be beneficial). In addition, in an attempt to improve customs compliance, purchasers are charged a ten percent fee on exchange purchases and receive in return a tax payment certificate equivalent in value to the fee. To the extent that this represents an interest free loan to the Central Bank, it should improve the Bank's cash flow. In addition to providing for twice weekly adjustments to the official exchange rate, the GOB's decree legalized the parallel foreign exchange market. A subsequent action permits the BCB to buy and sell small amounts of foreign exchange (less than $300) from the public on a daily basis.

Although the new system represents a substantial liberalization of the exchange system, it stops short of eliminating the official exchange rate altogether. All exporters are still required to surrender 100 percent of their export proceeds to the Central Bank at the official rate of exchange. These export proceeds provide the principal source of foreign exchange for the auction.

2. Fiscal Measures.

a. Exchange Rate Adjustment as a Fiscal Measure. The most important fiscal measure adopted by the GOB was the devaluation, together with the adoption of a system of frequent exchange rate adjustments in response to market forces. The initial result of this system was to move the official exchange rate from 75,000 pesos to 1.1 million pesos per dollar, a 93.2 percent devaluation. The current value is very close to the Mission's estimate of the purchasing power parity value of the peso. In relation to the average official exchange rate for 1984, the present official rate represents a 320 percent increase in the peso value of foreign exchange-denominated items. Thus, export sales of COMIBOL, YPFB, and other state enterprises, and values of exports and imports subject to tax will increase by approximately this percentage in relation to their 1984 values. On the other hand, debt service and foreign purchases of goods and services will also increase by the same percentage in real peso terms. On balance, the fiscal effect of devaluation, combined with the liberalization of the import regime discussed below, is expected to be strongly positive.

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b. Petroleum Price Adjustment. The second most important fiscal measure is the increase in domestic petroleum prices to the equivalent of $.30 per liter (approximately $1.14 per gallon). This represents approximately a ten-fold increase over the previous price. In addition, the price is to be adjusted twice monthly to maintain the dollar equivalency. At this price level, the operations of YPFB will be very profitable and will contribute to reduction of the fiscal deficit.

c. Electricity, Telephone and Other Public Utilities. Public utility prices are now fixed in dollars, and, in many cases, bills are payable in pesos at the exchange rate of the day on which they are paid.

3. Monetary Reforms.

The inflationary pressure produced by the public sector deficit has been worsened substantially by the shrinkage of the banking system's deposit base. This acceleration in velocity has had its origin in the highly negative real interest rates which were imposed by law until March of this year. In addition, there is substantial anecdotal evidence that negative real interest rates have encouraged unproductive lending to finance speculative purchases of dollars and the holding of stocks in anticipation of price increases. The GOB program addresses this problem by authorizing banks and other financial institutions to offer dollar-denominated loans and deposits. Deposits with a dollar maintenance-of-value clause are required to pay no less than LIBOR, while all controls on peso loan and deposit interest rates were eliminated. There is no maximum or minimum on the interest rates charged for the corresponding dollar-denominated loan. In addition, legal reserve requirements were lowered from 55 percent to 50 percent on peso-denominated demand deposits, and similar adjustments of the reserve requirements were made on other deposits. dollar-denominated deposits have no reserve requirement.

4. Trade and Tariff Policies.

The most unexpected aspect of the GOB program was the substantial liberalization of trade policy. Bolivia, like most of its South American neighbors, has a long history of very high tariffs on final manufactures combined with low or non-existent tariffs on capital goods and industrial inputs. In addition, since 1982, most imports of consumer goods have been prohibited (a provision largely bypassed through the practice of contraband). The new GOB program abolishes all import prohibitions and replaces the former steep tariff structure with a flat 10 percent ad valorem duty plus a variable duty equal to ten percent of the formerly prevailing tariff. As a result, imports will now face a tariff of from 10 to 23 percent. The principal motivation for this measure appears to be not only a desire to establish a free trade regime but also an attempt to improve revenue collection. The existence of enormous quantities of contraband goods for sale in La Paz was clear evidence that the legal system of tariff collections had all but completely broken down. By eliminating prohibitions and reducing tariffs to moderate levels (probably less than the bribes normally paid by smugglers), the GOB hopes to encourage the revenue producing legal import of goods which formally paid no taxes.

5. Wage and Labor Policy.

The program specifically freezes public sector wages until December 31, 1985 in an attempt to reduce expenditure levels, in part by encouraging resignations. Whether such a freeze can be maintained depends on the level of inflation in the next few months and the degree of labor militancy. The program also substantially increases the free play of market forces in the private sector labor market. Employers are now free to discharge employees for whatever reason, subject to the payment of three months severance pay (employers formerly required government approval to fire employees). In addition and most significantly, the implementing decree provides that private sector wages will be freely contracted between employers and employees. Previously, the GOB frequently decreed across-the-board wage increases for private as well as public sector workers.

6. Price Decontrol

The GOB program abolishes all price controls, except for state marketed items such as gasoline, electricity, telephone service, etc.

7. State Enterprise Decentralization

In one of the most controversial parts of the program, the GOB has divided the state mining company, COMIBOL, into four regional enterprises, and YPFB (the state petroleum company) into three, and has turned other state enterprises (those previously held by the central government holding company, CBF) over to the Departmental Development Corporations. This decentralization serves a number of purposes, all directed at increasing the management efficiency of state enterprises. First, it will enable the GOB to dispense with most of the bloated central bureaucracy of YPFB and COMIBOL. Second, it should increase fiscal discipline over state enterprises by placing strict controls on their access to Central Bank credit to cover deficits (in 1984, CBF's deficit was three times that of COMIBOL, although it had only half COMIBOL's sales). Finally, the move also appears to be an attempt to reduce the power of the disruptive mining and YPFB employee unions.

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III. Summary Analysis of the August 29 Measures

A. Comparison of the Measures with Those Recommended in the U.S. Mission's December 1984 Report on the Economy

It is clear that the measures enacted by the GOB represent a meaningful attempt to address the sources of the economic crisis. The critical questions are, are these measures sufficiently comprehensive and are they enough. In response to the first question, it is useful to compare the measures taken with the set of policy recommendations made in the USAID assessment of the Bolivian economic situation prepared in late 1984. That assessment made ten specific recommendations:

1. Devalue the peso by at least 50 percent and provide for inflation-offsetting adjustments at least monthly and preferably weekly.
2. Substantially increase petroleum prices.
3. Introduce a crawling peg system for adjusting controlled prices to offset the effects of inflation.
4. Introduce inflation-indexed savings and lending instruments.
5. Reduce required reserves for bank deposits.
6. Avoid inflationary increases in public sector wages.
7. Introduce inflation adjusted budgeting to improve expenditure control.
8. Improve the accounting for government expenditures.
9. Implement other revenue measures sufficient to yield 6 to 10 percent of GDP.
10. Regularize the Bolivian Government's international debt position through rescheduling negotiations with commercial and bilateral creditors.

Of the ten recommendations listed, six of the most important ones have been fully implemented (in some cases in ways that went beyond the recommendations), and the GOB has already begun to take steps towards implementing the other four recommendations.

The GOB's decision to allow market forces to determine the official exchange rate is clearly preferable to the Mission's recommendation for a substantial devaluation (however determined) followed by adjustments to keep up with inflation.

Petroleum product prices have been increased significantly. Instead of indexing the prices of other formerly controlled commodities to keep control from becoming more binding over time, the GOB has abolished controls completely.

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The creation of inflation-adjustable savings and lending instruments has been approved, and bank reserve requirements have been reduced.

On the budget front, public sector wages have been frozen until the end of the year, and although some increases are inevitable (and necessary), the GOB is determined to keep them in line. Two other budget control measures (improved accounting of expenditures and inflation-adjusted budgeting) are areas in which the Government has begun to investigate its options and must act as soon as IMF advisors help it put an initial FY 1986 budget together. The need for additional revenue measures (or expenditure reductions) will depend on the financial situation resulting from the package of measures already implemented. An estimate of the overall fiscal impact of the package of measures will be discussed below.

Finally, discussions have begun with Bolivia's creditors (see below) which should lead to a regularizing of the country's debt situation.

In three additional areas, the GOB package far exceeded the Mission's short to medium term recommendations. These are the liberalization of trade policies, the decentralization of the state enterprises, and labor law reform. All three of these measures look beyond the immediate inflation/balance-of-payments crisis toward an economic recovery based on improved efficiency in production.

In summary, the GOB program is clearly comprehensive in the sense that all of the types of measures needed to bring about economic recovery, including a substantial reduction in the fiscal deficit, measures to promote recovery of the financial system, and measures to restore international competitiveness, have been included. Given the enormous magnitude of the problem, the question is, are they sufficient? This question is considered below.

B. Longer Term Structural Consequences of the Program

By far the most significant effect of the GOB program is to reintroduce market processes as the determinant of a wide variety of domestic prices, including the exchange rate, interest rates, wages, and the prices of consumer goods, many of which were previously set by government fiat. During the past three years, "betting against the government" (i.e. speculation) has been by far the most profitable activity in the economy. This "betting" has taken the form of borrowing at negative real interest rates to buy dollars or stocks of commodities, or the withholding of merchandise from the market in anticipation of a change in controlled prices or of a devaluation. At the same time, price controls, labor laws prohibiting the discharge of employees, government-mandated across-the-board wage increases, and a general atmosphere of labor turmoil, policy uncertainty, and hostility toward private sector activity, inhibited productive investment. With the change of this environment, the entrepreneurial talent which previously had been directed at speculating on government pricing decisions will be increasingly redirected toward productive activity, within a significantly more secure policy environment. As a result of this change, Bolivia should experience substantially increased economic growth in the medium term, with a concomitant increase in employment, nutrition, health status, and other indicators of basic human needs fulfillment, as well as enhanced public sector resources for the provision of essential public services.

C. Fiscal Impact

Given that the principal source of the present economic crisis lies in the uncontrolled fiscal deficit, the adequacy of the program as a stabilization measure must be based on the extent to which it substantially reduces the fiscal deficit in the near term. Based on the analysis in later sections of this study, the measures already implemented by the GOB will have the effect of reducing the fiscal deficit from the 28.1 percent of GDP reached in 1984 to about 11.0 percent of GDP at an annual rate starting with the introduction of the program, of which about 8.7 percent would have to be financed through the domestic financial system. Still further gains are possible during the next year as a by-product of decelerating inflation through improved tax collection and expenditure control.

The short-term fiscal effects of the economic program depend primarily on four measures: the devaluation, the change in the tariff system, the elimination of the tax on foreign exchange, and the public sector wage freeze. As indicated above, the short-term impact of these four measures will be to reduce the consolidated public sector deficit from 28.1 percent of GDP to 11.0 percent. In the case of the central government (excluding state enterprises), the program is projected to produce a relatively lesser impact (apart from the effect of taxes paid by state enterprises). The devaluation, which has a powerful impact on lowering the deficit of the state enterprises has a mixed impact on the central government. It increases central government revenues from a variety of sources (by 3.4 percent of GDP), but this is largely offset by the increase in the peso value of external debt service obligations (3.25 percent of GDP). The tariff reform is projected to increase central government revenues by an additional 0.6 percent of GDP, while the public sector wage reductions (assuming a 10 percent reduction in the real wage bill) will reduce current expenditures of the central administration by

