

Bolivia: 2006 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Bolivia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2006 Article IV consultation with Bolivia, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 23, 2006, with the officials of Bolivia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 28, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of July 17, 2006 updating information on recent developments.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 17, 2006 discussion of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Bolivia.

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

Selected Issues Paper

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INTERNATIONAL MONETARY FUND

BOLIVIA

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with Bolivia

Approved by Markus Rodlauer and Carlo Cottarelli

June 28, 2006

- **Discussions.** Article IV consultation discussions were held during May 8–23 with, among others, Vice-President Garcia-Linera, Planning Minister Villegas, Finance Minister Arce, Hydrocarbons Minister Soliz-Rada, CBB President Raul Garron, key embassies, and representatives of the oil companies and the financial sector. The mission team comprised Messrs. Furtado (head), Gracia, and Mansilla; and Ms. Jaramillo-Mayor (all WHD); Mr. Cortavarría-Checkley (MFD); Mr. Dodzin (PDR); and Mr. Simone (FAD); and was assisted by the Fund’s resident representative, Mr. Vesperoni. Mr. Cuevas (OED) participated in the policy discussions.
- **Political setting.** Following a protracted period of political instability and social unrest, general elections were held in December 2005. Evo Morales, elected with a strong majority, is the first Bolivian president of indigenous origin and has vowed to reduce poverty and inequality through social inclusion and institutional changes. Elections for a constitutional assembly will be held on July 2, 2006.
- **Economic setting and key policy issues.** The new government has inherited a favorable macroeconomic situation, including a low fiscal deficit and inflation, and record international reserves. The short-term outlook remains favorable, reflecting the continued strength of natural gas and mineral exports. The authorities expressed a strong commitment to maintain macroeconomic stability. In the structural area, their policy framework relies on a greater economic role for the state, notably in the strategic hydrocarbons and mining sectors.
- **MDRI.** Bolivia has benefited from the debt relief from the IMF under the Multilateral Debt Relief Initiative. This covered 100 percent of all outstanding debt incurred by Bolivia to the Fund before January 2005, amounting to approximately US\$230 million (2½ percent of 2005 GDP and 4½ percent of public external debt).
- **Fund relations.** Bolivia has accepted the obligations of Article VIII, Sections 2, 3 and 4. The exchange system is free of restrictions on current international payments and transfers, and there are no significant controls on capital flows. The last Article IV consultation was concluded on July 7, 2003 (Country Report No. 03/257). The latest Stand-By Arrangement expired on March 31, 2006. Fund relations are summarized in Appendix I.

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EXECUTIVE SUMMARY

- **Over the past year, Bolivia has experienced far-reaching political changes, which culminated in the election of a government with an unprecedented popular mandate.** Given its wide base of support, the new government is uniquely positioned to implement policy initiatives that are conducive to higher and more equitable growth.
- **Benefiting from a favorable external environment, the Bolivian economy displayed positive trends in 2005 that are so far being maintained in 2006.** This includes satisfactory GDP growth and a strong balance of payments, led by the hydrocarbons sector, low inflation, smaller fiscal deficits, and historically high levels of international reserves. The banking system has remained stable and financial dollarization has declined somewhat. Reflecting relief under the MDRI, the public debt-GDP ratio has been substantially reduced.
- **The overall deficit of the combined public sector is projected to narrow to near balance in 2006, but this is driven by a large increase in hydrocarbons-based revenue that may be partially reversed in coming years.** Accordingly, there is a need to strengthen domestic taxation, carefully scrutinize spending, and rationalize intergovernmental fiscal relations. Large fuel subsidies should be phased out while protecting vulnerable groups.
- **The central bank should continue to pursue a cautious monetary policy stance, which could be supported by greater exchange rate flexibility.** The crawling peg does not allow an agile response to changes in external conditions and discourages exchange rate risk management. Accordingly, the authorities should move gradually towards greater exchange rate flexibility. The transition would have to be managed cautiously given the high dollarization and vulnerability to deposit outflows.
- **The authorities' medium-term policy framework calls for a greater state role in the economy, but also emphasizes continued macroeconomic stability and improvements in governance.** The government would participate in the strategic economic sectors of hydrocarbons and mining, and support small- and medium-scale producers through expanded access to credit and land. While emphasis on macroeconomic stability and improved governance is welcome, the envisaged role for the state is a source of serious concern because of its potential fiscal cost and adverse impact on the environment for private investment.
- **However, while the short-term outlook is positive and the global environment for exporters of energy and minerals is expected to remain favorable, the medium-term outlook for Bolivia presents important challenges and risks.** The outlook is particularly sensitive to developments in the hydrocarbons sector, where considerable uncertainty prevails at this stage regarding the modalities for implementing the recent nationalization decree. The authorities should undertake all efforts to achieve expeditiously mutually acceptable operating arrangements with the concerned energy companies. Other risks include potential institutional changes in the context of the forthcoming constitutional assembly, and a possible loss of trade preferences from the United States and Andean countries.

I. BACKGROUND

- 1. Despite wide-ranging economic reforms over the past two decades, the accomplishment of macroeconomic stability, and a major expansion of the hydrocarbons sector, Bolivia has achieved only modest gains in poverty reduction and inequality has remained high.** The reform process, which encompassed privatizations and liberalization of the exchange and trade systems, contributed to a major decline in inflation and to an increase in growth in the 1990s. However, the growth performance deteriorated during 1999–2003 in the context of rising social tensions and political instability, and the partial recovery of the last two years has been concentrated in the highly capital-intensive hydrocarbons sector. As a result, Bolivia’s key social indicators have continued to lag (Box 1).
- 2. Over the past year, Bolivia has experienced major political changes, against the background of entrenched dissatisfaction with the country’s poor social indicators and weak governance.** Following a protracted political crisis, the constitution was amended in June 2005 to allow early presidential and congressional elections for a new full five-year period in December 2005, together with the first direct elections for regional governors. Agreement was also reached on calling a constitutional assembly and a referendum on regional autonomy in July 2006. The elections resulted in a major renewal of Congress and in a landslide victory for Evo Morales, the first indigenous head of state in Bolivian history.¹
- 3. The new government has inherited a favorable macroeconomic situation, associated in large measure with the extremely favorable international environment.** In 2005, GDP growth was just above 4 percent and the fiscal deficit narrowed to 2.3 percent of GDP (Figures 1 and 2). Inflation was contained below 5 percent following an acceleration early in the year due to petroleum price increases, supply disruptions, and imported inflation. Financial sector stability improved as deposits and credit increased for the first time in several years, and the balance of payments remained strong with official foreign exchange reserves rising to historic highs. Financial dollarization declined, due to expectations of exchange rate appreciation as well as prudential and tax measures that have increased the cost of holding foreign currency.² The Multilateral Debt Relief Initiative has resulted in a substantial reduction of the public debt burden.³

¹ The new government has a majority in the lower house and strong support in the senate, in sharp contrast with the weak congressional position of previous governments. However, it faces opposition by a majority of the newly elected regional governors.

² Since May 2005, dollar deposits are subject to higher reserve requirements than boliviano deposits. Also, a financial transaction tax was introduced in mid-2004 that affects sight and savings dollar deposits, as compared to only sight boliviano deposits.

³ The combined contributions from the IMF and the World Bank reduced Bolivia’s external public debt by about US\$1.8 billion, or from about 50 percent to about 30 percent of GDP.

4. **The Bolivian authorities have partially implemented the policies recommended in the 2003 Article IV consultation, which were reflected in the design of the program supported by the recently-expired Stand-By Arrangement.** Fund advice emphasized regaining fiscal sustainability and improving the efficiency of public spending, maintaining low inflation and seeking a gradual build-up of international reserves, and strengthening the corporate and financial sectors. Under the SBA, substantial progress was made in reducing macroeconomic imbalances and reducing financial sector vulnerabilities. However, important structural issues, including inefficient government spending, remain to be addressed. The 2005 Ex Post Assessment concluded that a new focus was needed on improvements in governance, with a view to strengthening management of public expenditure, rationalizing the tax system, and removing institutional impediments to growth.⁴

II. REPORT ON THE DISCUSSIONS

5. **The authorities' key objective is to reduce poverty and inequality and achieve improvements in governance, underpinned by prudent macroeconomic management.** They plan to achieve these objectives with a policy framework that calls for a greater state role in the two strategic economic sectors (hydrocarbons and mining),⁵ and for targeted government interventions in support of small- and medium-scale producers, notably through expanded access to credit and the redistribution of land under an extensive land reform.⁶ The authorities noted that their policies would be reflected in their National Development Plan, an umbrella policy document just finalized. In addition to these issues, a substantial portion of the discussions focused on the short- and medium-term impact of the May 1, 2006 decree on nationalization of the hydrocarbons sector.

6. **The mission supported the government's emphasis on maintaining macroeconomic stability and its vision of greater equity, transparency, and accountability.** The staff noted, however, that a careful balance should be sought between a greater role of the state and the preservation of appropriate incentives for private investment

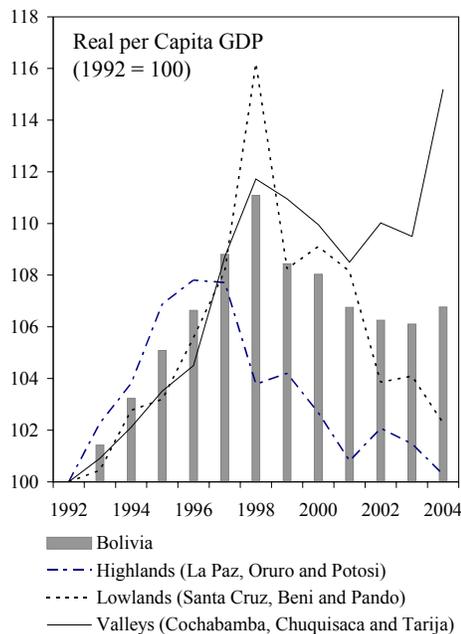
⁴ According to the indicators of Kaufmann, Kraay and Mastruzzi, over the last decade Bolivia's governance declined across four of the six dimensions measured. By 2004, in all areas except regulatory quality, Bolivia was below the average for South America and ranked in the bottom half of all countries sampled. On political stability and corruption, Bolivia ranked in the bottom third of the sample.

⁵ The government intends to strengthen its role in the mining sector through a revival of the state company Corporación Minera de Bolivia (COMIBOL). Large private mining operations will be allowed to proceed, but under as yet unspecified higher taxation.