C H A R T No. 2

ESTIMATED EFFECT OF ECONOMIC PROGRAM

ON STATE ENTERPRISE DEFICITS

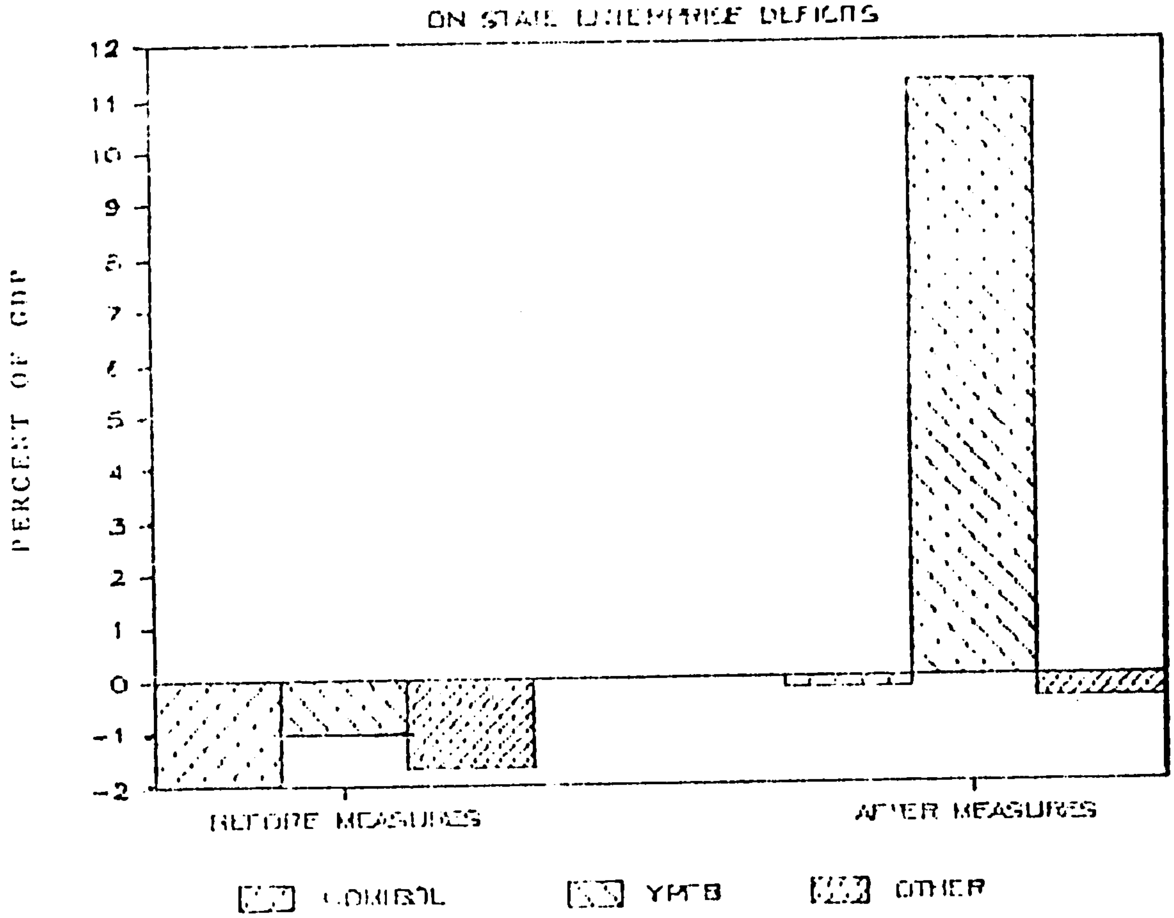
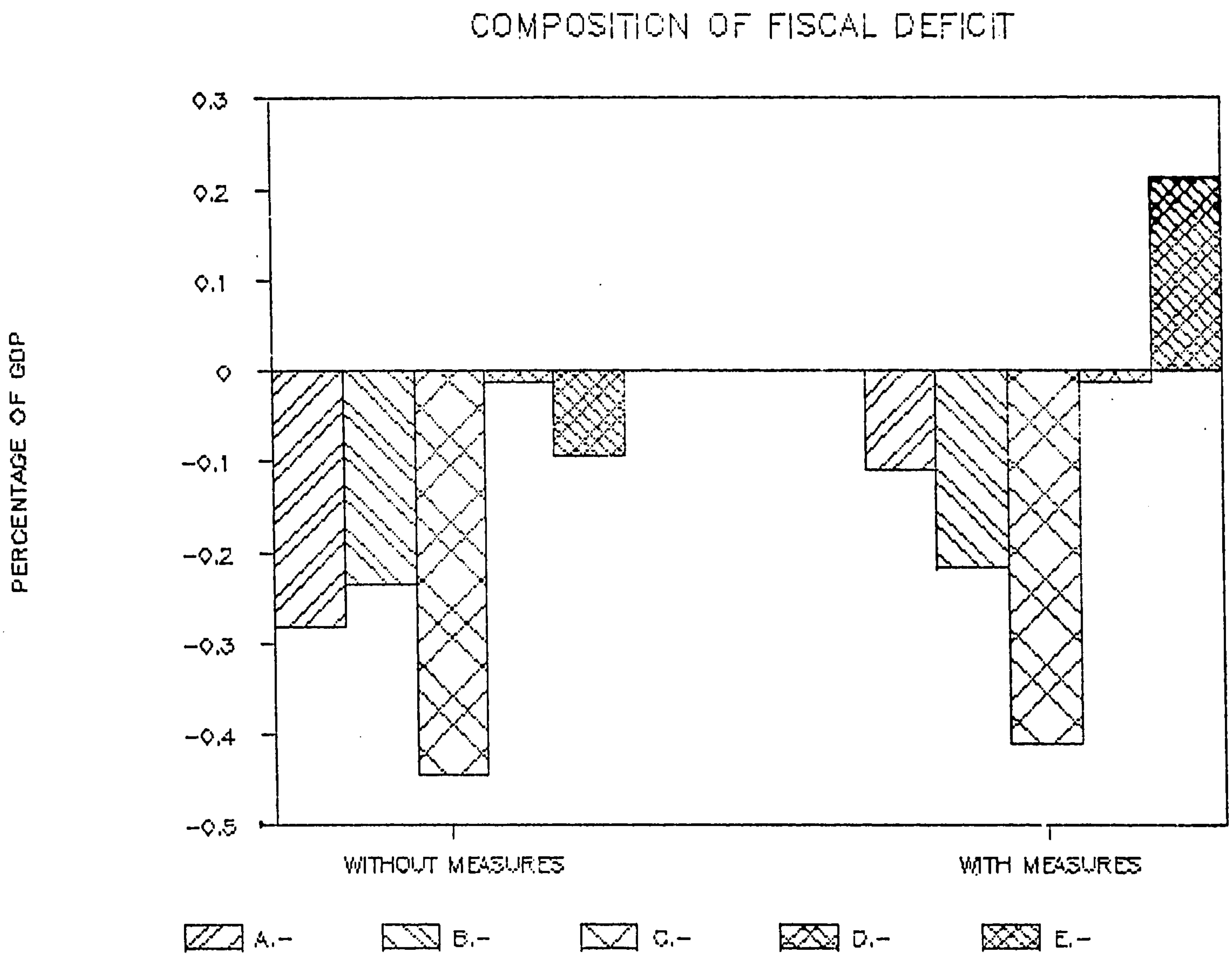


CHART 3



A. Consolidated Public Sector (General Government and State Enterprises)

B. General Government (Central Government and Local Government)

C. Central Government (Central Administration and Decentralized Agencies)

D. Local Governments

E. State Enterprises (COMIBOL, Y.P.F.B., Other)

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an additional 0.8 percent of GDP. Partially offsetting this is the elimination of the tax on foreign exchange which is estimated to reduce revenues by 0.35 percent of GDP. Added to these reductions in the central government deficit is an estimated reduction of 0.4 percent of GDP in the wage bill of decentralized agencies and local governments. Overall, the effect of the program in lowering the deficit of the general government sector (again, excluding state enterprises) is projected to be 1.8 percent of GDP.

The impact of the measures on the financial position of the state enterprises, especially COMIBOL and YPFB, is much more powerful (See Chart 2). The devaluation will increase the peso value of COMIBOL's foreign sales by 5.3 percent of GDP while increasing its costs by 3.68 percent of GDP; the wage freeze will reduce COMIBOL's deficit by a further 0.14 percent, for an immediate reduction of 1.76 percent of GDP. In addition, the decentralization of COMIBOL should produce additional savings, but these are difficult to predict in the short run.

The impact of the program on the financial surplus of YPFB is even more powerful. The entire program will increase that surplus by 12.3 percent of GDP, of which 2.8 percent is due to the increase in domestic petroleum prices, 0.5 percent to the reduction in real public sector wages, and the remainder to the increase in the peso value of sales of natural gas to Argentina.

The deficits of other state enterprises will be reduced by 1.3 percent of GDP due to a combination of devaluation and wage reduction effects. The overall immediate fiscal impact of the program thus reduces the fiscal deficit from 28.1 percent of GDP to 11.0 percent measured at an annual rate starting with the introduction of the program (See Chart 3). Improved tax administration, expenditure control, and further compression of real public sector wages could produce still further gains, but these are difficult to project at this time.

D. Outlook for Inflation and Credit Expansion

One of the most damaging aspects of the inflationary process of the past three years has been the virtual destruction of the Bolivian financial system. Negative real interest rates and accelerating inflation have driven domestic savings out of the financial system and into overseas accounts, commodity speculation, and, for small savers, holdings of dollar currency. The real (that is, adjusted for changes in the consumer price index) value of banking system deposits declined 81.5 percent between 1981 and 1984. As a consequence, credit for the private sector declined 65.8 percent over the same time period. Moreover, there is substantial evidence that negative real interest rates and a political climate generally hostile to productive investment caused much of the

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remaining portion of private sector borrowing to be diverted to speculative purchases of inventories and foreign exchange. In view of this, one of the most important reforms contained in the GOB package is the authorization for financial institutions allowing them to offer deposits and loans denominated in dollars or with a dollar maintenance of value clause. These funds and the generally improved investment climate should expand substantially the level of financial intermediation of the banking system.

Apart from offering "inflation proof" financial accounts, the program should produce a substantial deceleration of inflation itself. The precise extent to which inflation can be reduced depends both on the remaining requirement for domestic financing of the fiscal deficit and on the degree to which the Bolivian public's expectations about inflation can be reduced in the short run to a level commensurate with that degree of monetary expansion.

Inflation expectations already seem to have been reduced. For example, peso-denominated deposits paying 10% per month (not compounded) are currently more popular than dollar-denominated deposits. Based on the domestic financing requirement estimated above and taking into account the observed velocity of money (that is, gross income divided by the money stock) in the past when Bolivia had a similar financing requirement, a reduction of inflation to a range of 50 to 100 percent per year seems likely.

E. Balance of Payments and Debt Service

Primarily as a result of a chronically overvalued exchange rate, at which exporters were required to surrender their foreign receipts, Bolivia's balance of payments position deteriorated sharply during the past five years. Merchandise exports declined from $942 million in 1981 to $724 million in 1984, despite the emergence of significant natural gas exports to Argentina during that period. As a result of declining export receipts and a steadily growing debt service burden, the GOB first attempted to constrain imports through administrative controls and, when that proved insufficient, began to accumulate large arrearages on current debt service obligations. Despite a contraction of imports from $ 1,011 million in 1981 to $ 477 million in 1984, the GOB accumulated debt service arrearages which reached $928 million as of June 30, 1985, 141 percent of estimated 1985 exports.

The establishment of a realistic exchange rate, the expected improvement in the availability of private sector credit, and the reestablishment of a business climate more conducive to the expansion of productivity should all contribute to a reversal of the balance-of-payments deterioration in the short term. Nonetheless, the extent of the debt service problem, in particular, is so serious that long-term rescheduling of a substantial part of maturing debt, and a significant amount of additional external balance of payments assistance will be required in 1986, and probably beyond, if Bolivia is to regularize its external accounts and still maintain sufficient import capacity to achieve sustained real growth.

For 1986, USAID projects a significant recovery of exports from a projected $656 million in 1985 to $787 million. This improvement is based on a projection of a significant recovery of metal exports (other than tin, which is projected to show a relatively modest increase), some recovery of world commodity prices based on World Bank price projections, the resumption of petroleum exports as a result of reduced domestic consumption and elimination of clandestine exports, and a significant expansion of non-mineral exports.

Nonetheless, if Bolivia is to achieve 3.5 percent real growth in 1986, it will require, according to Mission estimates, an expansion of imports from their estimated level of $481 million in 1985 to $558 million. The achievement of this level of imports would require the closing of a financing gap of $265 million, if the GOB is to avoid the accumulation of still higher levels of arrearages. USAID estimates that some $142 million in additional financing could be realized through reschedulings with the Paris Club and a new arrangement with commercial bank creditors, leaving a currently unbudgeted financing requirement of $123 million to be filled by multilateral and bilateral financing sources.

F. Analytical Conclusions

There is little question that the August 29 economic program announced by the Bolivian Government is an excellent beginning to the long-range task of reversing the well established trend of deterioration of the country's economy. The program is comprehensive and austere, and goes well beyond the recommendations of the many international entitities which have sought to help Bolivia resolve its chaotic economic crisis.

The economic program announced by the GOB on August 29 represents a major effort to reduce the fiscal deficit and monetary emission, increase domestic savings, strengthen external competitiveness, and eliminate counterproductive public sector intrusion in economic decisions. The previous sections of this analysis conclude that the program will achieve a major reduction in the fiscal deficit, reduce the need for monetary emissions, reduce inflation, and stimulate recovery in the balance of payments.

The first few weeks of the program have produced notable evidence of success. After an initial burst of inflation of over 50 percent in the first week of September as a result of the devaluation, petroleum price increases, and elimination of price controls, prices actually declined in the last three weeks of September. Inflation was measured at 0.74 percent in the first week of October and zero in the second week. Similarly, there has been downward pressure on the exchange market. Exchange receipts have substantially exceeded exchange usage so that the net international reserves of the Central Bank, which stood at $71.1 million on August 31, 1985, had risen to $132 million by October 16. Both the price level declines and the strengthening of the peso, despite continuing significant monetary emissions (though at a lower rate), indicate a sharp decline in inflationary expectations. This evidence, combined with the GOB's obvious resistance to backsliding, indicate that the program has a very good chance of success.

The implementation of the stabilization program is, and will continue to be, an imposing task, both politically and administratively. The various economic programs undertaken by the Siles government were all defeated, virtually from the dates of their announcement, by the political pressures of a militant, leftist-oriented, anarchical labor movement. To continue to implement its stabilization program, the Paz government will have to remain firm in carrying out actions that will be inherently unpopular in the short term. The challenge will be to remain firm and to keep the peace (which is necessary for the social as well as the economic good), while not violating the human rights of the Bolivian people. In this context, a major advantage of the Paz recovery program over those attempted by Siles is the presence of automatic mechanisms which adjust such things as the exchange rate and gasoline prices without the necessity of having to make frequent, highly political ad hoc decisions. This "automaticity" has resulted in a much higher degree of social tranquility than would otherwise have been possible. The pact with the ADN should also help considerably as long as it continues to meet the political objectives of both the ADN and MNR parties.

Much remains to be done to implement the stabilization program successfully, particularly in dealing with the remaining budget deficit, renegotiation of external debt, public sector reorganization and the promotion of productive investment as a basis for long-term growth.

In the short term, the most important priorities for the GOB must be to reduce the fiscal deficit below 11 percent of GDP and to renegotiate its external debt. Deficit reduction will require reduction in personnel throughout the public sector, improved expenditure control, and, in the longer run, increased revenue collection.

As noted in the fiscal analysis, Government salaries constitute a major component of the deficit. Wage increases must be carefully controlled and employment rolls reduced. It is widely expected that

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unemployment will grow as wage increases are controlled, leading to concomitant social and political tension. The GOB will have to do everything possible to encourage private sector generation of new employment opportunities.

While its payroll must be carefully controlled and reduced, the GOB does not have enough of the skilled people that it needs to carry out efficiently the many complex and sophisticated tasks required by the new economic program. Many of the people who are qualified for such employment are currently employed by private sector entities, and cannot afford to accept the exceedingly low salaries now paid by the GOB. If the Government cannot attract such people, the future of its program could be seriously jeopardized. There are several potential solutions to this problem which could be offered through the assistance of external donor organizations. An example of an existing assistance program of this type is the USAID Policy Reform Project which provides the resources to employ and equip a team of well trained economic analysts. USAID will also give consideration to using the local currency generated under the ESF program to remunerate a cadre of skilled managers to help the GOB implement its recovery program. Similar support may be needed to assist with essential activities of such key government entities as the Central Bank and the Ministry of Finance.

Improved expenditure control will have to begin with the preparation of a consistent and wellthought-out 1986 budget and better control over the expenditures of state corporations. Careful distinctions will have to be made among productive and non-productive government expenditures in order to limit the inflationary impact of deficit spending. Increased revenue collection will require both more disciplined collection of taxes and analysis of new tax sources, leading to longer term adjustments in the GOB's tax base. It may also require salary adjustments for those assigned the responsibility for tax collection, in order to reduce the temptation for corruption.

To improve its balance-of-payments position, the GOB should move as quickly as possible to reach an arrangement with its commercial bank creditors in order to reactivate a normal flow of trade credits. Such a reactivation would both provide a useful capital inflow at a critical time and facilitate trade transactions. The GOB will also have to move expeditiously to renegotiate its debts with its Latin neighbors, principally Argentina, and with the members of the Paris Club. Without such debt relief, Bolivia will not be able to close its projected balance-of-payments gap and achieve its modest 1986 growth target. Paz Government officials, including the President himself, have repeatedly emphasized that Bolivia will meet its debt obligations, but within its ability to repay and maintain economic growth. Informal contacts have already been made with the commercial banking consortium, Argentina (Bolivia's largest Latin American creditor) and the World Bank. A high level commission has been established to negotiate rescheduling arrangements with Bolivia's creditors.

The foreign exchange auction system (bolsin) of the Central Bank has functioned exceptionally well during its first nearly two months of existence. Nevertheless, under its present system of operation, the bolsin is considered to be vulnerable to manipulation. Therefore, continued tightening of the bolsin mechanism will be essential to avoid the serious potential disruption that corrupt manipulation could unquestionably produce.

The new economic program calls for decentralization of COMIBOL, YPFB, and CBF. Implementation of this provision is beginning, but will be very difficult and subject to strong political pressures. The GOB must take immediate action to accelerate this decentralization so as to avoid the inevitable entrenchment of resistance that is already in evidence. In each instance, the task will require the services of skilled and reliable individuals, who, as noted above, are not now in large supply within the Government.

A similar problem exists with regard to the necessary reorganization of the Bolivian Central Bank. The Bank, which had been highly politicized by its corrupt leftist labor union, has been largely purged of its most disruptive elements. A complete audit of the Bank is being carried out by the Bolivia Controller General with the assistance of USAID and the United Nations. Effective management of the Bolivian economy will depend greatly on the reliability and professionalism of the Central Bank. Another urgent priority is the determination of the future of the Bank's Development Department, which has the responsibility for coordinating the various refinancing facilities provided by the international donors (e.g. USAID, IDB, World Bank). The Development Department has been nearly totally disfunctional for the last three years, due largely to the politicization of its management. This has resulted in large scale non-use of available donor resources. Some positive movement in the Development Department has already occurred since the onset of the Paz government. Nevertheless, the GOB should clarify, as quickly as possible, its intentions with regard to this key development finance entity so as to mobilize existing, and attract new, donor credit resources.

Finally, since the Bolivian economic recovery process will ultimately succeed or fail based on the economy's ability to grow, the GOB must do everything possible to motivate productive domestic and foreign investment. To improve the foreign investment environment in

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Bolivia, relationships with foreign companies currently operating in Bolivia (e.g. the Occidental and Tesoro Petroleum Companies) must be regularized, and agreements with entities such as OPIC will be essential. The Paz government has recognized this need and has already begun negotiations with OPIC. The signing of a new agreement is expected before the end of 1985. In addition, the GOB is moving quickly to resolve outstanding investment disputes in order to improve its image in the international investment community.

IV. PROPOSED ESF PROGRAM

A. A.I.D. Program Strategy

As detailed in several program documents submitted to AID/Washington (the most recent of which was the ABS/Action Plan in May 1985), the USAID/Bolivia program directly supports the U.S. Government's principal policy goals in Bolivia, which are: (a) strengthening the democratic process, (b) promoting recovery from the current economic crisis and long-term economic growth, and (c) reduction of the production and illicit trafficking of coca and its derivatives. Every element of the AID program is related to these key policy objectives.

Shortly after President Siles announced his decision late last year to advance the date of elections, it was determined that the U.S. Mission would condition the disbursement of a package of additional assistance (consisting of the $10 million second portion of the FY 1985 PL 480 Title I Program, $25.5 million to finance agro-industrial imports, new ESF balance-of-payments assistance, and the first portion of a new $75 million PL 480 Title III Program) to the implementation of a comprehensive set of economic measures. Later, in the FY 1986-87 FAA authorization bill, Congress - reflecting the continued high priority the USG places on coca control - established narcotics-related restrictions on the approval of ESF to be provided in FY 1986 and FY 1987.

Both the economic and coca-related conditions of the increased U.S. assistance were described in detail to the Siles and Paz Governments. Beginning the day he was sworn in, President Paz and his Cabinet emphasized to the U.S. inauguration delegation that their economic stabilization and coca control priorities were almost identical to those of the USG.

Before Paz was inaugurated, the Siles government enacted a law, on May 22, 1985, which met the USG's conditions for coca control legislation. During the August visit of a Congressional Delegation headed by Congressman Charles Rangel, Mr. Rangel noted the fact that the law met Congress' initial requirements for FY 1986 assistance, and expressed the Delegation's satisfaction with the Paz Government's plans to move decisively to control coca production and trafficking.

The Paz Government made it clear, early in its administration, that it felt it first had to concentrate on economic stabilization and its problems with the COB before it could effectively confront the coca problem. Despite the initial priority given to the economic program and the consolidation of political power, GOB cooperation with the DEA in interdiction has improved markedly. In addition, work has already begun to complete an erradication plan to be implemented in the months ahead.

As explained in Section III A, the economic measures, enacted by the Paz Government go well beyond the specific economic conditions to which additional U.S. assistance was tied. With the economically and politically successful initial implementation of the Paz Government's August 29 measures, and the satisfaction of the U.S. Congress' established conditions for the approval of the first half of FY 1986 ESF, it is clear that the GOB merits the additional support the USG indicated it would provide - both to help the Bolivians to continue to implement their stabilization program and to strengthen the democratic environment within which other USG policy goals can be achieved.

The balance-of-payments assistance requested in this PAAD is an essential element in the assistance package already used to support GOB action on both the economic policy and coca control fronts. The disbursement of the different components of the package - which has already begun with the release of $10 million in PL 480 Title I assistance and $25.5 million for agro-industrial imports - will continue to provide clear evidence of the USG's support for the Paz Government's policies. Such visible support is vital,both internally in Bolivia and as part of a concerted effort to ellicit additional assistance from the IMF, the World Bank and the IDB.

Given the magnitude of the balance-of-payments "gap" indicated in Section III E, it is clear that the relatively small amount of ESF balance-of-payments assistance that AID will be able to offer will only partially meet Bolivia's needs. Nevertheless, it will serve as a catalyst for more significant levels of support needed (a) from multilateral donors, (b) through the Paris Club, (c) from the consortium of commercial banks which have lent to Bolivia, and (d) from other Latin American countries. In addition, it will strengthen the U.S. Mission's prospects for success in its dialogue with the GOB with respect to implementation of, and follow-up to, the August 29 measures. Lastly, ESF assistance will generate significant local currency resources with which to support important elements of the GOB stabilization program.

B. <u>The Cash Transfer Program</u>

The magnitude and urgency of Bolivia's balance-of-payments problem argue in favor of a cash transfer as the vehicle for providing balance-of-payments assistance. Given Bolivia's serious debt situation and the fact that the proposed cash transfer most likely will not be used to finance long-term investments, a grant rather than a loan ESF program is requested.

An ESF grant agreement will be signed with the Minister of Planning (or other designated GOB authority). A GOB letter requesting FY 1986 ESF assistance will be obtained as soon as AID/W formally approves such assistance. It will provide for two tranched obligations and disbursements, the first of which will be for $7,177,000, by electronic transfer into a Central Bank (BCB) account in the United States. The first obligation/disbursement will be made without requiring any further economic measures, in recognition and support of the comprehensive measures already taken. The second obligation/disbursement will be contingent upon compliance with the coca erradication target established pursuant to the FY 1986-87 FAA authorization bill, and following the completion of a status report on the follow-up actions taken be the GOB to implement its stabilization program.

Within six months of each disbursement of ESF to the BCB's account, the GOB will deposit an equivalent amount of Bolvian pesos in an interest-bearing counterpart account in the BCB for expenditure as jointly agreed by the GOB and USAID.

The GOB will covenant that within twelve months following the disbursement of the first $7,177,000 of ESF to the BCB, it will make available to private importers an amount of foreign exchange not less than that disbursed to the BCB by AID under the ESF agreement for the importaiton of raw materials, machinery, intermediate goods and spare parts from the United States. The funds made available by the GOB will be in addition to those to be made available by AID for private sector agro-industrial imports under the Agro-industrial Reactivation Component of the Disaster Recovery Project. The BCB will document imports of eligible commodities by the private sector in compliance with this covenant and provide the Mission with a report of these transactions.

C. Local Currency Proceeds

USAID/Bolivia is currently engaged in discussions with the GOB on the uses of the local currency to be generated by the PL 480 Title I wheat sales and the upcoming Agro-industrial Reaction Program. The uses specified in the agreements for this assistance are being reviewed to determine the most appropriate allocation of resources to support the GOB's stabilization plan (e.g. supplementing commercial bank resources for financing agricultural credit) and other programs of interest to the USG.

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The local currency proceeds from the proposed ESF cash transfer program will also be used to support the GOB's stabilization program. Special attention will be paid to using this local currency in ways which do not exaccerbate inflationary pressures. Examples of the uses to which the proceeds could be put are: (a) severance pay for dismissed public employees; (b) the establishment of a special fund to attract personnel to be recruited from the private sector to help implement the GOB's stabilization program; (c) local currency project counterpart funds necessary to effect the disbursement of other donor foreign exchange project financing; and (d) employment-generation activities designed to cushion the social disruptions and pressures that are expected as a result of the implementation of the economic package.

Given the fact that ESF resources have not yet been received for Bolivia in FY 1986, it has not been possible to negotiate ESF local currency uses with the GOB. As soon as this PAAD is approved, negotiations will proceed. It is hoped that, by that time, the GOB, with IMF assistance, will have better defined its FY 1986 budget. USAID/Bolivia and the GOB will agree on a program for the use of local currency and the mechanisms for disbursement prior to signature of the Program Agreement.

V. CONDITIONS AND COVENANTS

The following conditions and covenants will be included in the ESF agreement:

A. Conditions Precedent to Disbursement of the First Half of ESF Assistance.

Prior to the disbursement of the first half of the ESF assistance to be provided under this agreement, or to the issuance by AID of documentation pursuant to which such disbursement will be made, the Government of Bolivia will, except as AId may otherwise agree in writing, furnish to AId, in form and substance satisfactory to AID:

1. a legal opinion from the Office of the Attorney General of Bolivia stating that this Agreement has been duly authorized and/or ratified by, and executed on behalf of, the Government of Bolivia (GOB), and that it constitutes a valid and legally binding obligation of the GOB in accordance with all of its terms and conditions; and

2. a statement warranting that the named person or persons have the authority to act as the representatives of the GOB under this Agreement, together with a specimen signature of each person certified as to its autenticity.

B. Conditions Precedent to Obligation/Disbursement of the Second Portion of ESF-Assistance.

The Program Agreement will contain languate stating that prior to obligation and disbursement of the second portion of the ESF assistance to be provided under this agreement, or to the issuance by AID of documentation pursuant to which such disbursement will be made, the Government of Bolivia will, except as AID may otherwise agree in writing: furnish to AID, in form and substance satisfactory to AID, proof that the GOB has achieved the erradication target for calendar year 1985 contained in its 1983 Narcotics Agreement with the United States.

C. Covenants

1. That within six months of each cash transfer disbursement from AID to the Central Bank (BCB) under this Agreement, the GOB will deposits an amount equivalent to such cash transfer in Bolivian pesos into a Special Account in the BCB, in separate disbursements in the amounts and on the dates requested by AID. The Special Account will pay interest at a rate equal to the average rate paid py commercial banks, on the date of each deposit of pesos, on six-month time deposits with a dollar maintenance of value clause. The peso equivalent of each dollar disbursement will be calculated at the highest legal official rate of exchange for the purchase of dollars on the date of each peso disbursement to the Special Account.

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2. That the GOB will agree with AID on a program for the use of the peso proceeds, deposited in accordance with Covenant 1 above in the Special Account, in support of the GOB's economic stabilization program.

3. That within 12 months of the first disbursement under this agreement, the GOB will have made available to private importers an amount of foreign exchange not less than that disbursed to the BCB by AID under this Agreement in U.S. Fiscal Year 1986, for financing of the importation of raw materials, machinery, intermediate goods, and spare parts from the United States, such foreign exchange being additional to that provided by the GOB to private sector importers under the AID-financed Agro-industrial Reactivation Program; and that the GOB will report promptly to AID that such transactions have been accomplished.

ANNEX I

Measures Contained in Supreme Decree 21060 (August 29, 1985)

Title I

Establishes new exchange rate system and procedure for twice weekly auctions and legalized the parallel market.

Authorizes the sale of the BCB's monetary gold in support of the new economic program.

Title II, Chapter I.

Authorizes banks and other financial institutions to offer foreign exchange denominated accounts and accounts with a dollar maintenance of value clause and to make dollar denominated loans or loans with a maintenance of value clause. Financial institutions are required to pay no less than LIBOR on such deposits. Interest rates on such loans are specifically exempted from all interest rate controls. Such deposits are also exempt from reserve requirements.

Eliminates interest rate controls on all peso deposits and loans. Reduces the legally required reserve for peso denominated deposits to 50 percent for demand deposits, 10 percent for term and savings deposits.

Commercial banks are specifically authorized to carry out foreign exchange and trade transactions.

Chapter II

Eliminates all restrictions on imports, except those dealing with public health or state security.

Establishes a new system of customs tariffs equal to a flat ten percent rate plus an amount equal to 10 percent of the previously existing tariff. Eliminates all tariff exemptions except those established by international agreements.

Chapter III

Eliminates all restrictions and administrative controls on exports with the exception of armaments, narcotics and other dangerous substances, and items prohibited by regulation for the protection of endangered species, and the "preservation of the artistic patrimony and cultural treasures of the Nation."

Adjusts the system of taxation of minerals to provide more realistic and adjustable presumed costs.

Title III Labor Laws

Chapter I

Permits both public and private sector employers to rescind labor contracts subject to a severance payment of three months pay, if paid in a lump sum, or six months pay if paid monthly, at the option of the employee.

Chapter II

Freezes public sector wages until December 31, 1985.

Establishes that private sector wages are to be freely contracted between employer and employee.

Eliminates "Pulperias" (subsidized commissaries) operated by the state corporation of production.

Workers formerly having "pulperias" in the public sector are to be compensated by the amount of the subsidy in cash.