⁶ The government has announced a land reform that would involve redistribution of significant extensions of land in the next five years. Although the land currently targeted for redistribution is owned by the Bolivian state, the government has indicated that it will eventually seize and redistribute privately-owned land that is unproductive, was obtained illegally, or is being used for speculation.

Box 1. Bolivia: Social and Governance Indicators

- A substantial decline in real per capita income in the period 1999–2003, which was followed by only a modest recovery, contributed to social unrest and to the political crises of recent years.** The extensive reform process of the 1980s and 1990s was accompanied by an increase in per capita income in Bolivia, improved social indicators, and some reduction in poverty. However, this trend has been reversed since the late 1990s, partly due to negative external shocks—including the Brazilian and Argentine crises. Furthermore, the economic recovery of the last few years has been concentrated almost exclusively in the hydrocarbons intensive region of Tarija. Thus, the per capita real GDP gains of the 1990s in the highlands and lowlands have been almost completely lost, with per capita income levels in 2004 similar to those of 1992.
- Social discontent was also fuelled by increased perceptions of poor governance.** As social conditions were weakening, so too were perceptions about the governance of the country. Indicators across six dimensions of governance produced by Kaufman et al. (2005)—including voice and accountability, political stability, and control of corruption—show some improvement until the late 1990s, followed by a steady deterioration across all measures.
- While Bolivia will be able to meet some of the Millennium Development Goals (MDG), it is unlikely to halve extreme poverty by 2015.** Some of the MDGs, such as universal primary education and gender equality in primary education, will likely be met. Some other goals, such as reducing child mortality, improving maternal health, combating HIV/AIDS, malaria and other diseases, and increasing access to safe and drinking water, appear within reach, although further efforts are required (Table 9). However, the objectives of reducing poverty to 34 percent and extreme poverty by half will probably not be met since they would require sustained annual growth rates of 5.5–6.5 percent through 2015.



Headcount poverty indicators (in percent of individuals 1/)				
		Extreme Poverty	Poverty	Gini Coefficient
National	1997	36.5	63.6	...
	1999	40.7	63.5	0.58
	2003	41.3	65.2	0.61
Capital Cities	1993	23.7	52.0	...
	1997	21.3	50.7	...
	1999	20.7	46.4	0.49
	2002	23.5	51.0	0.54

1/ Income based measures. The poverty indices express the number of individuals below the poverty line.

Source: Instituto Nacional de Estadísticas Bolivia

needed to support growth and raise employment and living standards. In view of the increasing role that is being proposed for the state, the mission also highlighted the need to preserve strong and efficient public institutions. Moreover, given the objective of maintaining macroeconomic stability, close attention must be paid to the economic impact of government interventions, including their short- and medium-term fiscal cost. In this connection, the mission noted the authorities' assurances that Bolivia's unsuccessful experiences of the past with public enterprises and development banking would not be repeated.

A. Recent Economic Developments and Short-Term Outlook

7. **Thus far in 2006, the economy has kept the positive trends observed in 2005.** Economic activity has been led by high export values of hydrocarbon and mining products, which have contributed to a strong external current account surplus. Inflation has continued in the low single digits, following a decreasing trend that started in the fourth quarter of 2005, and the overall fiscal position is in surplus. In particular, sub-national governments have been accumulating sizable deposits at the central bank, thereby helping sterilize the monetary impact of the rapid international reserve accumulation. Indicators of banking system soundness have been broadly stable, with high liquidity and capital adequacy ratios above mandatory levels.

8. **The economic outlook for the remainder of 2006 remains positive, helped in large part by continued highly favorable external conditions, notably high energy prices.** Real GDP growth is expected at just above 4 percent, with inflation in the low single digits (Table 1). The combined public sector is expected to record a near balance for the year as a whole as the temporary extra revenues accrued from the new hydrocarbons policy framework would not be translated immediately into investment spending by YPF. Reflecting debt relief under the MDRI, the ratio of public debt to GDP is projected to decline from 71 percent at end-2005 to 51 percent by end-2006.⁷ Accumulation of official reserves is projected to continue, reflecting a strong external current account surplus associated with high international prices of fuels and minerals.

B. Hydrocarbons Policy

9. **Key implementation aspects of the nationalization decree issued on May 1 remain to be negotiated over a period of six months, including the tax regime, export pricing, and compensation for the assets that are being nationalized.** High-level negotiating commissions have been appointed by Bolivia and Brazil, and in parallel discussions are being held concerning natural gas exports to Argentina. The authorities emphasized that the nationalization decree was consistent with the 2004 national referendum and the 2005 hydrocarbons law, which the electoral platform of the new government had

⁷ The implementation of the MDRI has released fiscal resources equivalent to about 0.5 percent of the GDP per year over 2006-11.

committed to implement. They also stressed that the new agreements with energy companies would all be approved by Congress, which in their view would provide for a more stable legal regime. The mission underscored the importance of reaching mutually acceptable arrangements with the concerned companies in order to ensure further development of Bolivia's natural gas reserves and sustained export growth.

C. Fiscal Policy

10. **Budget execution in the first three months of 2006 showed an overall surplus of 2.1 percent of GDP for the combined public sector (CPS).**⁸ While expenditure was seasonally low, this surplus reflected mostly strong hydrocarbons-based revenue associated with high oil and gas prices. In particular, sub-national governments accumulated deposits at the central bank at a brisk pace, as their share of hydrocarbons-based revenue was boosted by the change in revenue sharing agreements mandated by the 2005 hydrocarbons law.

11. **The overall deficit of the CPS for 2006 is now estimated at only 0.1 percent of GDP, compared with 3.0 percent of GDP projected in the budget, as higher hydrocarbons-based revenues will not be immediately spent.** The revenue projection has been revised upward, mainly reflecting increased hydrocarbons prices in international markets and a new hydrocarbon take for YPF, temporarily set by the nationalization decree at 32 percent of the value of production of gas and oil in the two largest gas fields. This would more than compensate for a significant overall spending increase, associated mainly with: (a) a higher wage bill in the wake of wage increases to the health and education sectors; (b) increased subsidies for diesel imports resulting from higher external prices; and (c) higher capital spending by subnational governments (Table 2). The substantial public enterprise surplus in 2006 reflects mainly the fact that the new revenue accruing to YPF is not likely to be translated immediately into project spending.

Structural fiscal issues

12. **The government is planning to take a range of structural fiscal measures, including to strengthen revenue and improve the budget process.** The authorities are working on a base-broadening and equity-enhancing tax reform that would include limiting tax exemptions, rationalizing and revamping free trade zone legislation, shifting large taxpayers in special regimes to the regular regime (e.g., transportation), and bringing into the tax net activities with potentially large taxpayers such as gambling. The authorities also indicated that they will abolish the financial transactions tax (FTT) on boliviano deposits and make it permanent for short-term dollar deposits above US\$2,000 in order to retain fiscal revenues while creating an incentive for dedollarization. A reform of mining sector taxation

⁸ The CPS comprises the nonfinancial public sector and the central bank.

Box 2. Bolivia: Nationalization of Hydrocarbons

Background

- **The 1996 “capitalization” (privatization) process granted a majority stake and managerial control of public enterprises to private investors.** At that time, ten companies in telecommunications, electricity, transport and hydrocarbons were divested in favor of foreign investors and the Bolivian population. Foreign firms acquired a 50 percent stake and complete managerial control of those companies in return for investment commitments. Some shares were also distributed among workers. The remaining shares (about 49 percent) were used to create a fund, *the Fondo de Capitalización Colectiva (FCC)*, whose management was assigned to the private pension funds. The dividends on these shares were earmarked to pay the *Bonosol*—a minimum pension payment (currently set at Bs. 1800) to all Bolivians who were 21 years or older at end-1995, collectable annually after reaching 65 years of age.
- **The authorities believe that the capitalization process in the hydrocarbons sector has not been beneficial for Bolivia and that it has breached the constitution.** In particular, they feel that the bulk of the gains from the expansion of the hydrocarbons sector has been captured by the foreign energy companies. Moreover, they argue that the current contracts with those companies are not valid because they were not ratified by parliament as would be required under the constitution.

The current nationalization initiative

- **The May 1 nationalization decree reverses the “capitalization” process in the hydrocarbons sector.** It has mandated a return to a state majority stake and managerial control over hydrocarbons companies, which is facilitated by the return of management of the FCC’s shares in hydrocarbons companies to the state. With FCC shares under state management, effective control over the capitalized enterprises could be accomplished by buying additional equity from workers and the foreign stakeholders. In this connection, the authorities will undertake an audit of the capitalized companies to determine their cost structure, profitability and whether they have fulfilled their investment commitments. In addition to stipulating that YPFB must regain control of the natural gas companies Chaco and Andina, and the pipeline company Transredes, YPFB must also acquire a controlling stake in the two oil refineries and a logistics company owned by the Brazilian company Petrobrás and by a German-Peruvian consortium, respectively. However, it is not clear that the foreign companies affected by the decree will agree to terms for selling their shares.
- **The mission emphasized the importance of maintaining efficient and independent management in the enterprises that are targeted to revert to state control.** The mission also expressed concern about the possible implications of changes in the status of FCC funds for the financing of BONOSOL payments.

And modifications to the tax refund system are also being considered, as are changes to the pension law aimed mainly at reducing the replacement rate required to retire under the private system (to facilitate for retirement at ages 55 for men and 50 for women, instead of at age 65 for both). The draft budget framework law is expected to be reviewed and resubmitted to parliament,⁹ and an improved balance between expenditure responsibilities and resources across levels of government will be sought.

13. **The mission suggested ways to improve the tax system and cautioned about the cost of changes in the pension system.** To spread the tax burden more fairly, the mission discussed with the authorities the possibility of introducing a personal income tax, which could exclude the lower 80 percent of the income distribution. The authorities stated that they were not considering such a tax at this stage. On the FTT, the mission reiterated past staff advice that the tax should be totally removed in the context of the forthcoming tax reform and suggested that dedollarization efforts should be supported, instead, by financial sector regulations. In addition, the mission urged the authorities to ensure that increased tax take in the mining taxation regime would be consistent with continued investment in the sector. Regarding the tax refund system, the mission supported efforts to reduce fraud while ensuring timely refunds to exporters. On pension reform, the mission recommended that the authorities analyze carefully the fiscal costs and the implications for the budget of possible changes to the pension law, particularly if these involve bringing forward pension payments.

14. **In line with an election commitment, the government has implemented a compression of salaries for senior officials.** As one of his early actions, the President cut his own salary by more than half, which automatically triggered a reduction in the maximum possible salary in the public sector. As a result, public entities (including the central bank, the superintendency of banks, and the tax administration) had to cut salary scales significantly at senior levels. The mission expressed concern that this policy might give rise to outflows of qualified high level officials from those public entities, which would run counter to the envisaged greater role of the state. The authorities argued that the salary cuts were fully manageable, adding that their medium-term impact would have to be assessed within the broader context of a phased reform of the public sector's salary structure to be implemented over the next two-three years, designed to facilitate retention of high-quality staff.

15. **Rigidities in domestic petroleum pricing are giving rise to large explicit and implicit subsidies, estimated at about 7 percent of GDP.** Domestic petroleum prices continue to be set administratively, without appropriate regard to changes in international prices. The explicit subsidy (1¼ percent of GDP) reflects budgetary transfers to importers to compensate them for the gap between the low wholesale price of diesel and its import cost.

⁹ The law would aim, inter alia, to avoid spending increases without congressional approval, require that the budget be prepared within a medium-term framework, strengthen rules on subnational government debt, and adopt a functional classification consistent with international standards.

The implicit subsidy (5¾ percent of GDP) arises from the low domestic price of crude oil (set at US\$27 per barrel) and natural gas (US\$0.58 per million BTU), which support correspondingly low domestic prices of gasoline and other oil derivatives.¹⁰ There is consensus that these subsidies are inefficient, as they are captured primarily by higher income groups and give rise to smuggling, while discouraging investment and energy conservation. Accordingly, the mission suggested that subsidies be phased out by moving domestic petroleum product prices gradually to market-based levels, while using part of the substantial resulting fiscal savings to protect vulnerable groups. The authorities emphasized that a planned change in the energy matrix of Bolivia over the medium term would lead to a gradual reduction in diesel subsidies and smuggling.¹¹ While acknowledging these plans, the mission underscored that a need would still remain to address domestic price distortions since the change in the energy matrix in itself would not necessarily reduce implicit and explicit subsidies, and the strategy for such a change had yet to be fully specified.

Intergovernmental fiscal relations

16. The revenue sharing/expenditure allocation system gives rise to structural imbalances between the central government and subnational governments, which reduces the effectiveness of public expenditure and the scope for fiscal management.

These imbalances will be aggravated by changes introduced in 2005. Specifically, with the full-year impact of the 2005 hydrocarbons law (which has reduced the central government's share of hydrocarbons-based revenue to around 35 percent in 2006, from 55 percent), total tax revenue kept at the central level will be reduced by about 2 percent of GDP while spending responsibilities remain the same across government levels. The combination of higher revenue sharing with increased spending at the national level undermines the central government's finances and, consequently, the overall fiscal position.

17. The mission therefore underscored the need to reform the intergovernmental fiscal relations system in order to reduce imbalances across levels of government. The existing revenue-sharing agreement should be reassessed in light of the capacity to generate revenue and the needs of each regional and local government, and there also needs to be a balanced allocation of spending responsibilities across the different layers of government. The mission underscored the critical importance of these reforms for the medium term fiscal outlook, and indicated that the Fund stands ready to provide technical assistance in this area, in coordination with the World Bank. The authorities agreed with the mission's view on the importance of better allocating responsibilities to subnational governments, and on the need

¹⁰ An adjustment in downstream prices to market levels would benefit the budget (about 1¼ percent of GDP in reduced expenditure and 4 percent of GDP in additional IDH and royalties); and oil companies (whose revenue before profit tax would increase by about 1¾ percent of GDP).

¹¹ The change in the energy matrix would involve the replacement of some oil derivatives (i.e., diesel) by derivatives from natural gas.

to improve the underlying fiscal position of the central government. They indicated that these issues are to be taken up in the context of the Constitutional Assembly.

D. Monetary, Exchange Rate, and Financial Sector Policies

18. **The central bank has continued to pursue a cautious monetary policy stance, facilitated by a large increase in public sector deposits.** Sustained foreign exchange inflows have boosted central bank NIR by close to US\$500 million during January–May, about the same increase as in the whole of 2005. This was largely sterilized by an accumulation of public deposits at the central bank of over 4 percent of GDP. Nonetheless, the 12-month growth of base money stood at more than 40 percent reflecting a sizable carry over from 2005. Although, as suggested by decelerating inflation, much of this expansion appears to be matched by an increased real demand for bolivianos, the central bank has taken the precaution of absorbing some liquidity through open market operations, mostly in boliviano denominated instruments and at lengthening maturities (Tables 3 and 4, and Figure 3).

19. **Looking ahead, the central bank may be called upon to step up its open market operations and/or to exercise further exchange rate flexibility as needed to forestall inflationary pressures.** Monetary policy may be called upon to contain mounting expansionary pressures once the fiscal accounts shift into a deficit in the second half of the year, in the context of a continued strong balance of payments position. The mission noted that the capacity of monetary and exchange rate policies to maintain low inflation will hinge on the evolution of the non-hydrocarbons fiscal deficit. In particular, it would be very difficult for the central bank to contain the pressures that would result from a rapid unwinding of public sector deposits without resorting to sharp interest rate and/or exchange rate action.

20. **The mission recommended that the authorities move toward increasing exchange rate flexibility.** Over the years, the crawling peg regime has contributed to maintaining competitiveness while the small adjustments that characterize the regime have succeeded thus far in keeping the balance sheets effects manageable in Bolivia's highly dollarized environment. The downside of this regime is that it does not allow an agile response to changes in external conditions, while it tends to discourage market participants from improving their management of exchange rate risk. There are indications that the currency is currently undervalued, as suggested by a real effective exchange rate that is well below the average level over the past 20 years despite the expansion of the hydrocarbons sector and substantial external debt reduction. While adjustment could be achieved through discrete nominal changes under the crawling peg regime, the mission pointed to the benefits of greater exchange rate flexibility in terms of allowing a more timely response to external shocks, as well as encouraging agents to internalize exchange rate risks. Moreover, the current prospect of currency appreciation in light of the underlying strength of the balance of payments should also contribute to reduce dollarization under a more flexible exchange rate regime. The mission noted that such greater flexibility, which could be achieved in the context of a managed float, would require an adjustment of the monetary policy framework

(to monetary or inflation targeting).¹² The transition should be carefully managed as large exchange rate fluctuations could be particularly disruptive in Bolivia's dollarized economy.¹³ The authorities acknowledged the shortcomings of the current regime, and were therefore open to gradually incorporating greater exchange rate flexibility in the anti-inflation policy menu.

Financial sector issues

21. The international reserves and liquidity of the financial system are at high levels and financial sector stability has improved, but important challenges remain. Reserve coverage of banking system deposits is close to 100 percent, and some banks have completed the accounting of new loan loss provisioning requirements ahead of the schedule permitted by the relevant regulation. However, the financial system remains vulnerable to large deposits outflows and systemic risks need to be carefully monitored. Moreover, bank profitability is still low and banks are yet to internalize in full the risk posed by financial dollarization (Tables 5 and 6). For some banks, significant holdings of restructured loans, and some incidence of unprovisioned nonperforming loans, remain a source of vulnerability.¹⁴

22. The mission underscored that the strengthening of the supervisory and institutional banking framework should continue.¹⁵ Further progress is still required to mitigate credit risk arising from dollar loans to non exporters, improve the regulation and supervision of financial conglomerates and market risk, introduce partial coverage deposit insurance and eliminate the option of the central bank to participate in bank resolution, and strengthen legislation on money laundering and corporate restructuring. The authorities were also advised to ensure that the transfer of the Financial Intelligence Unit to the ministry of finance does not affect its performance during the transition period and that compliance with its additional responsibility (investigation of corruption by public officials) does not detract from its main role. While the authorities were confident that existing losses in banks' loan portfolio have been already identified, and did not see a vulnerability in the financial sector that might require immediate action, they attached importance to remain vigilant.

¹² The mission noted that, in Bolivia's highly dollarized environment, the effectiveness of traditional monetary targeting might be hampered by instability in the demand for money. Key policy recommendations from a 2004 MFD technical assistance report on enhancing the use of local currency and the flexibility of the exchange rate have already been implemented, including improved prudential supervision, issuance of inflation-indexed bonds, and raising liquidity requirements on dollar deposits.

¹³ However, if the exchange rate were to appreciate, as suggested by the strong balance of payments position, banks would stand to benefit from the reduced credit risk from unhedged borrowers.

¹⁴ The proposed land reform could impact the banking system, particularly to the extent that it involved the redistribution of foreclosed properties or land collateralizing loans without fair and immediate compensation.

¹⁵ In this regard, the strengthening of the independence of the SBEF and recent measures to improve the monitoring of the banks' liquidity risk are welcome.

23. **The authorities are in the process of designing a public development banking system (SINAFID) to subsidize credit for small-scale enterprises in selected sectors and facilitate the absorption of new technology.** SINAFID would merge existing development financial entities (NAFIBO and FONDESIF) and maintain ownership of the state-owned Banco Union. The authorities stated that credit would be channeled through private sector financial institutions, if agreement on the conditions is reached, but did not discard the possibility of using Banco Union for these purposes (Box 2). While further details on SINAFID are yet to be determined, the mission welcomed the authorities' assurances that sound management of these public development banks would be a priority and also their commitment to complement, rather than replace, lending activities of private institutions. However, the mission noted that, as previous experience in Bolivia¹⁶ and other countries suggests, development banking tends to be problematic as it is prone to generate solvency problems in the involved financial institutions and to create fiscal costs. Accordingly, the mission advised, inter alia, that: (i) development banking be kept as a second-tier activity; (ii) earmarking of government revenues to finance development banking be avoided, and the quasi-fiscal costs of development banking be included in the budget; (iii) participation of private financial institutions be strictly voluntary; and (iv) a comparable and prudent supervisory regime be maintained, avoiding regulatory forbearance.