Public enterprises are prohibited from paying workers in kind or providing free products (e.g. gasoline, food) in addition to salary.

Chapter III

Reduces the number of public holidays to 10.

Title IV. Price Controls

Chapter I

Eliminates all price controls.

Establishes a price for regular gasoline of U.S.$.30 per liter and establishes corresponding prices for other petroleum products. The peso price to be adjusted twice monthly.

Establishes similar dollar denominated prices and price adjustments for electricity and telephone service and rail service.

Delegates rate setting for urban transport to municipalities.

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Establishes free entry into inter-urban transport and domestic airline service and eliminates price regulation.

Title V. State Enterprises

Chapter I

Requires all state enterprises to submit a set of accounts as of July 31, 1985 and to submit a detailed budget for the last quarter of 1985.

Requires all state enterprises to submit a plan within 30 days for the rationalization of personnel.

Prohibits Central Bank Credit to enterprises which have not complied with the previous provisions.

State enterprises are required to maintain deposits in pesos only in the Banco del Estado. All state enterprises are prohibited from maintaining bank accounts outside the country.

Chapter II

YPFB is to be broken up in three regional institutions.

Chapter III

COMIBOL is to be decentralized into four regional institutions.

Chapter IV

The Bolivian Development Corporation (CBF) is to be dissolved and its assets transferred to the regional development corporations where they are located.

Chapter V.

The National Automotive Transport Enterprise (ENTA) is dissolved and its assets transferred to the municipalities in which they are located.

Chapter VI

The domestic public debt in arrears (floating debt) is consolidated through the issuance of notes with a dollar maintenance of value clause.

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Chapter VII

Abolishes legal monopolies.

Title VII Fiscal and Monetary Reform

Requires the Ministers of Finance and Planning to submit to the Congress proposals for the reform of the monetary and tax systems.

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ANNEX II

Detailed Analysis of the GOB Economic Stabilization Program

I. Analysis of Fiscal Implications

In projecting the fiscal consequences of the new GOB program, it is important to emphasize that the quality of the fiscal data upon which these estimates are based is poor. The quality of fiscal accounting in Bolivia, which never was very high, has deteriorated further as a result of the acceleration of inflation (which has virtually destroyed expenditure control) and the overall turmoil in the public sector (which has produced inconsistent and unrecorded changes in accounting). USAID has, however, coordinated data reconciliation efforts with the Embassy Economic Section, the IMF and the Central Bank (BCB), and has concluded that the data upon which the estimates in this section are based are the best which can be obtained under present circumstances. Therefore, the Mission is reasonably confident of the accuracy of the projected effects of the package.

Because of deteriorations in the quality of fiscal statistics during the course of 1985 and the general problem of taking into account seasonal patterns in receipts and expenditures, the estimate of the impact of the program is based on the 1984 pattern of income and expenditures. That is to say, the analysis that follows will attempt to measure the outcome that would have been achieved if the new GOB program had been in effect during the year 1984.

A. Central Government

It is customary to divide the non-financial public sector into general government and state enterprises. General government, in turn. is divided into central government and other general government. Finally, in Bolivia, the central government is further divided into central administration (basically those activities funded by the Treasury) and decentralized agencies. Only the most general information is available on the financial position of Bolivian local governments and decentralized agencies.

Out of a total public sector deficit of 28.1 percent of GDP in 1984, the deficit of the central government accounted for 22.2 percent of GDP, of which the central administration accounted for 20.9 percent. The details of the 1984 actual reported outcome for the central administration together with the estimates of the impact of the new GOB program are shown on Table 1. Four of the recent economic measures will

TABLE 1
GENERAL GOVERNMENT INCOME AND EXPENDITURE --1984
(MILLION PESOS)

	ACTUAL	% OF GDP	WITH MEASURES	% OF GDP
CURRENT INCOME	593406	3.12%	1350625	7.10%
INCOME TAX	154415	0.81%	154415	0.81%
TAXES ON GOODS & SERVICES	67577	0.36%	208247	1.09%
YPFB PRODUCTION (1)	59215	0.31%	189489	1.00%
SALES OF REF. PROD.(2)	3549	0.02%	13946	0.07%
TAX ON BANK CREDIT	4813	0.03%	4813	0.03%
TAXES IN INT'L TRADE	330548	1.74%	947096	4.98%
IMPORT DUTIES (3)	122871	0.65%	497759	2.62%
CONSULAR FEES (1)	16429	0.09%	52573	0.28%
STATE MINING EXPORTS (1)	69621	0.37%	222787	1.17%
PRIV. MINING EXPORTS (1)	54290	0.29%	173729	0.91%
OTHER EXPORT TAXES (1)	77	.00%	248	.00%
FOR. EX TAX (4)	67259	0.35%	0	0.00%
NON-TAX REVENUE	40867	0.21%	40867	0.21%
CURRENT EXPENDITURES	4295050	22.58%	4761441	25.03%
PERSONAL SERVICES	1503516	7.90%	1353165	7.11%
OTHER SERVICES	106227	0.56%	106227	0.56%
MATERIALS & SUPPLIES	150724	0.79%	150724	0.79%
INTERNAL PUBLIC DEBT	27930	0.15%	27930	0.15%
EXTERNAL PUBLIC DEBT (1)	280337	1.47%	897079	4.72%
CURR TRANS PRIV SECT	422657	2.22%	422657	2.22%
CURR TRANS PUB SECT	601392	3.16%	590245	3.10%
SUPP INT ORGAN. (1)	5067	0.03%	16214	0.09%
OTHER EXPENDITURE	1197200	6.29%	1197200	6.29%
CAPITAL REVENUE	12533	0.07%	12533	0.07%
CAPITAL EXPENDITURES	281231	1.48%	281231	1.48%
OVERALL SURPLUS/DEFICIT OF CENTRAL ADMINISTRATION	-3970342	-20.87%	-3679514	-19.34%

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TABLE 1 (cont'd)
GENERAL GOVERNMENT INCOME AND EXPENDITURE --1984
(MILLION PESOS)

SUMMARY: SOCIAL SECURITY SYSTEM	ACTUAL	% OF GDP	WITH MEASURES	% OF GDP
CURRENT REVENUE	371309	1.95%	371309	1.95%
CURRENT EXPENDITURE	295927	1.56%	295927	1.56%
CAPITAL EXPENDITURE	75382	0.40%	75382	0.40%
SURPLUS/DEFICIT OF SOCIAL SECURITY SYSTEM	0	.00%	0	.00%
SUMMARY: OTHER DECENTRALIZED AGENCIES				
CURRENT REVENUE	251882	1.32%	251882	1.32%
CURRENT EXPENDITURES (5)	497327	2.61%	472461	2.48%
CAPITAL REVENUE	36523	0.19%	36523	0.19%
CAPITAL EXPENDITURES	36216	0.19%	36216	0.19%
SURPLUS/DEFICIT OF DECENTRALIZED AGENCIES	-245138	-1.29%	-220271	-1.16%
SUMMARY:LOCAL GOVERNMENT				
CURRENT REVENUE	287682	1.51%	287682	1.51%
CURRENT EXPENDITURES (5)	463449	2.44%	440277	2.31%
CAPITAL REVENUE	16276	0.09%	16276	0.09%
CAPITAL EXPENDITURES	79717	0.42%	79717	0.42%
SURPLUS/DEFICIT OF LOCAL GOVERNMENT	-239208	-1.26%	-216035	-1.14%
SUMMARY: GENERAL GOVERNMENT				
OVERALL SURPLUS/DEFICIT OF GENERAL GOVERNMENT	-4454608	-23.42%	-4115821	-21.64%

SOURCE: IMF, RECENT ECONOMIC DEVELOPMENTS, SEPT 1985, TABLE 38.

Notes: (1) Adjusted by the estimated change in the real exchange rate in relation to the average official rate of 1984.

(2) Taxes on domestic petroleum consumption are assumed to increase by the same proportion as the real increase in domestic petroleum prices.

(3) Customs receipts adjusted as explained in the text.

(4) Tax on foreign exchange transactions was eliminated as part of the economic program.

(5) Assumes a 10 percent reduction in the public sector wage bill. All other items are assumed unchanged.

affect the central administration fiscal deficit: the devaluation, the elimination of import restrictions together with the restructuring of the tariff schedule, the elimination of the tax on official foreign exchange transactions; and the public sector wage freeze.

Although the most powerful fiscal measure for the public sector as a whole is the devaluation followed by a system of at least twice weekly adjustments dictated by market forces, its beneficial effects on the central government revenue are substantially offset by the adverse effect of the devaluation on the peso value of external debt service payments. The initial impact of the new foreign exchange auction system was to increase the official exchange rate to a level of approximately 1.1 million pesos. This figure is slightly higher than the Mission's estimate of a purchasing power parity exchange rate calculated on Table 2. This estimate of the purchasing power parity rate* must be treated with some caution since it assumes no erosion of underlying Bolivian productivity or other structural fundamentals since the early 1970s. To the extent that there has been such an erosion, the exchange rate required to equilibrate Bolivia's external accounts will be correspondingly higher. In the political and economic turmoil and the consequent lack of investment undertaken in the past five years, it is not at all surprising that an exchange rate generated by free market forces is somewhat higher than a purchasing power parity calculation would suggest. Nonetheless, the parity calculation suggests that it is very likely that the real (that is inflation adjusted) exchange rate will continue to adjust itself to maintain the equivalent of 1.1 million pesos at the price level prevailing on September 1, 1985. This is the assumption upon which the fiscal estimates of this section are based.

The initial results of the foreign exchange auction, adjusted for changes in the consumer price index since 1984, produced a real exchange rate 3.2 times the average official exchange rate for 1984. If it is assumed that this exchange rate will continue to increase in line with inflation, the fiscal impact will be that taxes and other receipts which arise from international transactions, as well as purchases abroad of goods and services and foreign debt service payments, will increase by the amount of the increase in the real exchange rate. Thus, devaluation has both positive and negative effects on the fiscal deficit.

* A more sophisticated calculation of purchasing power parity would take into account not just U.S. inflation but a weighted average of inflation rates for Bolivia's major trading partners adjusted for changes in their dollar exchange rates. However, experience with such calculations in other South American countries suggests that the degree of distortion introduced by the use of U.S. inflation alone is small.

TABLE 2
ESTIMATED PURCHASING POWER PARITY EXCHANGE RATE

DATE	U.S. WHOLESALE PRICE INDEX	LA PAZ CPI	PESOS PER U.S. DOLLAR		
			ESTIMATED PARITY RATE	OFFICIAL EXCHANGE RATE	PARALLEL RATE (BUYING)
1972	100.0	100	20	20	
1979	198.0	345	35	25	
1980	225.7	508	45	25	
1981	246.3	671	55	25	
DEC. 1982	252.6	2,782	220	198	280
DEC 1983	262.9	11,921	907	505	1,300
MARCH 1984	260.5	19,462	1,495	505	3,200
JUNE 1984	261.1	48,527	3,719	2,000	3,300
SEPT 1984	260.2	80,602	6,198	2000/5000	15,000
DEC. 1984	260.0	271,468	20,892	9,000	20,000
~~JAN. 1985~~	~~260.0~~	458,130	35,258	9,000	73,016
FEB 1985	259.6	1,295,464	99,872	45,000	141,101
MARCH 1985	259.1	1,618,562	124,998	45,000	128,137
APRIL 1985	259.6	1,809,275	139,483	45,000	167,428
MAY 1985	260.2	2,454,607	188,742	75,000	272,375
JUNE 1985	259.6	4,380,533	337,711	75,000	481,756
JULY 1985	259.6	7,284,961	561,623	75,000	885,476
AUG. 1985	259.6	12,126,612	934,883	75,000	1,182,303

SOURCE: IMF, INTERNATIONAL FINANCIAL STATISTICS AND UNPUBLISHED BCB AND USAID DATA

The initial effect of the devaluation is to increase central administration current revenues by 3.43 percent of GDP as a result of its effect on customs duties and a variety of export and import taxes (other than taxes on state enterprises which represent transfers within the public sector). However, much of this improvement is offset by increases in the peso value of external debt service payments and certain other external obligations totalling to 3.25 percent of GDP. The net effect of the devaluation alone will be to reduce the central government deficit by only 0.2 percent of GDP.

There are serious discrepancies in the data between tax payments reported by state enterprises and tax receipts reported by the Treasury. In the estimates in this section, the Treasury figures have been taken as correct and changes in the tax payments of state enterprises have been based on those figures, rather than the tax payments reported by the enterprises themselves. In any case, changes in such payments represent transfers within the public sector and do not affect the overall deficit.

In one of the most controversial elements of its revenue package, the GOB eliminated virtually all administrative restrictions on imports and drastically reduced the level of tariffs. The primary purpose of this measure is not so much to improve economic efficiency (although it certainly should do that), but rather to increase revenues first, by increasing the proportion of final goods which pay a relatively higher duty, second, by taxing capital goods, raw materials, and semi-finished products, which make up the bulk of Bolivian imports, and finally, by reducing the rates of import duties to a point where smuggling will no longer be attractive. The calculation of the effect of the trade policy reform on revenues (see Table 1) assumes that an average duty of 15 percent will be applied and that there will be no increase in the volume of legal imports over those actually recorded in 1984. Under these conservative assumptions, the trade policy reform is projected to increase revenues to 2.6 percent of GDP from the level of 2.1 percent of GDP which would have been produced by the devaluation alone and the 0.7 percent of GDP actually produced by customs duties in 1984. It should be emphasized that these estimates are based on an assumption of no increase in legal imports. To the extent that formerly contraband imports will now move through legal channels, customs receipts will be correspondingly higher. For example, if legal imports should increase by 10 percent, customs revenues will increase by 0.26 percent of GDP over those forecast in Table 1.

The third significant fiscal measure affecting the central government accounts is the elimination of the tax on official foreign exchange transactions. The purpose of eliminating this tax was to narrow the differential between the official and parallel foreign exchange markets. The revenue loss from the elimination of this tax is relatively small, approximately 0.35 percent of GDP. Part of this loss may be offset by what is, in effect, a prepayment of customs duties through the 10 percent surcharge on official foreign exchange purchases.

The final measure which will affect the central government deficit is the freeze of public sector wages until December 31, 1985. The effect of this measure will depend on the rate of inflation in the last four months of the year and on the degree to which the GOB can, in fact, resist pressure for wage increases. In the calculation of Table 1, it has been assumed that the real (that is, price adjusted) wage bill of the central government will be reduced by 10 percent. The effect of such a reduction, whether achieved by a 10 percent reduction in real wages, a 10 percent reduction in personnel and constant real wages, or a combination, would be to reduce the central government deficit by 0.8 percent of GDP.