E. Competitiveness

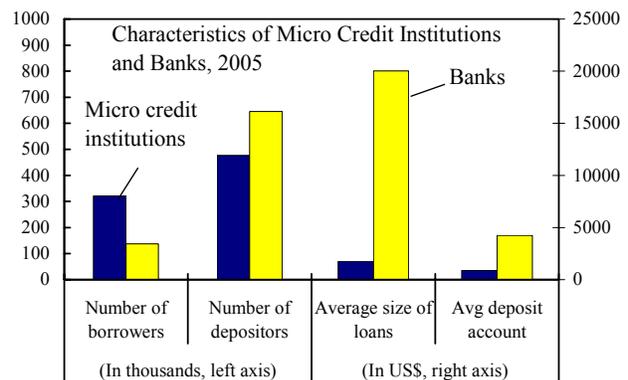
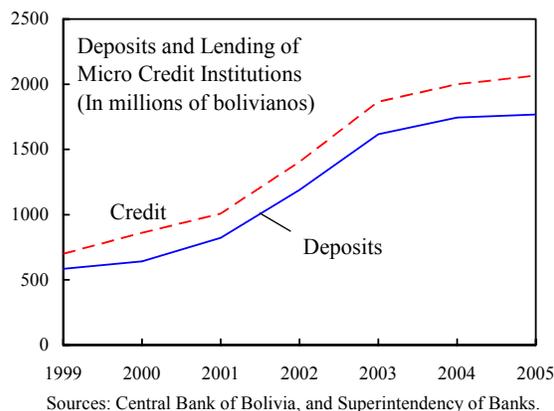
24. **In recent years, competitiveness of nontraditional exports, which exclude hydrocarbon and mineral exports, has hinged on a depreciated real exchange rate, low labor costs, and preferential access to key markets.** Since late 2002, the real exchange rate has depreciated steadily by more than 20 percent, and is currently at a historical low (Figure 4). Wages in dollar terms have also been the lowest in the region. Bolivia has taken advantage of the benefits provided by the Andean free trade area and customs union, in particular for soy-product exports, which now represent about 10 percent of total exports. The country has also benefited from duty-free access to the U.S. market for certain products—including apparel and jewelry—under the Andean Trade Promotion and Drug Eradication Act (ATPDEA), which account for about 7 percent of total exports.

25. **However, these key determinants of competitiveness may shift against Bolivia in the period ahead.** A continued strong balance of payments position, driven by natural gas exports, may lead to real appreciation pressures on the boliviano. In this regard, the mission underscored the need to contain these pressures through prudent fiscal and monetary policies, and continued openness of the exchange system. On the wage front, despite recent

¹⁶ Four development banks were closed during the 1990s due to solvency problems.

Box 3. Bolivia: Micro-Credit Institutions

- Though still a small part of the financial system, micro-credit institutions have been growing rapidly in recent years.** These institutions, known in Bolivia as *fondos financieros privados* (FFPs), hold only about 7 percent of financial system deposits and credit to the private sector. However, between December 2002 and end-March 2006, their deposits increased by almost 60 percent (to US\$234 million), and their loan portfolio rose by more than 50 percent (to US\$270 million). Furthermore, in contrast to the banking system, FFP deposits and lending maintained a growing trend despite the political and economic turmoil of recent years.
- Lending rates of FFPs are higher than those of the banking system due to the nature of their client pool.** Micro-credit institutions provide loans to small scale clients in the informal sector. This implies that FFPs have a large number of clients (58 percent of financial system borrowers in 2005), with an average loan size less than 10 percent of the average for the financial system. Also, 40 percent of FFPs branches are in rural areas, compared to 20 percent for banks. These characteristics imply large operational and administrative costs, more than double those of banks as a percent of loan portfolio. As a result of this cost structure, average FFP lending rates are relatively high (at 38 percent for boliviano credit, and 23 percent for dollar credit) compared to an average of 12 percent for banking sector credit.
- The government's policy initiative to provide concessional lending to small businesses is expected to have some impact on the activities of micro-credit institutions.** To jump start its initiative, the government recently channeled US\$30 million, financed by a grant from Venezuela, to selected sectors at 4 percent interest and a 10-year maturity. An additional grant of US\$70 million is expected in 2007. Concessional lending would continue thereafter based on other financing sources. FFPs have argued that it is impossible for them to compete on these terms and fear that, unless selection criteria and collection efforts are similar to their own, this policy could undermine credit culture. However, the envisaged concessional lending operations may also reach borrowers that are not currently serviced by FFPs.



adjustments to the minimum wage—currently at US\$63 per month—wages are not likely to catch up with those in the region in the near term. However, Bolivia’s wages in manufactured goods are higher than those of competitors outside the region, such as China and India. Furthermore, recent changes in the labor regime have raised redundancy costs, albeit modestly, with some impact on overall labor costs. The authorities explained that the competitiveness impact of this measure was minimal, and emphasized its benefits in terms of enhanced workers’ rights.

26. **The mission expressed concern about the erosion of preferential access once ATPDEA expires at end-2006, and as Andean countries implement bilateral free trade agreements with the U.S.** Though Bolivia has formally requested an extension of ATPDEA to the United States government, bilateral FTA agreements between the U.S. and other ATPDEA beneficiaries raised the possibility that the ATPDEA might not be extended. A free trade agreement with the United States could substitute for ATPDEA benefits, but Bolivia has not engaged in negotiations to this end. Meanwhile, the bilateral free trade agreements of Peru and Colombia with the United States may weaken Bolivia’s ability to compete in the soy market as these countries will tend to substitute Bolivian soy products with cheaper imports. The authorities stated that they are engaging with their Colombian counterparts in efforts to extend the transition period for soy duty reduction to the United States. They also indicated that they are seeking alternative markets, and that their recent trade agreement with Venezuela and Cuba would help absorb some exports.

F. Medium-Term Outlook

27. **The medium-term economic outlook is characterized by both continuing favorable external conditions and major uncertainties regarding private investment and overall growth.** In view of the large remaining uncertainty about the prospects for foreign investment in the hydrocarbons sector, the mission’s baseline medium-term scenario (2006–11) assumes unchanged natural gas production and exports (Tables 7 and 8, and Figure 5). On this basis, annual GDP growth would stay above 3 percent as zero growth in the hydrocarbons sector would be partially offset by the positive impact of a key mining project expected to come into production next year. Higher growth rates would require a more generalized increase in manufacturing, agriculture, and other sectors over the medium term. However, prospects for higher growth in these sectors are dampened by a host of factors, ranging from uncertainties regarding the environment for private investment to the potential loss of export markets.

28. **The medium-term fiscal outlook is highly dependent on the evolution of hydrocarbons-based revenues.** This in turn hinges on several factors, including the level of additional royalties, possible new export prices of hydrocarbons, and productivity of the nationalized natural gas fields. Since these parameters depend on the outcome of negotiations with oil companies, considerable uncertainty remains over the medium-term fiscal path. Against this background, the staff’s baseline fiscal scenario projects an initial jump in the deficit in 2007 in the absence of the exceptional hydrocarbons take for YPF available in

2006 and as expenditures are projected to rise due to increased YPFB investments and payments for the acquisition of shares in the nationalized companies. While the increase in the deficit from the low level of 2006 will be large (3 ½ percentage points of GDP), its macroeconomic impact will be more limited because the increase in the domestic component of the deficit (i.e. the deficit excluding net payments to foreign hydrocarbon companies) will be small (0.4 percentage points of GDP). While this fiscal expansion, in itself, is unlikely to endanger macroeconomic stability—in light of the strong external position it is indeed consistent with a further increase in net international reserves (see Table 8)—it would bring the deficit to a level that is at the border of what can be regarded as appropriate from a long-term fiscal sustainability perspective. Assuming a broadly unchanged policy stance in subsequent years, the fiscal deficit is projected to remain within the range of 3–4 percent of GDP. The ratio of expenditure to GDP would gradually return to the 2006 levels by 2011, partly reflecting declining levels of public investment, pension payments, and explicit fuel subsidies as a share of GDP.¹⁷ Meanwhile, constant hydrocarbons production, relatively stable hydrocarbon prices, and a gradual decline in grants would combine to generate a roughly commensurate fall in total revenue. As a result, the public debt ratio would remain stable at about 50 percent of GDP during the projection period. While this baseline scenario would therefore appear sustainable, it should not be viewed with complacency as the projected fiscal deficit beyond 2007 would demand considerable fiscal discipline, notably a control over subnational government spending consistent with falling transfers from the center as hydrocarbons revenue declines as a share of GDP.

29. **On the external front, high prices of minerals and hydrocarbons would support the continuation of substantial, albeit declining, current account surpluses.** As noted, Bolivia would also benefit from an increase in exports from a new mining project expected to start production in 2007. At the same time, the prospects for some agricultural and manufacturing exports may be hindered by erosion of trade preferences. Under the baseline scenario, FDI inflows are modest and, in the hydrocarbons sector, would be aimed solely at supporting current capacity levels. Overall, the strength of the external sector would be reflected in further accumulation of international reserves over the medium term.

30. **The above scenario is subject to a range of downside risks.** First, substantial investment may be required just to sustain hydrocarbons production at current levels. Second, as noted, maintenance of a stable public debt ratio in the post-MDRI period will require broad-based expenditure containment. Third, as also discussed above, Bolivia's competitiveness for nontraditional exports hinges on preferential access to the Andean Community and U.S. market, a competitive real exchange rate, and low labor costs—all factors subject to reversal. These risks are compounded by the prospect of wide-ranging institutional changes in the context of the forthcoming constitutional assembly, and the referendum on regional autonomy, which could complicate macroeconomic management and

¹⁷ Declining explicit fuel subsidies would reflect the authorities' plan to change the energy matrix towards increased use of natural gas.

could affect financial sector stability. The mission noted that, in order to mitigate these risks, the authorities will need to keep within a prudent fiscal envelope and enhance competitiveness. In this context, it is very important to improve governance and maintain a stable legal framework, including in taxation and property rights.¹⁸ The authorities indicated that efforts will be made to minimize related policy uncertainties, particularly during the period of the forthcoming constitutional assembly.

31. At the same time, there remains ample scope for an alternative scenario leading to sustained upside growth and poverty reduction benefits over the medium-term compared with the baseline scenario, in the context of appropriately designed policies. These could comprise: (i) ensuring that negotiations in the hydrocarbons sector lead to additional investment consistent with increased production and exports; (ii) strengthening the fiscal position through a bolder tax reform than currently contemplated that would also improve the investment climate and help promote greater equity; and (iii) more broadly, sustaining macroeconomic and structural policies that enhance the environment for private investment, and expand Bolivia's access to external markets.

III. DEBT SUSTAINABILITY ANALYSIS

32. While Bolivia's external and public debt have declined significantly in relation to GDP in recent years, as a result of the sharp reduction in the fiscal deficit and implementation of the MDRI, the debt sustainability analysis points to the potential for some reversal of these gains over the long term. The NPV of Bolivia's external debt is projected to fall gradually from 35 percent of GDP in 2006 to 24 percent of GDP by 2026. The public external debt service to export ratio is projected to remain at comfortable, albeit increasing levels. However, the NPV of the overall public debt shows an increasing trend in the period beyond 2011, rising by about 7 percentage points of GDP, to 51 percent of GDP by 2026. This would be driven by a slight increase in the fiscal deficit associated with declining hydrocarbon revenues as a share of GDP. These results are sensitive to standard stress tests and specific adverse shocks. In particular, a decline in natural gas production and exports of 5 percent annually over the next five years (i.e., a cumulative decline of more than 20 percent), would place the NPV debt-to-exports ratio on a steadily rising path that could bring it near the HIPC threshold at the end of the projection period. Conversely, a one-time 50 percent increase in the natural gas export prices to Brazil and Argentina relative to the baseline would bring about a declining trend in the long term path of the debt ratio.

¹⁸ For example, the government's initiative in the area of land reform will need to be carefully managed, especially because it incorporates the possibility of redistribution of private land. Aside from its potential impact on confidence in property rights, this initiative may affect the financial system, particularly if it involves foreclosed properties or properties that have been used as collateral.

IV. STAFF APPRAISAL

33. **Over the past year, Bolivia has experienced far-reaching political changes, which culminated in the election of a government with an unprecedented popular mandate.**

Given its wide base of support, and the fact that it has inherited a favorable macroeconomic situation, the new government is uniquely positioned to implement policy initiatives that are conducive to higher and more equitable growth.

34. **Benefiting from a favorable external environment, the Bolivian economy displayed positive trends in 2005 and so far in 2006.** This includes satisfactory GDP growth and a strong balance of payments, led by the hydrocarbons sector, low inflation, smaller fiscal deficits, and historically high levels of international reserves. Despite periods of political uncertainty, the banking system has remained stable and dollarization, although still exceptionally high, has declined somewhat. Reflecting debt relief under the MDRI, the burden of the public debt has been substantially reduced. The strong emphasis placed by the authorities on safeguarding macroeconomic stability—seen by them as a national asset of the Bolivian people and an important foundation for increased growth and higher living standards—is highly commendable.

35. **Following a sharp decline in the fiscal deficit during 2003–05, the combined public sector is projected to record a near balance in 2006.** However, this is partly the result of a large increase in hydrocarbons-based revenue, including exceptional revenues created by the nationalization decree that may not be maintained beyond the current year. While the higher deficits in the range of 3–4 percent of GDP projected for 2007 onwards appear manageable, they should be viewed as an upper bound beyond which Bolivia's debt sustainability would be in jeopardy. Accordingly, aiming at a deficit close to the lower bound of this range—or below—seems more appropriate, as it would to maintain a safety margin against shocks that may otherwise lead to a rebound in the debt ratio in coming years. In any case, careful scrutiny is of the essence in spending decisions and the authorities are encouraged to strengthen expenditure management at all levels of government. In this context, the firmness displayed by the government in containing wage increases to fiscally responsible levels is welcome. However, salary cuts at the higher levels appear at odds with the government's economic strategy, which is partly based on assigning a more strategic role for the state and may therefore require an upgrading of the management of public entities. In this connection, the plan to reform the public sector salary structure in order to facilitate retention of high-quality staff is a welcome initiative. Regarding pensions, the authorities should carefully analyze the fiscal costs and the implications for the budget of planned changes to the pension law, particularly if these involve bringing forward pension payments.

36. **Rigidities in domestic petroleum pricing generate inordinately large explicit and implicit subsidies.** These subsidies are inefficient and regressive, as they are captured primarily by higher income groups and give rise to smuggling, while discouraging investment and energy conservation. Accordingly, there is a need to move domestic petroleum product prices to international market-based levels, which could be undertaken gradually while using part of the resulting fiscal savings to protect vulnerable groups.

37. **Despite the outlook for continued high hydrocarbons-based revenue, attention must be given to enhancing domestic taxation in order to entrench fiscal sustainability and improve the efficiency and equity of public finances.** Current plans to reduce exemptions, rationalize the free trade zones legislation, shift large taxpayers in special regimes or outside the tax system to the regular regime, and modify the VAT refund system to reduce fraud, are welcome. The authorities are encouraged to revisit the scope for introducing a tax on high personal incomes, which would exclude the bulk of the population and thereby spread the tax burden more fairly. In the mining sector, where the government is considering an increased tax take, it is important that revenue measures do not discourage additional private investment.

38. **Strengthening the budget process and intergovernmental fiscal relations is crucial to enhance fiscal transparency and accountability at all levels of government.** The authorities are therefore encouraged to review expeditiously and resubmit to Congress for early approval the draft budget framework law, which is aimed at enhancing the budget process at all levels of government. Regarding intergovernmental relations, the current revenue sharing/expenditure allocation system gives rise to structural imbalances between the central government and subnational governments, which reduces the effectiveness of public expenditure and the scope for fiscal management. It should therefore be reassessed in light of the capacity to generate revenue at the subnational level, and consistent with an agreed allocation of spending responsibilities across the different layers of government.

39. **Following many years of successful monetary and exchange rate management, including several near-crisis periods, the central bank has continued to pursue a cautious monetary policy stance.** Looking ahead, while fiscal policy will play a key role in forestalling inflationary pressures, the central bank should stand ready to step up its open market operations and/or to exercise further exchange rate flexibility as needed to maintain low inflation. On the exchange rate policy front, the crawling peg regime has contributed to maintain competitiveness while keeping the balance sheets effects manageable in Bolivia's highly dollarized environment. However, the crawling peg does not allow an agile response to changes in external conditions, and the currency may indeed be undervalued at this stage. The crawling peg also discourages market participants to improve their management of exchange rate risk. Accordingly, the staff recommends a gradual move towards greater exchange rate flexibility, which could be achieved in the context of a managed float. Such a move would require an adjustment of the monetary policy framework to monetary or inflation targeting, although in Bolivia's highly dollarized environment, inflation targeting appears more suited as the effectiveness of traditional monetary targeting might be hampered by instability in the demand for local currency.

40. **While international reserves are high and the financial sector has strengthened notably, important challenges remain.** In particular, the system remains highly dollarized and vulnerable to large deposit outflows, bank profitability is still low, and banks are yet to internalize in full the risk posed by financial dollarization. Moreover, the significant holdings of restructured loans and the unprovisioned portion of nonperforming loans of some banks remain a source of vulnerability. Accordingly, the authorities are encouraged to continue

with their efforts to closely monitor banks' performance and to strengthen the supervisory and institutional banking framework. In addition, care must be taken that the proposed public development banking system (SINAFID) does not introduce distortions in the banking system, and that the related fiscal costs are clearly included in the budget. In particular, the authorities are urged to keep development banking as a second-tier activity, the participation of private financial institutions strictly voluntary, and a comparable supervisory regime free of regulatory forbearance.

41. **On the structural policy front, the staff strongly supports the government's emphasis on greater equity, transparency, and accountability.** However, the parallel emphasis on an elevated role for the state is a source of serious concern as it has the potential for impacting adversely on the environment for private investment. The authorities are therefore urged to maintain a careful balance between the pursuit of a greater role for the state and the preservation of appropriate incentives for private investment needed, which remains critical to support growth and raise employment and living standards. Moreover, given the objective of maintaining macroeconomic stability, close attention must be paid to the economic impact of government interventions, including their short- and medium-term fiscal cost.

42. **In the hydrocarbons sector, considerable uncertainty prevails at this stage regarding the modalities for implementing the recent nationalization decree.** A key concern in this regard is that any deterioration of the relationship between the government and private investors in this strategic sector could produce serious collateral damage on the environment for domestic and foreign private investment in other areas of the economy and hurt medium-term growth prospects. The authorities are therefore urged to undertake all efforts to achieve, as soon as possible within the six-month period established by the May 1 decree, mutually acceptable arrangements with the concerned oil companies on the key issues of taxation, export pricing, and payments for the assets that are being nationalized. Moreover, the expanded role newly assigned to YPFB in the hydrocarbons sector will demand high-quality management and full transparency, consistent with international accounting and auditing standards.

43. **While the short-term outlook is positive and the global environment for exporters of energy and minerals is expected to remain favorable, the medium-term outlook for Bolivia presents a range of challenges and risks.** First, as noted, it will be critical for the country's investment and export prospects to wrap up the strategic negotiations over hydrocarbons policy in a manner that is conducive to full development of the sector's potential. Second, avoidance of a rebound in the public debt ratio in the post-MDRI period will require enhancing domestic taxation, containing expenditure, and strengthening intergovernmental fiscal relations. Third, key determinants of competitiveness may shift against Bolivia in the period ahead. A continued strong balance of payments position, driven by natural gas exports, could lead to appreciation pressures on the boliviano. Furthermore, recent changes in the labor regime have raised redundancy costs, albeit modestly, with some impact on overall labor costs. To counteract these effects, it will be necessary to maintain prudent fiscal and monetary policies, and continued openness of the

exchange system. Finally, Bolivia faces the prospect of an erosion of its access to important markets as the ATPDEA is scheduled to expire at end-2006, and other Andean countries are expected to implement in the near future bilateral free trade agreements with the United States. The authorities will therefore need to intensify their efforts to expand Bolivia's access to external markets. Last but not least, the medium-term outlook hinges crucially on the maintenance of a stable legal framework, notably with regard to taxation and property rights, which takes on added relevance in light of the land reform initiative and the potential for major institutional changes in the context of the forthcoming constitutional assembly.

44. **Bolivia's economic statistics** are of adequate quality, timeliness, and coverage to allow the conduct of Fund surveillance.