It should be emphasized that the GOB faces a very difficult dilemma in its wage and employment policies in the public sector. Personnel costs are by far the largest single component of current expenditures and the only one subject to reductions in the short term. However, real public sector salaries are already down 45 percent from their 1980 levels, and further compression would impose very serious hardships on those who have to implement the GOB's program. On the other hand, the alternative of a large scale discharge of public employees faces the problem that there probably are not, in the near term, alternative sources of employment for them. The GOB policy seems to be to compress wages in the short run, encouraging those with alternatives to quit, followed by a rationalization of the workforce over the next year.

The combined effect of these four measures, devaluation, tariff reform, wage restraint, and the elimination of the tax on foreign exchange, on the central administration deficit is a reduction by 1.6 percent of GDP, from 20.9 percent of GDP to 19.3 percent.

B. Decentralized Agencies and Local Government

The absence of detailed information on the structure of income and expenditure of decentralized agencies and local government makes it very difficult to reach any definite conclusions about the effect of the new economic program on their fiscal deficits. On the whole, it is likely to be small. Their primary sources of revenue are transfer payments and taxes on domestic activity. On the assumption that half of their current expenditures are for personnel compensation, it is estimated that the projected ten percent decline in public sector wages will result in an aggregate reduction in their deficits of .41 percent of GDP.

C. COMIBOL

The effects of the measures taken on COMIBOL and other state enterprises are shown in Table 3. The principal measures which affect the deficit of COMIBOL are the devaluation and the wage freeze. As shown in Table 3, the devaluation, by increasing the peso value of COMIBOL's foreign sales more than its foreign purchases and taking into account its increased tax liability, reduces its deficit by 1.19 percent of GDP. In addition, the increase in COMIBOL's export values in 1986 will increase COMIBOL's revenue by a further 0.43 percent of GDP. Finally, a ten percent reduction in real wages would reduce the deficit by a further 0.14 percent of GDP. These measures taken together would reduce the deficit by 1.76 percent of GDP. The decentralization of COMIBOL is likely to have some further impact by increasing the company's operating efficiency and enabling it to reduce the size of its central bureaucracy. The size of these effects and their timing is difficult to predict. In addition, the elimination of subsidized commissaries (pulperias) should reduce COMIBOL's costs. However, in announcing this measure, GOB officials pledged to financially compensate the miners for the elimination of this subsidy. Therefore, the short term gain from this measure may be minimal.

D. YPFB

In addition to the devaluation and wage freeze, YPFB's operating surplus will be augmented by the increase in domestic petroleum prices, accompanied by a system of twice monthly price adjustments designed to maintain domestic petroleum prices constant in dollar terms at US$.30 per liter for gasoline. The devaluation, as shown in Table 3, will increase the peso value of YPFB's foreign sales by 17.7 percent of GDP. However, it will also increase the péso value of current and capital expenditures by 7.9 percent. The increase in domestic sales prices is estimated at 3.93 times the average real domestic sales price realized by YPFB in 1984. The total value of domestic sales is projected to increase by 4.22 percent of GDP. However, some part of this increase represents sales to other parts of the public sector. In the absence of any information on the proportion which such sales comprise of YPFB's total domestic income, it has been assumed that petroleum product sales to the public sector is the same proportion of total sales which the public sector represents of total GDP, approximately 33 percent. This reduces the revenue gain to the public sector of the price increase by approximately 1.4 percent of GDP.

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TABLE 3
STATE ENTERPRISES
(PERCENT OF GDP)

	COMIBOL W/O MEASURES	COMIBOL W/ MEASURES	YPFB W/O MEASURES	YPFB W/ MEASURES
CURRENT INCOME	2.43%	7.73%	9.54%	30.11%
SALES: GOODS & SERV				
PESOS	0.00%	0.00%	1.44%	4.28%
DOLLAR DENOM.	1.52%	5.16%	0.00%	0.00%
DOLLAR	0.69%	2.34%	8.06%	25.79%
OTHER INCOME				
PESOS	0.22%	0.22%	0.04%	0.04%
DOLLAR DENOM.	0.00%	0.00%	0.00%	0.00%
DOLLAR	.00%	0.01%	0.00%	0.00%
TRANSFERS	0.00%	0.00%	0.00%	0.00%
CURRENT EXPENDITURES	4.23%	7.45%	9.57%	16.28%
WAGES & SALARIES				
PESOS	1.43%	1.29%	3.70%	3.33%
DOLLAR DENOM.	.00%	.00%	0.02%	0.08%
DOLLAR	0.06%	0.19%	0.80%	2.55%
BENEFITS	0.06%	0.06%	0.04%	0.04%
PURCHASE OF GOODS				
PESOS	0.89%	0.89%	0.10%	0.10%
DOLLAR DENOM.	0.44%	1.39%	0.01%	0.04%
DOLLAR	0.57%	1.84%	1.59%	5.07%
PURCHASE OF SERVICES				
PESOS	0.33%	0.33%	0.37%	0.37%
DOLLAR DENOM.	0.00%	0.00%	0.15%	0.48%
DOLLAR	0.09%	0.28%	0.13%	0.41%
INTEREST				
PESOS	0.05%	0.05%	0.04%	0.04%
DOLLAR	0.01%	0.02%	0.18%	0.59%
TAXES				
PESOS	0.00%	0.00%	0.10%	0.15%
DOLLAR	0.31%	1.11%	2.34%	3.03%
PUB SECT TRANS	0.00%	0.00%	0.00%	0.00%
PRIVATE SECTOR TRANSFERS				
PESOS	0.00%	0.00%	0.00%	0.00%
DOLLAR	0.00%	0.00%	0.00%	0.00%
OTHER				
PESOS	0.00%	0.00%	0.00%	0.00%
DOLLAR	0.00%	0.00%	0.00%	0.00%
CAPITAL INCOME	0.00%	0.00%	0.00%	0.00%
PESOS	0.00%	0.00%	0.00%	0.00%
DOLLAR	0.00%	0.00%	0.00%	0.00%
CAPITAL EXPENDITURE	0.16%	0.48%	1.01%	2.56%
PESOS	0.01%	0.01%	0.30%	0.30%
DOLLAR	0.14%	0.46%	0.70%	2.25%
SURPLUS/DEFICIT	-1.96%	-0.20%	-1.04%	11.27%

NOTE: "DOLLAR DENOM." INDICATES ITEMS WHICH ARE PAYABLE IN PESOS BUT WHOSE VALUES ARE CLOSELY TIED TO THE EXCHANGE RATE.

TABLE 3 (CONT'D)
STATE ENTERPRISES
(PERCENT OF GDP)

	OTHER W/O MEASURES	OTHER W/ MEASURES	TOTAL W/O MEASURES	TOTAL W/ MEASURES
CURRENT INCOME	7.03%	16.35%	19.00%	54.19%
SALES: GOODS & SERV				
PESOS	2.54%	2.54%	3.99%	6.83%
DOLLAR DENOM.	0.45%	1.45%	1.98%	6.61%
DOLLAR	3.57%	11.42%	12.32%	39.55%
OTHER INCOME				
PESOS	0.17%	0.17%	0.42%	0.42%
DOLLAR DENOM.	.00%	.00%	.00%	.00%
DOLLAR	0.21%	0.68%	0.22%	0.70%
TRANSFERS	0.08%	0.08%	0.08%	0.08%
CURRENT EXPENDITURES	7.57%	15.02%	21.37%	38.75%
WAGES & SALARIES				
PESOS	2.31%	2.09%	7.44%	6.69%
DOLLAR DENOM.	0.03%	0.09%	0.05%	0.17%
DOLLAR	0.29%	0.92%	1.14%	3.66%
BENEFITS	0.05%	0.05%	0.16%	0.16%
PURCHASE OF GOODS				
PESOS	1.23%	1.23%	2.22%	2.22%
DOLLAR DENOM.	2.09%	6.70%	2.54%	8.13%
DOLLAR	0.28%	0.90%	2.44%	7.81%
PURCHASE OF SERVICES				
PESOS	0.28%	0.28%	0.98%	0.98%
DOLLAR DENOM.	.00%	.00%	0.15%	0.48%
DOLLAR	0.20%	0.65%	0.42%	1.35%
INTEREST				
PESOS	0.02%	0.02%	0.11%	0.11%
DOLLAR	0.59%	1.89%	0.78%	2.50%
TAXES				
PESOS	.00%	.00%	0.10%	0.15%
DOLLAR	.00%	.00%	2.65%	4.14%
PUB SECT TRANS	0.09%	0.09%	0.09%	0.09%
PRIVATE SECTOR TRANSFERS				
PESOS	0.06%	0.06%	0.06%	0.06%
DOLLAR	.00%	.00%	.00%	.00%
OTHER				
PESOS	0.03%	0.03%	0.03%	0.03%
DOLLAR	.00%	0.01%	.00%	0.01%
CAPITAL INCOME	0.17%	0.32%	0.17%	0.32%
PESOS	0.10%	0.10%	0.10%	0.10%
DOLLAR	0.07%	0.22%	0.07%	0.22%
CAPITAL EXPENDITURE	1.34%	2.11%	2.50%	5.15%
PESOS	0.98%	0.98%	1.30%	1.30%
DOLLAR	0.35%	1.13%	1.20%	3.85%
SURPLUS/DEFICIT	-1.71%	-0.45%	-4.70%	10.62%

SOURCE: UNPUBLISHED MINISTRY OF FINANCE DATA

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TABLE 4
SUMMARY: FISCAL DEFICIT
(PERCENT OF GDP)

	WITHOUT MEASURES	WITH MEASURES
CONSOLIDATED PUBLIC SECTOR	-28.12%	-11.02%
GENERAL GOVERNMENT	-23.42%	-21.64%
CENTRAL GOVERNMENT	-22.16%	-20.50%
CENTRAL ADMINISTRATION	-20.87%	-19.34%
SOCIAL SECURITY SYSTEM	0.00%	0.00%
DECENTRALIZED AGENCIES	-1.29%	-1.16%
LOCAL GOVERNMENT	-1.26%	-1.14%
STATE ENTERPRISES	-4.70%	10.62%
COMIBOL	-1.96%	-0.20%
YPFB	-1.04%	11.27%
OTHER	-1.71%	-0.45%

SOURCE: TABLES 1 AND 3

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Finally, as with the central government and COMIBOL, a ten percent reduction in the wage bill will significantly increase YPFB's operating surplus. The amount of that reduction is estimated in Table 3 at 0.37 percent of GDP. Overall, the effect of the combination of the three measures on YPFB will reduce the public sector deficit by 12.3 percent of GDP. As with COMIBOL, the decentralization of YPFB is likely to result in some cost saving but, again, the degree and timing of such a saving is difficult to determine. Finally, in the longer term, the improved cash flow of YPFB should enable it to devote more resources to exploration and secondary recovery, postponing the day when Bolivia will have to import petroleum.

E. Other State Enterprises

The deficit of other state enterprises (ENTEL, LAB, CBF, and others) will be affected by the devaluation and by wage reductions. As shown on Table 3, the devaluation will reduce their deficits by 1.02 percent of GDP. While a ten percent wage reduction will improve their fiscal position by a further 0.17 percent. The total reduction of the deficit of "other" state enterprises due to the package is thus 1.26 percent of GDP. One measure which should reduce the deficit of "other" state enterprises still further is the dissolution of CBF, the state holding company, a chronic money loser, and the distribution of its assets to the Departmental Development Corporations. In the course of this operation, the Central Government will be assuming the debts of CBF's component parts. This decentralization should eventually improve fiscal control of these enterprises by cutting off their access to Central Bank financing. The amount of CBF's deficit after the introduction of the measures is basically unchanged at approximately 0.4 percent of GDP.

F. Overall Fiscal Implications

Taken together, the combined impact of the economic measures on the central government and the state enterprises will result in a deficit reduction of 17.1 percent of GDP (See Table 4). While this is an enormous improvement (and it is difficult to think of any other government in the world which has implemented such a strong fiscal package), the consolidated fiscal deficit for 1984 was 28.1 percent of GDP (not counting certain debt service payments in arrears), of which 25.8 percent was financed domestically. Thus, the GOB program will produce a major reduction in the deficit to approximately 11 percent of GDP. In addition, an increased flow of donor disbursements (estimated at $ 197 million for 1986) will increase external financing of the deficit from 2.4 percent of GDP to about 4.5 percent. The combination of these two factors will reduce the domestic financing requirement from 25.8 percent of GDP to 6.5 percent of GDP. *

To some extent, positive feedback from the measures already taken should produce further improvement in the fiscal situation. This is the reverse of the process which has been observed over the last three years in which accelerating inflation has reduced revenue collections in real terms and undermined expenditure control, leading to a further fiscal deterioration and still larger inflationary pressures. One source of positive improvement on the revenue side is the income tax (corporate and individual), which, in 1980 and 1981, yielded more than 2.5 percent of GDP. This declined to 1.6 percent of GDP in 1983 and 0.8 percent in 1984, chiefly as a result of the effect of accelerating inflation on the real value of nominal tax proceeds during the time period between receipt of income and payment of the tax. An additional improvement of 1.5 to 2.0 percent of GDP might be expected as a result of a significant slowing of inflation and improved tax administration. In addition, a relaxation of the import constraints and a concomitant shift of contraband into legal channels could increase revenues from customs duties. For example, an increase to the level of imports forecast for 1986 elsewhere in this paper would produce an increase in customs revenue of 0.65 percent of GDP. On the expenditure side, there is substantial room for reductions through improved controls.