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

Table 1. Bolivia: Selected Economic and Financial Indicators

	2002	2003	2004	Prel.	Proj.					
				2005	2006	2007	2008	2009	2010	2011
	(Annual percentage changes)									
Income and prices										
Real GDP	2.5	2.9	3.9	4.1	4.1	3.9	3.1	3.3	3.3	3.0
GDP deflator	2.8	6.2	7.4	4.6	5.3	4.9	4.3	3.4	3.3	3.4
CPI inflation (period average)	0.9	3.3	4.4	5.4	4.1	4.0	4.0	4.0	4.0	4.0
CPI inflation (end-of-period)	2.4	3.9	4.6	4.9	4.0	4.0	4.0	4.0	4.0	4.0
	(In percent of GDP)									
Combined public sector										
Revenues and grants	24.5	24.1	27.0	31.7	35.9	35.1	33.4	32.6	31.9	31.4
<i>Of which:</i>										
Royalties on hydrocarbons	2.3	2.8	3.4	6.7	10.1	9.7	8.9	8.2	7.6	7.1
Expenditure	33.3	32.0	32.6	33.9	36.1	38.7	36.6	36.1	35.8	35.3
Current	24.9	23.9	23.4	23.7	25.0	25.4	24.9	24.4	24.2	24.1
Capital	8.4	8.1	9.2	10.3	11.1	13.4	11.8	11.8	11.6	11.2
Overall balance	-8.8	-7.9	-5.6	-2.3	-0.1	-3.6	-3.3	-3.5	-3.8	-3.9
Total public debt	69.3	74.0	77.2	70.8	50.8	49.8	49.5	49.6	50.1	50.8
NPV of the public debt	44.8	51.5	54.6	53.4	42.7	42.2	42.1	42.2	42.8	43.5
External sector										
Current account	-4.1	1.0	3.9	5.0	5.0	4.8	3.5	2.0	1.3	0.8
Merchandise exports	16.4	19.7	24.5	28.5	32.7	31.0	29.0	27.4	26.1	25.3
<i>Of which: Natural gas</i>	3.4	4.7	7.1	10.5	14.0	13.4	12.2	11.3	10.4	9.7
Merchandise imports	22.4	19.9	21.1	25.0	29.0	26.8	25.7	25.7	25.3	24.9
Gross international reserves ^{1/}										
In millions of U.S. dollars	1,085	1,266	1,474	2,019	2,564	2,657	2,815	2,901	2,959	3,020
In percent of broad money	36.7	42.0	49.6	57.2	64.7	60.7	59.3	56.9	54.2	51.8
	(Changes in percent of broad money at the beginning of the period, unless otherwise)									
Money and credit										
NFA of the banking system	-11.4	3.5	3.8	25.2	15.4	3.0	3.3	1.7	1.0	0.9
NDA of the banking system	0.8	-4.7	-5.5	-8.0	-2.6	7.5	5.1	5.6	6.2	5.9
<i>Of which: Credit to the private sector (in percent of GDP)</i>	41.5	38.9	33.7	32.2	32.6	32.6	32.6	32.6	32.6	32.6
Broad money	-10.7	-1.2	-1.7	17.2	12.9	10.5	8.4	7.3	7.2	6.7
Interest rates (percent, end-of-period)										
Yield on treasury bills in local currency	17.2	10.9	10.6	7.9	...	...	...	...	...	...
Yield on treasury bills in U.S. dollars	4.9	6.2	4.3	7.4	...	...	...	...	...	...
Exchange rates										
Bolivianos/U.S. dollar (end-of-period) ^{2/}	7.48	7.82	8.04	8.00	...	...	...	...	...	...
REER, period average (percentage change)	0.4	-10.2	-6.3	-4.5	...	...	...	...	...	...
Memorandum item:										
Nominal GDP (in millions of Bolivianos)	56,682	61,980	69,152	75,285	82,529	90,005	96,837	103,509	110,510	117,627

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

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

^{2/} Official (buy) exchange rate.

Table 2. Bolivia: Operations of the Combined Public Sector
(In percent of GDP)

	2002	2003	2004	Prel. 2005	Proj. 2006
Revenue and grants	24.5	24.1	27.0	31.7	35.9
Current revenue	22.2	21.2	24.5	29.5	33.1
General government	21.6	21.1	24.1	29.0	31.5
Tax revenue	17.8	17.8	20.7	25.7	28.3
Hydrocarbons	4.6	4.6	5.0	9.2	12.5
<i>Of which: excise taxes of fuel</i>	2.3	1.7	1.7	2.5	2.3
Other	13.2	13.2	15.7	16.6	15.8
<i>Of which: FTT</i>	...	...	0.5	0.8	0.7
Customs duties	1.0	0.9	1.0	1.0	1.0
Nontax revenue	3.8	3.4	3.4	3.3	3.3
Public enterprise operating balance	0.1	-0.1	0.1	0.1	1.1
Central bank operating balance	0.5	0.2	0.3	0.3	0.4
Total expenditure	33.3	32.0	32.6	33.9	36.1
Current expenditure	24.9	23.9	23.4	23.7	25.0
Wages	9.3	9.4	9.1	8.8	8.7
Goods and services	2.9	2.6	2.1	2.0	2.1
Interest	2.6	2.8	2.9	3.1	2.8
Transfers (excludes pensions)	1.7	1.5	1.9	2.3	3.6
<i>Of which: petroleum product subsidies</i>	...	...	0.7	0.8	1.3
Pensions	4.5	4.4	4.3	4.1	4.1
Other	3.8	3.2	3.1	3.4	3.7
Capital expenditure	8.4	8.1	9.2	10.3	11.1
Overall balance	-8.8	-7.9	-5.6	-2.3	-0.1
Financing	8.8	7.9	5.6	2.3	0.1
External	6.0	5.3	3.9	2.3	1.6
Domestic	2.8	2.6	1.6	0.0	-1.4
Central bank	1.6	-0.2	-0.8	-2.1	-2.5
Commercial banks	-2.0	-0.2	0.7	1.3	-0.3
Pension funds	1.6	1.6	1.5	1.5	1.3
Other domestic	1.5	1.5	0.2	-0.7	0.0
Memorandum items:					
Nonhydrocarbons balance	-11.1	-10.7	-9.0	-9.0	-10.3
GDP (in billions of Bolivianos)	56.7	62.0	69.2	75.3	82.5

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

Table 3. Bolivia: Monetary Survey 1/

	2002	2003	2004	Prel. 2005	Proj. 2006
(Changes in millions of Bolivianos unless otherwise specified)					
Net foreign assets	-2,666	772	886	6,018	4,357
(In millions of U.S. dollars)	-379	100	110	738	547
Net domestic assets	177	-1,040	-1,286	-1,917	-722
Net credit to the public sector	1,021	-250	-345	-1,840	-2,328
Credit to the private sector	-2,276	-1,162	-1,659	1,363	2,315
Medium- and long-term net foreign liabilities	1,157	139	811	-415	50
Other	273	234	-92	-1,025	-760
Broad money	-2,489	-267	-400	4,101	3,635
(Stocks in millions of Bolivianos unless otherwise stated)					
Net foreign assets	8,986	10,831	12,533	18,648	24,125
(In millions of U.S. dollars)	1,278	1,401	1,561	2,288	3,021
Net domestic assets	13,106	12,758	11,372	9,616	7,411
Net credit to the public sector	3,189	3,720	3,624	1,875	-1,951
Credit to the private sector	22,559	23,583	22,819	24,510	26,380
Medium- and long-term net foreign liabilities	-3,088	-3,193	-2,500	-2,950	-2,845
Other	-9,554	-11,353	-12,571	-13,820	-14,172
Broad money 2/	22,092	23,590	23,905	28,264	31,537
(Changes in percent of broad money at beginning of period)					
Net short-term foreign assets	-11.4	3.5	3.8	25.2	15.4
Net domestic assets	0.8	-4.7	-5.5	-8.0	-2.6
Net credit to the public sector	4.4	-1.1	-1.5	-7.7	-8.2
Credit to the private sector	-9.8	-5.3	-7.0	5.7	8.2
Medium- and long-term net foreign liabilities	5.0	0.6	3.4	-1.7	0.2
Other	1.2	1.1	-0.4	-4.3	-2.7
Broad money	-10.7	-1.2	-1.7	17.2	12.9
Memorandum items:					
Broad money (average stock in percent of GDP)	38.3	37.1	32.6	34.2	35.5
Credit to private sector (average stock in percent of GDP)	41.5	38.9	33.7	32.2	32.6
Banking system liquid foreign asset coverage of dollar deposits (percent)	46.9	53.0	65.0	92.0	110.0
U.S. dollar and dollar-indexed deposits (in percent of total deposits)	91.4	90.5	86.5	81.7	75.6
U.S. dollar and dollar indexed credit (in percent of total credit)	95.3	97.0	95.3	91.8	87.7

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

1/ Stocks and flows in foreign currency are valued at the accounting exchange rate for the corresponding period.

2/ At the beginning of 2005 Banco Los Andes was reclassified as a bank. This has led to a steep increase in the recorded levels of broad money and credit to the private sector in 2005.

Table 4. Bolivia: Central Bank of Bolivia 1/

	2002	2003	2004	Prel. 2005	Proj. 2006
(Flows in millions of Bolivianos unless otherwise stated)					
Net international reserves	-1,936	718	1,112	4,105	3,523
(Flow in millions of U.S. dollars)	-275	93	138	503	442
Net domestic assets	2,273	-231	-354	-2,208	-2,317
Net credit to nonfinancial public sector	935	-135	-561	-1,543	-2,066
Net credit to financial intermediaries	380	-187	-355	-604	-255
<i>Of which:</i> open market operations (increase -)	163	-18	-294	-221	-353
Medium- and long-term net foreign liabilities (increase -)	1,055	-32	873	8	3
Other	-96	124	-311	-69	0
Currency issue	337	487	758	1,897	1,206
(Stocks in millions of Bolivianos unless otherwise stated)					
Net international reserves	5,428	6,866	8,640	12,785	17,543
(Stock in millions of U.S. dollars)	772	888	1,076	1,569	2,197
Net domestic assets	-2,391	-3,341	-4,357	-6,605	-10,157
Net credit to nonfinancial public sector	1,706	2,112	1,710	236	-3,330
Net credit to financial intermediaries	1,467	1,475	1,200	627	94
<i>Of which:</i> open market operations (-)	-71	-95	-391	-615	-946
Medium- and long-term net foreign liabilities (-)	-980	-1,064	-227	-220	-216
Other	-4,584	-5,864	-7,039	-7,247	-6,706
Currency issue	3,037	3,525	4,283	6,180	7,385
(Change in percent of currency issue at beginning of period)					
Net international reserves	-71.7	23.6	31.6	95.8	57.0
Net domestic assets	84.2	-7.6	-10.0	-51.6	-37.5
Net credit to nonfinancial public sector	34.6	-4.5	-15.9	-36.0	-33.4
Net credit to financial intermediaries	14.1	-6.1	-10.1	-14.1	-4.1
<i>Of which:</i> open market operations (increase -)	6.0	-0.6	-8.3	-5.2	-5.7
Medium- and long-term net foreign liabilities (increase -)	39.1	-1.1	24.8	0.2	0.1
Other	-3.6	4.1	-8.8	-1.6	0.0
Currency issue	12.5	16.0	21.5	44.3	19.5
Memorandum items:					
Currency issue (average stock in percent of GDP)	4.1	4.4	4.7	5.7	6.5
NIR coverage of broad money (percent)	24.6	29.1	36.1	45.2	55.6

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

1/ Stocks and flows in foreign currency are valued at the accounting exchange rate for the corresponding period.