To summarize, the Victor Paz government, on taking office, faced an imposing fiscal deficit (28% of GDP), of which almost 26 percent of GDP was financed domestically (primarily through monetary emissions). The measures which it has taken and which have an immediate impact (devaluation, trade policy reform, petroleum price increases, and moderate public sector wage compression) will reduce this deficit by approximately 17 percent of GDP almost immediately, leaving a

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* It should be emphasized that the deficit, and, as a result, the domestic financing requirement, is extremely sensitive to small changes in the real exchange rate. During the month of September, while the nominal exchange rate remained essentially unchanged at slightly less than $b1.1 million, the price level increased by more than 50 percent. This appreciation of the real exchange rate appears to be a temporary aberration, a result of a sharp decline in inflationary expectations and a resulting sharp increase in demand for pesos. If the significantly lower real exchange rate which prevailed at the end of September were to prevail permanently, the consolidated public sector deficit would be 18.4 percent of GDP rather than the 11 percent estimated here. By mid-October, however, despite essentially no increase in price levels, the peso showed signs of softening and returning to something approaching its estimated purchases power parity value.

consolidated public sector deficit of 11 percent of GDP. Improved income and other tax collection and a relaxation of the import constraint could yield an additional 2-3 percent of GDP, thus reducing the total deficit to about 8 percent of GDP, and the domestic financing requirement to about 4 percent of GDP. Improved expenditure control and personnel reductions could make further inroads on the domestic financing requirement. The GOB has implemented a heroic program, but much remains to be done.

II. Monetary Developments and the Prospects for Inflation Control

Given that there is still likely to be a significant, although greatly reduced, fiscal deficit to be financed internally, the GOB's measures to insulate the banking system from some of the effects of inflation are particularly significant. The GOB program permits banks to accept deposits and make loans denominated in dollars or with a dollar maintenance of value clause. In addition, such deposits are exempted from reserve requirements. With savings and time deposits again able to earn a positive real rate of interest, and with the requirement for monetary emissions to finance the public sector deficit substantially reduced, although not eliminated, there is likely to be a substantial reduction in the expansion of currency and demand deposits in nominal terms and, consequently, in inflationary pressures.

Recent trends in the monetary aggregates, both in nominal and real terms, are shown in Table 5. The most important development over the past four years has been the decline, in real terms, of currency and banking system deposits as a result of accelerating inflation and controls on bank deposit and loan interest rates. The real value of banking system deposits declined 81.5 percent between 1981 and 1984. This deterioration in the monetary base both reduced credit available to the private sector and contributed to the acceleration of inflation. Between mid-1980 and the end of 1984, banking system credit to the private sector declined 65.8 percent in real terms (i.e. adjusted for changes in the consumer price index) as a result of the erosion of the deposit base. Over the same time period, inflation accelerated from 25 percent to over 1000 percent, before accelerating to even more astronomical levels in 1985.

The declining willingness of the Bolivian public to hold peso currency and deposits (that is, the increasing velocity of circulation) has been a major source of the inflationary process. The last section of Table 4 shows the relative contribution in recent years of monetary expansion, changes in velocity and changes in output on the inflationary process. In 1982 and 1983, monetary expansion was the principal source of inflation, although declines in output and some acceleration in

TABLE 5
MONETARY AGGREGATES AND INFLATION
(MILLION PESOS)

	AVERAGE 1981	AVERAGE 1982	AVERAGE 1983	AVERAGE 1984
NOMINAL MONETARY AGGREGATES				
M1	15694	37194	117394	447625
CURRENCY	10109	25165	82937	339139
DEMAND DEPOSITS	5585	12029	34457	108487
OTHER DEPOSITS	10498	26919	64105	350452
SAVINGS DEPOSITS	5533	12712	34998	25658
TERM DEPOSITS	1111	6811	18662	12525
OTHER LIABILITIES	953	2882	7050	4776
FOREIGN CURRENCY DEP	2901	4516	3396	465
M2	26191	64113	181499	798077
REAL MONETARY AGGREGATES (1980 PESOS)				
M1	12756	11104	9354	2405
CURRENCY	8217	7513	6609	1822
DEMAND DEPOSITS	4540	3591	2746	583
OTHER DEPOSITS	8533	8037	5108	1883
SAVINGS DEPOSITS	4498	3795	2789	138
TERM DEPOSITS	903	2033	1487	67
OTHER LIABILITIES	775	860	562	26
FOREIGN CURRENCY DEP	2358	1348	271	2
M2	21289	19141	14462	4288
NOMINAL GDP	153006	389004	1332361	19023836
REAL GDP (1980 PESOS)	124371	116139	106165	102206
INFLATION (GDP DEFLATOR)	23.02%	172.26%	274.68%	1383.14%
VELOCITY -CURRENCY	15.14	15.46	16.06	56.09
VELOCITY-M1	9.75	10.46	11.35	42.50
VELOCITY-M2	5.84	6.07	7.34	23.84
SOURCES OF INFLATION:				
PERCENT CHANGE IN M1		137.00%	215.63%	281.30%
PERCENT CHANGE M1 VELOCITY		7.27%	8.51%	274.46%
DECLINE IN OUTPUT		-6.62%	-8.59%	-3.73%
INFLATION (GDP DEFLATOR)		172.26%	274.68%	1383.14%

SOURCE: UNPUBLISHED BCB DATA

velocity played a distinct part in the process.* By 1984 (and in fact by late 1983), inflation had reached a point where the public began to reduce substantially its holdings of peso currency and deposits. As a result, the rate of inflation began to far outstrip the rate of growth in the monetary aggregates. This process continued through August 1985.

The extent to which rates of inflation can be reduced in the short run clearly depends on the speed with which inflationary expectations can be altered. The fact that current Bolivian rates of inflation are a relatively recent phenomenon and are widely perceived as a direct consequence of a monetized fiscal deficit makes it very likely that expectations about rates of inflation will converge fairly quickly toward the rate of monetary expansion implied by the fiscal deficit.

A reduction in the fiscal domestic financing requirement to a level of about 4 percent of GDP, if accompanied by a commensurate decline in velocity, should permit a reduction of inflation to the 100 percent per year range. For example, a financing requirement of 4 percent of GDP, if accompanied by a reduction in M1 (currency plus demand deposits) velocity to 11 (approximately the velocity the country experienced when it had inflation of 50 to 100 percent per year) and assuming no further expansion of M1 other than that required to finance the deficit, would imply an inflation rate of 55 percent per year.

All these assumptions presume that the rate of monetary expansion can be decreased proportionately to the reduction in the fiscal deficit. One obstacle to this is the fact that much of the reduction in the fiscal deficit arises from increases in the peso price of exports sold by the state enterprises. To the extent that the formerly "cheap" export proceeds were previously used, in effect, to subsidize private sector activities, the elimination of these subsidies will permit a real reduction in the rate of monetary expansion. However, to the extent that these proceeds were previously used for public sector purposes or to subsidize the operations of the Central Bank itself, it may not be possible to decrease the rate of monetary expansion in proportion to the reduction in the deficit. Little information is available on the use to which the Central Bank has put export earnings during the past year.

* Of course, in a fundamental sense, the monetary expansion was the source of the acceleration in velocity and (except for the disaster-related declines of 1983) the source of the contraction in real output which resulted from the "crowding out" of private sector credit. Nonetheless, it is useful analytically to consider their effects separately.

All the above projections are based on an assumption of a rapid convergence of inflationary expectations to a level consistent with the minimum needed to finance the remaining public sector deficit. If inflationary expectations do not drop quickly,-the Bolivian monetary authorities would face a serious dilemma. They must either validate those expectations through additional monetary expansion in order to maintain real levels of private sector credit, and thus produce a rate of inflation higher than that required for fiscal financing, or they must accept a very sharp contraction in output as the real money supply contracts until the public becomes convinced of the new underlying inflationary path. The initial experience with the foreign exchange auction and the growth in peso deposits in banks do, however, suggest a stabilizing of inflationary expectations. Demand for dollars has been very weak, and on several occasions, none of the bids offered met the Central Bank's "floor" rate. Bank deposits have risen from about 5 percent to 30 percent of money supply in just a few weeks. In any case, monetary management in Bolivia over the next several months will be a very delicate process.

The prospect that the monetary authorities will have to follow a very restrictive pattern of growth in currency and demand deposits makes the introduction of dollar-indexed accounts, and the lifting of interest rate ceilings on deposits in general, particularly important. By allowing depositors to earn a positive real rate of interest, these accounts should cause the real amount of time and savings deposits to return to their levels of the 1970s. As a result of inflation and negative real rates of interest, the real value of time and savings deposits declined by 78 percent between 1981 and 1984, from 6.9 percent of GDP in 1981 to 1.8 percent in 1984. A major expansion of these deposits should permit a major expansion of private sector credit without additional expansion of currency and demand deposits.

III. Balance of Payments and Debt Service

A. Exports. Primarily as a result of a chronically overvalued official exchange rate, at which all exporters were required to surrender 100 percent of export proceeds, and its adverse effects on exporters' profitability and, in some cases, financial viability, Bolivia's external position has deteriorated drastically over the past five years. Merchandise exports have declined steadily from $942 million on an F.O.B. basis in 1980 to $724 million in 1984. In fact, the decline would have been far greater, except for the increase in natural gas exports to Argentina, the volume of which is insensitive to (peso) export price declines due to exchange rate overvaluation. Other export volumes have declined substantially. Tin production in 1984 was down 10 percent from its 1980 level; lead exports declined by 85 percent, zinc by 19 percent, tungsten

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by 26 percent, and silver by 49 percent. Non-mineral exports have declined even more sharply. Sugar exports, by volume, have declined 74 percent, cotton has fallen to zero, coffee has diminished 40 percent, and timber by 74 percent. Previous governments responded to the problem, first, by compressing imports and, subsequently, by accumulating debt service arrearages. The compression of imports through administrative controls contributed to the decline in output, incomes, and employment, while arrearages on public sector external debt, which by June 30, 1985 were $928 million, equivalent to 141 percent of estimated 1985 merchandise exports, have led to a cut off of most new credits, including trade credits. As a result, most Bolivian imports must now be paid for in advance.

The projections in Table 6 for 1985 are based on current U.S. Embassy forecasts of volumes and prices. Actual mineral export figures for the first quarter show export volumes at one half the volumes of the corresponding period in 1984. Much of this decline, however, seems to represent withholding of stocks in anticipation of a devaluation, and there are reports of inventories with a market value of $60 million awaiting shipment. Nonetheless, mineral exports for 1985 are forecast to decline to $301.7 million from $364.0 million in 1984, while overall exports are forecast to be reduced (on an F.O.B. basis) to $656.1 from $724.4 million in 1984.

The degree to which the new economic program will reverse this trend depends on the responsiveness of output to improved domestic prices for exports and to the increased availability of credit for productive activities. USAID projections of the recovery of exports in 1986, as well as projections for 1985, are presented in Table 6. Total exports of metallic tin and concentrates are projected to recover slightly in 1986, to 22 thousand tons, only marginally higher than export levels achieved in 1984. In addition, some recovery of world tin prices is forecast. Among other mineral exports, tungsten is forecast to recover essentially to its 1984 level of 2.5 thousand metric tons, well below the 3 thousand metric tons achieved in 1980-83. Similarly, antimony and copper exports in 1986 are projected to recover their 1984 levels, although larger increases in subsequent years are likely. In the case of lead, zinc, and silver, somewhat stronger recoveries are forecast in view of the greater sensitivity of production to price changes. Lead exports, in particular, will expand in response to the opening of the Karachipampa smelter, for which stocks of ore have been accumulated for some time, reducing export levels in recent years. Table 6 forecasts some improvement in most mineral prices in line with World Bank projections. In the case of tin, copper, and silver, however, where the Bank's projections appear overly optimistic, the projections have been adjusted somewhat downward.

TABLE 6
MERCHANDISE EXPORTS
(VALUES IN MILLION DOLLARS, VOLUMES IN THOUSAND METRIC TONS)
(PRICES IN DOLLARS/LB., UNLESS SPECIFIED)

	1984	1985	1986
TOTAL METALS	363.96	301.74	4[illegible]16
TIN (CONCENTRATE)	190.77	49.61	83.35
VOLUME	15.67	4.50	7.00
UNIT PRICE	5.52	5.00	5.40
TIN (METALLIC)	56.98	146.19	181.91
VOLUME	4.66	13.00	15.00
UNIT PRICE	5.54	5.10	5.50
TUNGSTEN	18.94	15.87	19.29
VOLUME	2.53	2.30	2.50
UNIT PRICE	3.39	3.13	3.50
ANTIMONY	22.93	25.93	31.53
VOLUME	12.53	12.00	13.00
UNIT PRICE	0.83	0.98	1.10
LEAD	1.01	0.83	4.85
VOLUME	2.40	2.50	10.00
UNIT PRICE	0.19	0.15	0.22
ZINC	37.28	31.49	40.57
VOLUME	36.86	34.00	40.00
UNIT PRICE	0.46	0.42	0.46
COPPER	1.84	1.59	2.15
VOLUME	1.61	1.20	1.50
UNIT PRICE	0.52	0.60	0.65
SILVER	21.44	14.23	35.00
VOLUME (TONS)	90.30	80.00	150.00
UNIT PRICE (TR OZ)	8.14	6.10	8.00
OTHER METALS	12.77	16.00	18.50

TABLE 6 (continued)
MERCHANDISE EXPORTS
(VALUES IN MILLION DOLLARS, VOLUMES IN THOUSAND METRIC TONS)
(PRICES IN DOLLARS/LB., UNLESS SPECIFIED)

	1984	1985	1986
TOTAL HYDROCARBONS	388.91	378.46	394.82
PETROLEUM	8.37	0.00	15.12
VOLUME (THOU BBL)	310.00		630.00
UNIY PRICE	27.00		24.00
NATURAL GAS	375.72	375.56	376.80
VOLUME (MILL CU FT)	78603.00	78241.00	78500.00
UNIT PRICE (THOU CU FT)	4.78	4.80	4.80
OTHER HYDROCARBONS	4.82	2.90	2.90
SUGAR	6.65	6.62	7.94
VOLUME	25.12	25.00	30.00
UNIT PRICE	0.12	0.12	0.12
COFFEE	6.57	6.30	7.50
VOLUME (MILLION LB)	7.22	7.00	7.50
UNIT PRICE	0.91	0.90	1.00
TIMBER	5.98	5.70	7.75
VOLUME	19.93	19.00	25.00
UNIT PRICE ($ PER TON)	300.00	300.00	310.00
OTHER (VALUE)	9.98	9.50	14.00
RUBBER	0.75	0.75	1.50
LEATHER	0.76	0.75	1.50
MACHINERY & EQUIP.	0.00		
OTHER	8.46	8.00	11.00
TOTAL CIF	782.04	708.32	849.17
LESS INSURANCE AND FREIGHT	57.64	52.20	62.58
TOTAL FOB	724.40	656.11	786.58

SOURCE: UNPUBLISHED BCB DATA AND USAID AND EMBASSY ESTIMATES

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adjusted somewhat downward. If minerals prices in 1986 were to show no improvement at all over their 1985 level, exports will be $ 37 million lower than those shown in Table 6.