Table 5. Bolivia: Commercial Bank Performance Indicators
(In percent)

	2002	2003	2004	2005				Mar.
				Mar.	Jun.	Sep.	Dec.	2006
Profitability ratios								
Ratios to total average assets								
Operating income	4.1	4.4	5.3	5.6	5.5	5.7	6.1	6.5
Profits before taxes	0.4	0.6	0.2	0.3	0.4	0.8	1.1	1.4
Profits after taxes	0.1	0.3	-0.1	0.0	0.1	0.5	0.7	1.0
Ratios to average equity								
Profits before taxes	3.5	5.1	1.4	2.3	3.4	7.0	9.1	12.8
Profits after taxes	0.6	2.7	-1.2	-0.4	0.7	4.2	6.3	9.6
Assets quality ratios								
Ratios to end-of-period total loans								
Nonperforming loans	17.6	16.7	14.0	15.5	13.7	13.7	11.3	12.2
Nonperforming loans (net of provisions)	6.4	4.4	2.2	4.1	3.0	3.5	2.1	2.8
Provisions (as percentage of NPL)	63.7	74.0	84.3	73.6	78.1	74.7	81.1	76.9
NPL + repossessed assets	...	...	...	23.5	20.6	21.1	17.2	18.6
"Expanded NPL" 1/	...	...	40.7	38.3	35.5	33.9	31.2	30.6
"Expanded NPL" (net of provisions) 1/	...	...	28.8	26.9	24.8	23.7	22.1	21.2
Provisions over "expanded NPL" 1/	...	...	29.1	29.8	30.1	30.2	29.4	30.6
Ratios to net worth								
Nonperforming loans (net of provisions)	33.2	24.1	12.9	24.3	18.1	21.1	12.9	17.2
"Expanded NPL" (net of provisions) 1/	...	...	168.9	159.2	150.0	144.8	132.3	129.7
Liquidity ratios								
Ratios to end-of-period total deposits								
Total loans	94.6	94.1	94.6	95.9	95.5	90.8	90.1	89.7
Total liquidity assets	30.2	30.2	33.1	31.8	31.6	31.2	33.6	33.2
<i>Of which:</i> Government papers	5.1	6.1	7.0	7.1	6.6	7.1	6.7	5.2
Capital adequacy ratio								
Qualif. capital over risk-adjusted assets	16.1	12.9	14.9	14.9	14.9	14.6	14.7	14.5

Sources: Superintendency of Banks; and Financial Institutions.

1/ Refers to the sum of NPLs and current performing restructured loans.

Table 6. Bolivia: Financial and External Vulnerability Indicators
(End-of-period; in percent, unless otherwise indicated)

	2002	2003	2004	2005	Proj. 2006
Financial indicators 1/					
Lending rate in domestic currency	...	10.4	10.6	9.8	...
Lending rate in U.S. dollars	...	9.5	9.5	11.6	...
Velocity of money	...	2.1	2.4	2.4	2.3
Credit to the private sector (average stock, percent of GDP)	41.5	38.9	33.7	32.2	32.6
Share of foreign currency deposits in total deposits	91.4	90.5	86.5	81.7	75.6
Share of foreign currency loans in total credit	95.3	97.0	95.3	91.8	87.7
Nonperforming loans (percent of total loans)	17.6	16.7	14.0	11.3	...
Loan-loss provisions (percent of nonperforming loans)	63.7	74.0	84.3	81.1	...
Risk-based capital-assets ratio	16.1	15.3	14.9	14.7	...
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	2,521	2,384	2,151	2,263	2,350
Commercial banks' net short-term foreign assets (in millions of U.S. dollars)	506	513	485	719	824
External sector					
Exports, U.S. dollars (percent change)	1.1	23.0	34.3	24.5	26.9
Imports, U.S. dollars (percent change)	3.7	-8.7	14.1	27.0	28.1
Terms of trade (percent change)	0.5	6.1	11.9	12.4	18.1
Real effective exchange rate (percent change)	0.4	-10.2	-6.3	-4.5	...
Current account balance (percent of GDP)	-4.1	1.0	3.9	5.0	5.0
Capital and financial account balance (percent of GDP)	0.4	-0.1	-2.4	0.3	0.7
Net FDI inflows (percent of GDP)	8.5	2.4	0.7	-3.0	1.2
Total external debt (percent of GDP)	55.9	74.9	68.4	65.5	43.7
Medium- and long-term public debt (percent of GDP)	55.9	63.8	57.7	52.9	32.3
Medium- and long-term private debt (percent of GDP)	...	11.1	10.7	12.6	11.4
Total external debt (percent of exports of goods and services)	...	380	283	224	131
Short term external debt (original maturity, percent of total external debt)	0.27	0.20	0.23	0.25	0.36
Gross international reserves (GIR) (in millions of U.S. dollars) 2/	1,085	1,266	1,474	2,019	2,564
GIR (percent of broad money)	36.7	42.0	49.6	57.2	64.7
GIR (in months of imports of goods and services)	6	7	8	8	9
GIR (percent of short-term debt and banks' FX deposits)	45.6	53.5	68.1	87.0	108.2
Net international reserves (in millions of U.S. dollars)	772	888	1,076	1,568	2,197
Nonfinancial public sector					
Overall balance (percent of GDP)	-8.8	-7.9	-5.6	-2.3	-0.1
Primary balance (percent of GDP)	-6.2	-5.1	-2.6	0.8	2.6
NFPS gross debt (percent of GDP)	69.3	74.0	77.2	70.8	50.8
<i>Of which:</i> in domestic currency (percent of GDP)	13.4	10.2	19.6	17.9	18.4
NFPS net debt (percent of GDP)	62.2	66.4	68.2	60.8	40.6

Source: Bolivian authorities; and Fund staff estimates.

1/ Excludes nonbank financial institutions.

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

Table 7. Bolivia: Summary Balance of Payments

	2002	2003	2004	Prel.	Proj.					
				2005	2006	2007	2008	2009	2010	2011
(In millions of U.S. dollars, unless otherwise noted)										
Current account	-324	85	337	467	518	540	423	264	175	122
Trade balance	-471	-18	302	329	391	472	395	219	116	52
Exports, f.o.b.	1,299	1,598	2,146	2,671	3,390	3,500	3,524	3,557	3,630	3,736
Natural gas	266	381	620	984	1,445	1,516	1,488	1,467	1,450	1,434
<i>Of which:</i> natural gas to Brazil	206	360	542	794	1,155	1,212	1,190	1,173	1,160	1,147
Volume (millions of cubic meters p/day)	10.3	13.8	19.5	22.4	24.0	24.0	24.0	24.0	24.0	24.0
Price (US\$ per thousand cubic feet)	1.5	2.0	2.2	2.8	3.7	3.9	3.8	3.8	3.7	3.7
Natural gas to Argentina	...	...	49	163	250	262	257	254	251	248
Volume (millions of cubic meters p/day)	...	...	2.2	4.8	6.3	6.3	6.3	6.3	6.3	6.3
Price (US\$ per thousand cubic feet)	...	...	1.7	2.7	3.1	3.2	3.2	3.1	3.1	3.1
Mining	348	367	456	548	863	999	1,042	1,072	1,127	1,206
Soy - related 1/	244	306	387	263	187	179	161	168	168	176
Other	442	543	684	876	895	807	833	850	884	919
Imports, c.i.f.	-1,770	-1,616	-1,844	-2,341	-2,998	-3,028	-3,129	-3,338	-3,514	-3,683
Services (net)	-18	-69	-71	-74	-154	-162	-170	-178	-187	-197
Income (net)	-205	-302	-385	-373	-378	-435	-441	-446	-455	-467
Transfers (net)	369	474	491	584	659	664	639	670	702	733
<i>Of which:</i> HIPC assistance from grants	80	67	68	62	55	32	33	38	39	44
Capital and financial account	32	-7	-211	26	74	-479	-291	-202	-139	-83
Capital transfers 2/	0	7	8	9	240	9	9	10	10	10
Direct investment (net)	674	195	63	-280	127	-202	-156	95	95	95
Gross investment	...	...	385	404	442	242	142	142	142	142
Disinvestment and investment abroad	...	...	-320	-681	-315	-443	-297	-47	-47	-46
Portfolio investment (net)	-19	-68	-35	-153	2	-24	-17	-15	-15	-13
Public sector loans	321	374	234	162	149	136	161	156	179	209
Disbursements	577	744	547	498	436	360	360	360	420	470
Amortization	-256	-370	-313	-336	-287	-224	-199	-204	-241	-261
Banks' net foreign assets, excl. liquid asset requirement	16	-124	18	-97	-98	-26	11	5	7	11
Nonbank private sector loans	-34	111	65	293	60	0	0	0	0	0
Other, including errors and omissions	-926	-502	-563	93	-406	-372	-300	-453	-416	-396
Overall balance	-293	77	126	493	593	61	133	62	36	39
Financing	293	-77	-126	-493	-593	-61	-133	-62	-36	-39
Exceptional financing	17	16	13	11	9	8	8	9	8	8
Change in net international reserves (increase -)	275	-93	-138	-503	-602	-69	-141	-71	-43	-47
(In percent of GDP)										
Current account balance	-4.1	1.0	3.9	5.0	5.0	4.8	3.5	2.0	1.3	0.8
Merchandise exports	16.4	19.7	24.5	28.5	32.7	31.0	29.0	27.4	26.1	25.3
Merchandise imports	-22.4	-19.9	-21.1	-25.0	-29.0	-26.8	-25.7	-25.7	-25.3	-24.9
(In millions of U.S. dollars)										
Memorandum items:										
Gross official reserves (end-of-period)	854	1,057	1,212	1,674	2,212	2,281	2,422	2,493	2,537	2,584
MDRI debt relief (on flow basis)	...	...	...	...	93	100	63	41	35	30
Principal	...	...	...	...	82	87	52	30	25	20
Interest	...	...	...	...	11	13	11	11	10	10
GDP	7,917	8,102	8,749	9,358	10,355	11,307	12,165	13,004	13,883	14,777

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

1/ Excluding reexports.