Natural gas sales to Argentina, which are made under a long-term contract, are projected to maintain their 1984 volumes and prices through 1985 and 1986. Petroleum represents a very different case. The export improvement shown for 1986 represents the effect of the price increase in eliminating clandestine sales to neighboring countries and the elimination of gasoline allocations to employees of YPFB. The result will be to free up 1,500 to 2,000 barrels per day for export. In addition, there may be some reduction in domestic demand as a result of the large increase in price. Counterbalancing this, however, will be an increase in demand resulting from the expected recovery of economic activity in 1986. The amount of such a recovery is highly speculative. An assumption of a price elasticity of -0.1 and an income elasticity of 1, and a 5 percent growth of economic activity in 1986, would suggest a decrease in domestic consumption of 15 percent. However, the presence of adjustment lags would probably delay some of this decrease.

Even more important than this rather modest contribution to exports is the fact that the reduction in domestic consumption produced by the increase in petroleum product prices and the additional exploration YPFB will be able to carry out with its profits, will postpone for several years the need for Bolivia to import petroleum (which had been been projected to begin in 1986). In addition to the added foreign exchange outlay, such imports would have required major infrastructure investments which the country is not in a position to undertake in the near future.

Other exports are projected to show stronger recoveries in response to enhanced export incentives. Overall, exports for 1986 are projected at $849.2 million on a C.I.F. basis and $786.6 million F.O.B.

B. Imports. The level of imports for 1985 and 1986 is essentially a function of the level of economic activity, now that administrative controls on imports have been removed. Indeed, the ultimate purpose of measures to improve the balance of payments is to increase import capacity in order to permit higher levels of output, income, and employment. Table 7 estimates the import requirements consistent with a two percent decline in output in 1985 and a 3.5 percent growth of output in 1986. The table divides imports into three categories, raw materials and semi-finished products, consumer goods, and capital and other goods. Raw materials and semi-finished goods imports are assumed to be based on

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TABLE 7
MERCHANDISE IMPORTS
(MILLION DOLLARS)

ACTUAL AND PREDICTED IMPORTS
RAW MATERIALS AND SEMI-FINISHED PRODUCTS

	COEFFICIENTS	1979	1980	1981	1982	1983	1984	1985	1986
AGRICULTURE	0.0031	9.99	10.13	10.84	10.60	8.27	9.28	9.66	9.99
MINING	0.0064	7.24	7.46	7.60	6.66	6.69	5.20	4.57	4.73
HYDROCARBONS	0.0031	0.65	0.64	0.64	0.69	0.65	0.63	0.59	0.61
MANUFACTURING	0.0446	137.99	139.73	134.42	113.86	105.35	89.56	80.60	83.42
CONSTRUCTION	0.1191	95.76	84.68	55.14	33.11	33.11	27.99	25.19	26.07
UTILITIES	0.0082	2.61	2.80	3.06	3.08	3.03	3.12	3.12	3.23
TRANSPORT & COMM	0.0137	30.61	31.24	31.09	28.73	27.35	26.66	25.33	26.21
COMMERCE & FINANCE	0.0084	28.66	28.14	27.13	22.55	20.02	20.19	19.59	20.27
PUBLIC ADMINISTRAT	0.0050	8.99	9.21	9.35	9.42	9.53	9.96	9.46	9.79
OTHER	0.0023	6.57	6.71	6.72	6.48	6.51	5.78	5.43	5.62
PREDICTED IMPORTS OF RAW MATERIALS & SEMI-FINISHED PRODUCTS CIF (1981 DOLLARS)		329.26	320.73	285.99	235.17	220.50	198.37	183.54	189.97
UNIT VALUE OF IMPORTS (1981 = 100)		0.976004	1.009	1	0.965	0.955	0.913	0.9	0.90
PREDICTED IMPORTS OF RAW MATERIALS & SEMI-FINISHED PRODUCTS CIF (CURRENT DOLLARS)		321.36	323.62	285.99	226.94	210.58	181.11	165.19	170.97
ACTUAL IMPORTS		325.30	250.50	341.90	231.90	261.00	238.12		
UNDER/OVER-PREDICTION		-1.21%	29.19%	-16.35%	-2.14%	-19.32%	-23.94%		
CONSUMER GOODS		184.90	169.30	233.60	80.40	53.40	53.40	115.35	122.83
CAPITAL GOODS & OTHER		422.20	277.60	370.90	219.70	274.10	199.00	200.00	264.59
TOTAL IMPORTS		932.40	697.40	946.40	532.00	588.50	490.52	480.54	558.39
MEMORANDUM:									
PERCENT CHANGE IN GDP		1.80%	0.57%	-0.95%	-8.73%	-7.59%	-3.50%	-4.09%	3.50%

SOURCE: Source: Daniel Cohen, Mar Dieye, Jean Le Ney, and Charles Richter
Una Prevision Exploratoria para la Economia Boliviana en 1983
UNDP, La Paz, 1983, p. 42; unpublished BCB data; and Mission estimates.

fixed imported input coefficients in each sector of the economy. These coefficients were estimated by a United Nations study based on an input-output table. The coefficients measure the imports (in 1981 dollars) required as a proportion of real GDP (measured in 1970 pesos). In estimating 1985 and 1986 import requirements, each sector is assumed to grow at the same rate as the overall change in output. These import requirements are translated into current dollars based on a projected unit value of imports index. In the years prior to 1983, as shown in the table, this procedure has resulted in a fairly accurate prediction of actual imports. In 1983 and 1984, however, the result has been an almost 20 percent underprediction of raw materials and semi-finished goods imports in each year. This is believed to result from a misclassification of final goods imports as raw materials and semi-finished goods. With the elimination of import controls, this misclassification should end. Therefore, no adjustment has been made to the predicted levels of imports to take into account this previous underprediction.

Consumer goods and capital goods are believed to respond primarily to the overall level of economic activity. These have been estimated based on a simple regression of each category of imports (measured in constant dollars) to current year real GDP and then adjusting by the unit value of imports index. For 1985, the level of capital goods imports has been adjusted downward because of the observed low level of investment activity in the first eight months of the year.

C. Capital Account. The situation of the capital account for 1986 (and for 1985 as well) is still highly speculative. The figures in Table 8 show some recovery of direct investment as well as significant increases in public sector medium and long-term disbursements, generally reflecting increases in multilateral and bilateral disbursements. More precise estimates will depend on the GOB's ability to reach agreement with external creditors on rescheduling arrangements. This point will be considered more fully below.

Private direct investment and other private capital inflows are expected to make a relatively small contribution to the capital account in 1986. Although a significant recovery of the private capital account is expected as a result of the improved investment climate, especially if significant oil exploration activity resumes, the bulk of this activity is projected to take place in 1987 and beyond. On the other hand, a substantial increase in public sector disbursements, essentially a doubling, is forecast in 1986 as the climate for donor financed projects will have improved substantially.

TABLE 8
BALANCE OF PAYMENTS
(MILLION DOLLARS)

	1984 CREDIT	1984 DEBIT	1984 NET	1985 CREDIT	1985 DEBIT	1985 NET	1986 CREDIT	1986 DEBIT	1986 NET
CURRENT ACCOUNT	928.6	1033.8	-105.2	854.0	1071.7	-217.7	996.6	1126.4	-129.8
EXPORTS (FOB)	724.4		724.4	656.0		656.0	786.6		786.6
IMPORTS (CIF)		476.8			480.5	-480.5		558.4	-558.4
FACTOR SERVICES	17.7	378.8	-361.1	20.0	403.2	-383.2	20.0	-378.0	-358.0
DIRECT INVESTMENT		36.2	-36.2		40.0	-40.0		40.0	-40.0
INTEREST	17.7	330.4	-312.7	20.0	351.0	-331.0	20.0	325.8	-305.8
OTHER		12.2	-12.2		12.2	-12.2		12.2	-12.2
NON FACTOR SERVICE	95.0	175.2	-80.2	85.0	185.0	-100.0	90.0	190.0	-100.0
OTHER TRANSPORT	35.5	57.0	-21.5	28.0	65.0	-37.0	30.0	70.0	-40.0
TRAVEL	32.5	30.0	2.5	30.0	30.0	0.0	30.0	30.0	0.0
OTHER	27.0	88.2	-61.2	27.0	90.0	-63.0	30.0	90.0	-60.0
TRANSFERS	91.5	3.0	88.5	93.0	3.0	90.0	100.0		100.0
CAPITAL ACCOUNT	998.3	720.4	277.9	591.5	422.0	169.5	307.0	442.0	-135.0
PRIVATE	7.0	1.1	5.9	8.0	1.0	7.0	10.0	1.0	9.0
DIRECT INVESTMENT	7.0		7.0	8.0		8.0	10.0		10.0
OTHER		1.1	-1.1		1.0	-1.0		1.0	-1.0
PUBLIC SECTOR	905.8	653.0	252.8	533.5	421.0	112.5	297.0	441.0	-144.0
DISBURSEMENTS	104.9		104.9	100.0		100.0	197.0		197.0
AMORTIZATION		275.8	-275.8		321.0	-321.0		341.0	-341.0
ARREARS ON GAS EX	565.7	377.2	188.5	188.5	100.0	88.5	100.0	100.0	0.0
RESCHEDULING	235.2		235.2	245.0		245.0	0.0		0.0
ARREARS ETC.									
INTEREST	47.1		47.1	50.0		50.0	0.0		0.0
AMORTIZATION	188.1		188.1	195.0		195.0	0.0		0.0
BANKING SYSTEM		66.3	-66.3	0.0		0.0			0.0
SHORT TERM	85.5		85.5	50.0		50.0			0.0
ERRORS AND OMISSIONS		4.8	-4.8			0.0			0.0
COUNTERPART ITEMS	0.9		0.9			2.0			0.0
CHANGE IN NET INT'L RESERVES (- INCREASE)			-168.8			46.2			264.8

SOURCE: IMF, RECENT ECONOMIC DEVELOPMENTS, SEPT. 6, 1985, UNPUBLISHED BCB DATA, AND MISSION ESTIMATES

TABLE 9
DEBT SERVICE
ARREARAGES TO JUNE 30, 1985

	AMORTIZATION	INTEREST	TOTAL
MULTILATERAL CREDITORS	14,120	16,421	30,541
WORLD BANK/IDA	3,268	4,658	7,926
IDB	4,680	5,514	10,194
OTHER	6,172	6,249	12,421
BILATERAL CREDITORS	63,128	5,388	68,516
PRIVATE CREDITORS	581,689	247,176	828,865
BANKS	509,416	222,005	731,421
SUPPLIERS	71,022	24,091	95,113
OTHERS	1,251	1,080	2,331
SHORT-TERM	0	0	0
TOTAL	658,937	268,985	927,922

SOURCE: BCB UNPUBLISHED DATA

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TABLE 10
DEBT SERVICE PROJECTIONS 1985-1986
(MILLION DOLLARS)

	1985			1986		
	AMORTIZATION	INTEREST	TOTAL	AMORTIZATION	INTEREST	TOTAL
TOTAL	319.7	186.9	506.6	299.2	165.6	464.8
MULTILATERAL	83.6	47.9	131.5	59.4	46.3	105.7
BILATERAL	131.5	105.2	236.7	158.1	94.2	252.3
PARIS CLUB	51.5	22.7	74.2	53.3	19.6	72.9
BANK GUARANTEED	14.8	4.7	19.5	13.9	3.4	17.3
SUPPLIERS	11.0	3.7	14.7	10.3	2.0	12.3
OTHER	25.7	14.3	40.0	29.1	14.2	43.3
LATIN AMERICAN GOV'TS	75.7	81.8	157.5	101.5	74.1	175.6
OF WHICH: PREVIOULY REFINANCED	31.9	67.9	99.8	69.6	63.9	133.5
SOCIALIST COUNTRIES	4.3	0.7	5.0	3.3	0.5	3.8
PRIVATE CREDITORS	108.5	32.0	140.5	81.1	20.7	101.8
BANK CONSORTIUM	98.9	28.1	127.0	73.0	17.8	90.8
OTHER BANKS	2.0	0.7	2.7	1.0	0.4	1.4
SUPPLIERS	0.7	0.2	0.9	0.2	0.1	0.3
BONDS	6.9	3.0	9.9	6.9	2.4	9.3
STATISTICAL DISCREPANCY	(3.9)	1.8	(2.1)	0.6	4.4	5.0

SOURCE: IMF RECENT ECONOMIC DEVELOPMENTS, SEPT. 6, 1985, TABLE 61

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The longstanding problem of Argentine arrears on gas payments seems to have been resolved, with an understanding to maintain, in effect, a three-month delay in payments and to accept partial payment in commodities and to offset debts owed by Bolivia to Argentina. The regularization of these payments shows as an $88.5 million net inflow in 1985 and as balancing debit and credit entries in 1986.

The figures shown in Table 8 forecast a deficit of $46.2 million for 1985. The 1985 figures forecast an increase in arrearages of $245 million, based on a continuation of the pattern of arrears accumulation recorded in the first half of the year. The <u>ex ante</u> deficit for 1986, is $265 million, despite the significant improvement in exports, but based an a rate of growth of imports sufficient to sustain 3.5 percent real growth in 1986. The $265 million figure assumes no new accumulation of arrearages, nor any reduction of outstanding arrearages. It also does not include an IBRD Structural Adjustment Loan or any other extraordinary financing. It is thus the baseline for a major external financing exercise involving external creditors, the IBRD, the IMF, and the USG.

D. <u>Debt Service Capabilities and Debt Arrearages</u>. The Bolivian public sector debt arrearage situation as of the end of June 1985 is presented in Table 9. The debt service required for 1985 and 1986 are presented on Table 10. Of the debt service due in 1985 (apart from arrears from previous years), 26.0 percent is owed to multilateral institutions, 46.7 percent to bilateral creditors, 27.7 percent to private creditors lacking official guarantees (of which 25.6 percent is to foreign commercial banks). Of the arrearages accumulated as of the end of June 1985, however, 89.3 percent was owed to private creditors, of which 78.8 percent was owed to commercial banks. Only 3.3 percent of the arrearages were owed to multilateral institutions and only 7.4 percent to bilateral donors. Thus, although multilateral and bilateral debt service make up about three quarters of current debt service obligations, the arrearages problem is predominantly a problem with commercial banks.