2/ In 2006 includes effect of MDRI debt relief from the IMF.

Table 8. Bolivia: Comparison of Medium-Term Scenarios

	Sixth Review Baseline 1/				Article IV Baseline							
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010	2011	
Income and prices												
Real GDP Growth	4.1	3.9	3.0	3.0	3.0	4.1	3.9	3.1	3.3	3.3	3.0	3.0
CPI inflation (period average)	3.4	3.1	3.0	3.0	3.0	4.1	4.0	4.0	4.0	4.0	4.0	4.0
Public sector												
Overall balance, before hydrocarbons based revenue (in percent of GDP)	-9.7	-8.9	-8.2	-7.7	-7.0	-10.3	-13.3	-12.1	-11.7	-11.5	-11.0	-11.0
Hydrocarbons based revenue (in percent of GDP)	6.7	6.3	5.9	5.5	5.2	10.1	9.7	8.9	8.2	7.6	7.1	7.1
Overall balance (in percent of GDP)	-3.0	-2.6	-2.3	-2.2	-1.9	-0.1	-3.6	-3.3	-3.5	-3.8	-3.9	-3.9
Public debt (in percent of GDP)	71	69	67	66	64	51	50	50	50	50	51	51
External sector												
Exports, f.o.b. (in millions of US dollars)	2,721	2,702	2,748	2,770	2,819	3,390	3,500	3,524	3,557	3,630	3,736	3,736
Natural gas	1,002	1,033	1,037	1,023	1,018	1,445	1,516	1,488	1,467	1,450	1,434	1,434
<i>Of which:</i> Natural gas to Brazil	747	768	771	760	756	1,155	1,212	1,190	1,173	1,160	1,147	1,147
Volume (millions of cubic meters p/day)	22.5	22.5	22.5	22.5	22.5	24.0	24.0	24.0	24.0	24.0	24.0	24.0
Price (US\$ per thousand cubic feet)	2.6	2.6	2.7	2.6	2.6	3.7	3.9	3.8	3.8	3.7	3.7	3.7
Natural gas to Argentina	2.11	2.18	2.19	2.15	2.14	2.50	2.62	2.57	2.54	2.51	2.48	2.48
Volume (millions of cubic meters p/day)	6.5	6.5	6.5	6.5	6.5	6.3	6.3	6.3	6.3	6.3	6.3	6.3
Price (US\$ per thousand cubic feet)	2.5	2.6	2.6	2.6	2.6	3.1	3.2	3.2	3.1	3.1	3.1	3.1
WEO oil price (US\$ per barrel)	62	60	58	57	57	67	70	69	68	67	66	66
Current account balance (in percent of GDP)	1.5	1.1	1.0	0.1	-0.4	5.0	4.8	3.5	2.0	1.3	0.8	0.8
Net international reserves (in millions of US dollars)	1,628	1,716	1,799	1,892	1,996	2,197	2,266	2,407	2,478	2,521	2,568	2,568
Monetary sector												
Broad money (annual percentage change)	8.7	7.1	6.0	6.1	6.0	12.9	10.5	8.4	7.3	7.2	6.7	6.7
Local currency broad money (annual percentage change)	8.7	6.6	5.9	6.2	6.0	30.5	16.1	13.9	11.8	11.4	10.8	10.8
Credit to the private sector (in percent of GDP)	28.9	28.0	27.4	26.6	25.8	32.6	32.6	32.6	32.6	32.6	32.6	32.6

Source: Fund staff estimates and projections

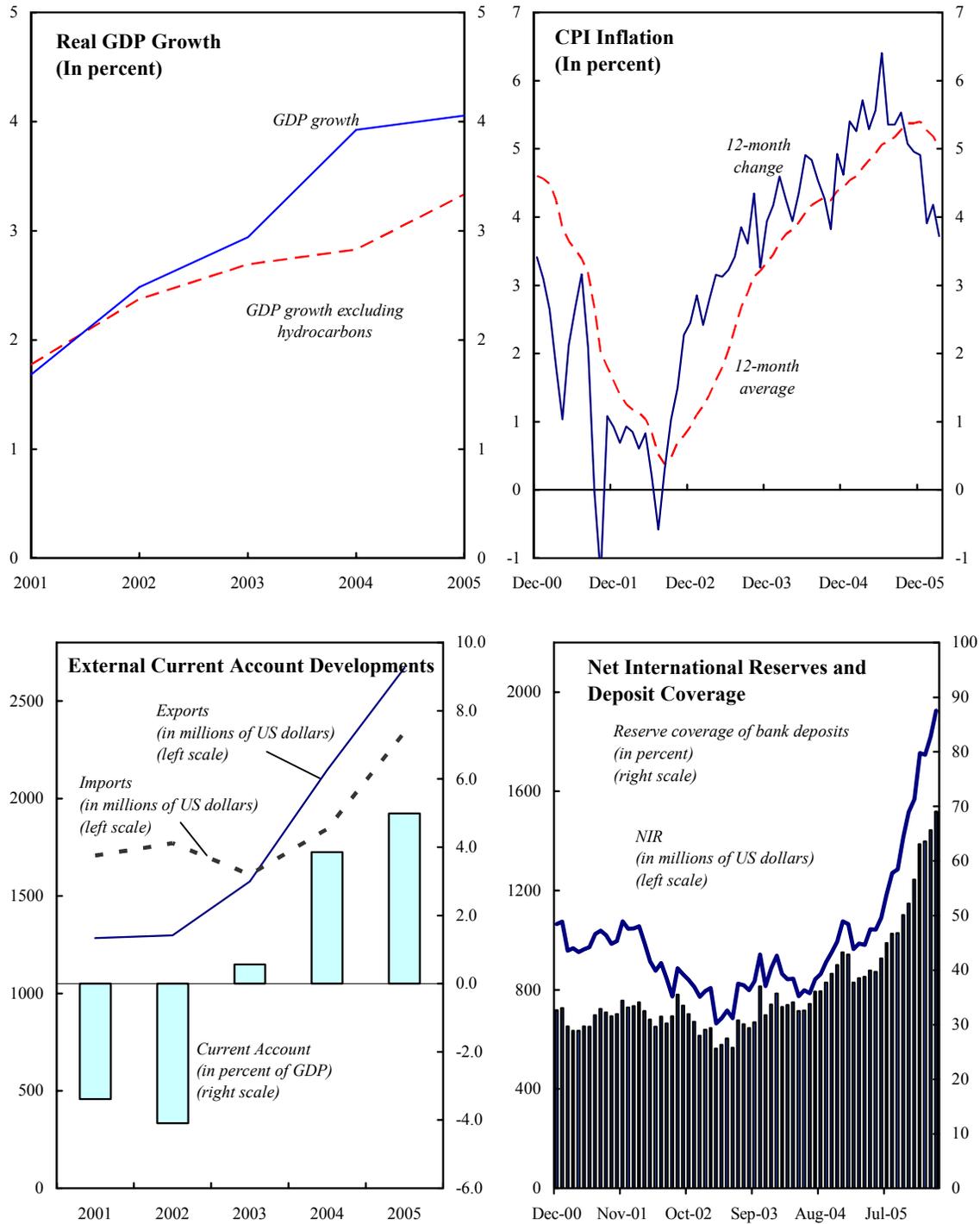
1/ As in Country Report No. 05/393.

Table 9. Bolivia: Millennium Development Goals

	First Observation	1998	2000	2001	2002	2003	2004	2015 Target
Goal 1. Eradicate Extreme Poverty and Hunger								
Target 1: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day.								
Population below US\$1 a day (in percent)	41.2 (1990)	...	45.0	39.0	...	41.3	...	24
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger								
Prevalence of child malnutrition (percent of children under 3)	38.3 (1990)	25.6	...	...	...	24.2	...	19
Goal 2. Achieve Universal Primary Education								
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling.								
Net primary enrollment ratio (percent of relevant age group)	...	...	96.4	97.0	97.7	97.1	...	100
Percentage of cohort reaching grade 5	55.4 (1992)	...	...	71.5	74.8	75.0	...	100
Goal 3. Promote Gender Equality and Empower Women								
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015.								
Gender disparities at completion of primary education (percent)	6.6 (1992)	...	...	3.7	2.9	3.4	...	0
Gender disparities at completion of secondary education (percent)	3.4 (1992)	...	...	1.1	0.9	0	...	0
Goal 4. Reduce Child Mortality								
Target 5: Reduce by two-thirds, between 1990 and 2015, the under five mortality rate								
Infant mortality rate (per 1,000 live births)	89 (1990)	67	...	...	...	54	...	30
Immunization against measles (percent of children under 12-months)	68 (1994)	77	90	92	86	80	...	95
Goal 5. Improve Maternal Health								
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.								
Maternal mortality ratio (modeled estimate, per 100,000 live births)	416 (1990)	235	...	...	...	229	...	104
Proportion of births attended by skilled health personnel (percent)	27 (1995)	42.0	52.0	54.0	53.9	55.3	...	70
Goal 6. Combat HIV/AIDS, Malaria, and Other Diseases								
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS								
HIV prevalence, total (percent ages 15-24)	1.8 (1990)	5.2	5.0	9.4	6.5	11.5	13.4	13
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases								
Incidence of malaria (per 1,000 people)	7.5 (1990)	24.8	8.8	5.0	4.3	6.1	4.1	2
Incidence of tuberculosis cases cured (percent of diagnosed)	52.6 (1995)	55.8	71.2	78.1	81.2	...	...	95
Target 10: halve by 2015 proportion of people without access to safe drinking water								
Access to potable water (percent of population)	57.5 (1992)	...	...	72.0	72.0	72.0	72.3	78.5
Access to improved water source (percent of population)	28 (1992)	...	...	40.7	41.5	41.3	41.6	64
Goal 8. Develop a global Partnership for Development								
Target 17: Provide access to affordable essential drugs								
Proportion of households expenditure on essential drugs (percent of national health expenditure)	17.8 (1995)	19.4	17.2	20.5	21.6	...	...	15