Clearly, Bolivia cannot immediately pay current debt service due plus arrearages. It is probable, however, that a series of restructuring arrangements could be negotiated on more or less normal terms which would permit Bolivia to resume regular debt service and still leave sufficient import capacity to permit significant rates of growth. First, the GOB will have to continue to make regular payments on debt to multilateral institutions. This will not, however, represent an additional burden over and above what it has already been paying. In the case of bilateral creditors, an arrangement with the Paris Club could probably be negotiated which would permit a rescheduling of 90 percent of interest and amortization of current debt. The rescheduling of arrears might present some problem because the GOB has been paying some bilateral creditors and not others. It is probable that some arrangement could be reached which would permit a rescheduling of prior arrearages as well. A major problem which will face the GOB is that a substantial portion of its bilateral debt and debt service are owed to non-Paris Club countries, primarily other Latin American governments. Much of the Latin debt has been previously rescheduled. Moreover, these other Latin American governments face serious debt service problems of their own. What rescheduling arrangements could be reached with these governments is difficult to predict, although recent discussions with Argentina suggest that that country is prepared to be quite forthcoming.

The more complex problem is that of the commercial banks and other private creditors. This problem is further exacerbated by the existence of an April 1981 rescheduling agreement with commercial bank creditors with which the GOB has not complied. Nonetheless, the size of the problem is such that private creditors will clearly have to agree to a long-term rescheduling of current amortization and all principal and interest in arrears. The best that bank and other private creditors can hope for in the present circumstance is to receive current interest due and eventually, at some time in the remote future, to recover their principal.

If an arrangement can be reached with the Paris Club to reschedule 90 percent of principal and interest payments, including principal and interest in arrears, the GOB could obtain debt relief in an amount of about $61 million from this source in 1986 ($66 million from the debt service owed in 1986 less about $5 million that would have to be paid on debt due and in arrears from previous years). If in addition, the commercial banks can be persuaded to accept current payment of interest in return for the rescheduling of 100 percent of amortization currently due and the capitalization of interest in arrears, this would provide $81 million of additional financing. The combination of these two sources would fill $142 million of the $265 million gap. Sources for filling the remaining $123 million are less clear. One possibility is the bilateral Latin American debt, at least that portion of it which has not previously been rescheduled. This might provide as much as $40 million of additional financing. Multilateral and bilateral sources, including a US ESF funded balance-of-payments support program, could probably supply all or much of the rest.

COUNTRY CHECKLIST

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FAA Sec. (481). Has it been determined that the government of the recipient country has failed to take adequate steps to prevent narcotic drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully? — No.

2. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a)such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government? — No

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3. <u>FAA Sec. 620(e) (1).</u> If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?	No
4. <u>FAA Sec 532(c), 620 (a), 620 (f), 620D; FY 1982 Appropriation Act Secs. 512 and 513.</u> Is recipient country a Communist country? Will assistance be provided to Angola, Cambodia, Cuba, Laos, Vietnam, Syria, Libya, Iraq, or South Yemen? Will assistance be provided to Afghanistan or Mozambique without a waiver?	No
5. <u>ISDCA of 1981 Secs. 724, 727 and 730.</u> For specific restrictions on assistance to Nicaragua, see Sec. 724 of the ISDCA of 1981. For specific restrictions on assistance to El Salvador, see Secs. 727 and 730 of the ISDCA of 1981.	N/A
6. <u>FAA SEC. 620 (j).</u> Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action of U.S. property?	No

7. FAA Sec. 620 (l). Has the country failed to enter into an agreement with OPIC?

The GOB is currently engaged in discuss with OPIC with the objective of signing an agreement.

8. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters?

No

(b) If so, has any deduction required by the Fishermen's Protection Act been made?

9. FAA Sec. 620 (q); FY 1982 Appropriation Act. Sec. 517, (a) Has the government of the recipient country been in default for more than six months on interest or principal of any AID loan to the country? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan, under a program for which the appropriation bill appropriates funds?

No.

10. FAA Sec. 620 (s). If contemplated assistance is development loan or from Economic Support Fund, has the Administrator taken into account the amount of foreign exchange or other resources which the country has spent on military equipment? (Reference may be made to the annual "Taking into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)

He will

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11. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?	No
12. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget? (Reference may be made to the Taking into Consideration memo.)	No arrearages.
13. FAA Sec. 620 A; FY 1982 Appropriation Act Sec. 520. Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism? Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed a war crime?	Not during the administration of the current democratically elected consititutional government.
14. FAA Sec. 666. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?	No.

15. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device, after August 3, 1977? (FAA Sec.620E permits a special waiver of Sec. 669 for Pakistan.)	No.
16. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Session of the General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.)	Bolivia was represented at the Meeting of Ministers by the Torrelio Government. It did not formally disassociate itself from the communique issued.
17. ISDCA of 1981 Sec. 721. See special requirements for assistance to Haiti.	N/A

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria.

a. FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?	N/A (but no)

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2. Economic Support Fund Country Criteria

a. FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest?

No

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

N/A

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

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

N/A

NONPROJECT ASSISTANCE CHECKLIST

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

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

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

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

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

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

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

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

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

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

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for ESF

a. FAA Sec. 531. How will this assistance support promote economic or political stability? Is the country among the 12 countries in which Supporting Assistance may be provided in this fiscal year? — By reinforcing a well reasoned and market-led economic stabilization program.
N/A

2. Nonproject Criteria for Development Assistance — N/A

3. Nonproject Criteria for Development Assistance (Loans only) — N/A

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

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

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

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

4. Additional Criteria for Alliance for Progress

a. FAA Sec. 251 (b)(1)-(8). Does assistance take into account principles of the Act of Bogota and Charter of Punta del Este; and to what extent will the activity contribute to the economic or political integration of Latin America?

Yes. It will not

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

N/A

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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

FEB 3 1986

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR (LAC)

FROM : LAC/DR, Terrence J. Brown

SUBJECT: Approval of an Economic Support Fund (ESF) Program for Bolivia

Problem: To approve a FY 1986 ESF balance-of-payments program for Bolivia.

Background: Fueled by continuing political instability and declining world prices for key exports, economic conditions in Bolivia reached by 1985 a crisis of unprecedented proportions. By the end of the 12-month period ending August 1985, the inflation rate had reached a yearly level of over 20,000 percent. Exports, which attained a level of $942 million in 1980, will drop to a projected $558 million in 1986. In addition, Bolivia has had to face large fiscal deficits, a declining level of productive imports, large funding gaps in the balance-of-payments, and the adverse effects of natural disasters (El Nino) on its productive capacity. The net effect of these factors has been a sharp GDP decline of 20.1 percent over the past five years.

Barely three weeks after assuming office, on August 29, 1985, the new democratic government of Bolivia launched a comprehensive program of economic reforms to stabilize the country's economy and put it back on a growth path. The program includes measures which have:

-- Allowed the previously highly over-valued official exchange rate to find its market equilibrium;
-- Drastically reduced the inflation rate;
-- Increased domestic gasoline prices to about $1.14 per gallon - a ten-fold increase over the previous price;
-- Liberalized trade policies, allowing market forces to operate with minimal government interference;
-- Frozen public sector wages and reduced the government role in the negotiation of wages by private sector employers;
-- Abolished all price controls, except some state-marketed items such as gasoline, electricity, and telephone services which will be adjusted periodically to reflect international market prices; and
-- Decentralized the operations of state enterprises which will be run by the various Departmental Development Corporations.

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The potentially very favorable impact of these reforms on economic recovery over the medium term is seriously jeopardized by the extremely difficult current economic situation which has been aggravated by the recent collapse of the international tin market. Yet the scope of reforms represents a bold, courageous GOB attempt to put the economy on a sound and sustained recovery path.

The forceful GOB recovery measures merit the support of the donor community, especially of A.I.D. which has influenced heavily GOB decisions through a persistent policy dialogue process. Particularly important in the initial implementation stages of the recovery program is assistance to cover the projected large balance-of-payments financing gap, as discussed below. While we believe that $25 million in ESF balance-of-payments assistance would be the appropriate level necessary to show a credible support for these reforms and to improve the probability of successful implementation, budget realities preclude funding at this level. Therefore, we are proceeding to authorize a (post-Gramm-Rudman) level of $14.355 million.

Please note that the FY 1986 Congressional Presentation shows only $10 million in ESF assistance to Bolivia. This figure is a token level set over a year ago, which did not envision the highly positive political and economic stance taken by the new government.

Discussion: Bolivia's balance-of-payments financing gap for 1986 is estimated at $355 million. This gap could be reduced by some $142 million through proposed Paris Club and commercial bank debt reschedulings. The unfinanced gap of around $213 million, must be met by multilateral and bilateral agencies. Planned A.I.D. contributions will include:

(a) $14.355 million in ESF;
(b) $20 million in PL-480 Title III (under discussion) and;
(c) $25.5 million obligated in FY 1985 under the Agro-Industrial component of the Disaster Recovery Project. (This amount was included in the calculation of the overall financing gap.)

The World Bank (IBRD) and the International Monetary Fund (IMF) are expected to be main contributors to closing the remainder of the gap. The IBRD is planning to provide a fast-disbursing import credit of approximately $50 million by the second semester of 1986. The IMF is expected to sign a stand-by agreement, perhaps by February 1986, which may entail a first tranche of around $55 million.

Immediate approval of the A.I.D. ESF program will help the GOB meet critical foreign exchange needs prior to the availability of funds under the proposed IMF stand-by agreement and the IBRD Import Credit programs.

Initially, we can only provide $7.177 million (i.e. $7.5 million adjusted for Gramm-Rudman) of the approved total to the GOB. This is consistent with Section 611 of the International Security and Development Cooperation Act of 1985 which precludes obligation in one tranche of the full amount of FY 1986 ESF assistance to Bolivia. Obligation of 50 percent of such assistance may occur only after the U.S. President certifies to the U.S. Congress that the GOB has enacted a law setting its coca requirements and making coca production above those requirements illegal. The GOB has complied with this condition and the U.S. President signed the certification on December 24, 1985. The certification has subsequently been forwarded to Congress. The remaining 50 percent can be provided as soon as another certification is sent to Congress stating that the GOB has met the coca eradication targets for 1985 as set forth in a 1983 narcotics agreement.

The program agreement will contain the following provisions:

(1) Language stating that obligation of the second tranche will be contingent upon: (a) GOB compliance with the coca eradication targets set in the 1983 agreement; (b) completion of a status report on the follow-up actions taken by the GOB to carry out its economic stabilization program; and (c) the availability of funds and the mutual agreement of the parties to proceed with the program.

(2) A covenant that within twelve months following disbursement of the first 50 percent of the total ESF program, the GOB will make available to private importers an amount of foreign exchange equal to the amount disbursed by A.I.D. to the Bolivian Central Bank (BCB). The foreign exchange will be used to finance imports of raw materials, machinery, intermediate goods, and spare parts from the United States.

The following decisions were made at the DAEC review:

(1) Specific local currency uses will be based on a detailed plan to be negotiated with the GOB prior to signing the Program Agreement. One of the uses will be a trust fund to help cover some of the operating costs of our Mission in La Paz; and

(2) The ESF program should be approved as a grant rather than as a loan as shown in the FY 1986 Congressional Presentation. Bolivia is the second poorest country in Latin America, its financial situation is one of the worst in the region, and other countries which economically are better off than Bolivia are receiving such assistance on a grant basis. The Congressional Notification, which was forwarded to Congress on January 27, 1986, reflects this change.

Recommendations: (1) That you approve a $14.355 million FY 1986 ESF grant program for Bolivia; and (2) that you sign the attached PAAD facesheet for $7.177 million.

Approved: Malcolm Butler

Disapproved: ____________

Date: FEB - 6

Attachment: Program Assistance Authorization Document Facesheet

CLASSIFICATION:

AID 1120-1	AGENCY FOR INTERNATIONAL DEVELOPMENT	1. PAAD NO. 511-0570 511-K-601
PAAD	PROGRAM ASSISTANCE APPROVAL DOCUMENT	2. COUNTRY Bolivia
		3. CATEGORY Cash Transfer
		4. DATE January , 1986
5. TO: AA/LAC, Dwight Ink		6. OYB CHANGE NO.
7. FROM LAC/DR, Terrence J. Brown T.B.		8. OYB INCREASE TO BE TAKEN FROM:
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 7,177,000		10. APPROPRIATION - BPC: LESA-86-35511-KG31 (637-65-511-00-50-61)

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
☐ LOAN ☒ GRANT	☐ INFORMAL ☒ FORMAL ☐ NONE	FY 1986	Date of Authorization

15. COMMODITIES FINANCED

N/A

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: $7,177,000
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: $7,177,000	Other:

18. SUMMARY DESCRIPTION

The purpose of this Program is to provide balance-of-payments assistance to the Government of Bolivia (GOB) in support of its economic reforms. The ESF program is part of the package of assistance which also includes PL-480 Title I and Title III and the Agro-industrial Reactivation component of the FY 1985 Disaster Recovery project. This assistance has been conditioned on GOB taking broad economic reforms and on progress in coca control.

This $7,177,000 grant is the first tranche of a $14.355 million FY 1986 ESF program which will be obligated in two tranches. It will be disbursed as a cash transfer into a U.S. bank account of the GOB. Within six months after disbursement of the assistance, the GOB will deposit into a special account an equivalent amount of Bolivian pesos to be used for mutually agreed development purposes consistent with the general criteria of the Foreign Assistance Act, especially Sections 103-106.

The GOB will agree to make available an equivalent amount of dollars to the private sector for imports of raw materials and intermediate goods from the U.S. within twelve months following each disbursement.

19. CLEARANCES		DATE
LAC/SA:FAlmaguer		11/22/85
LAC/DR:ILevy		
LAC/DP:WWheeler		1/13/86
FM/PAD:CChristensen		1/15/86
GC/LAC:GDavidson		1/27/85
ARA/EC P.R Beckham		1/2/85
DAA/LAC:MButler		

20. ACTION

☒ APPROVED ☐ DISAPPROVED

Malcolm Butler

AUTHORIZED SIGNATURE DATE

(Acting)
Assistant Administrator (LAC)

TITLE

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CLASSIFICATION: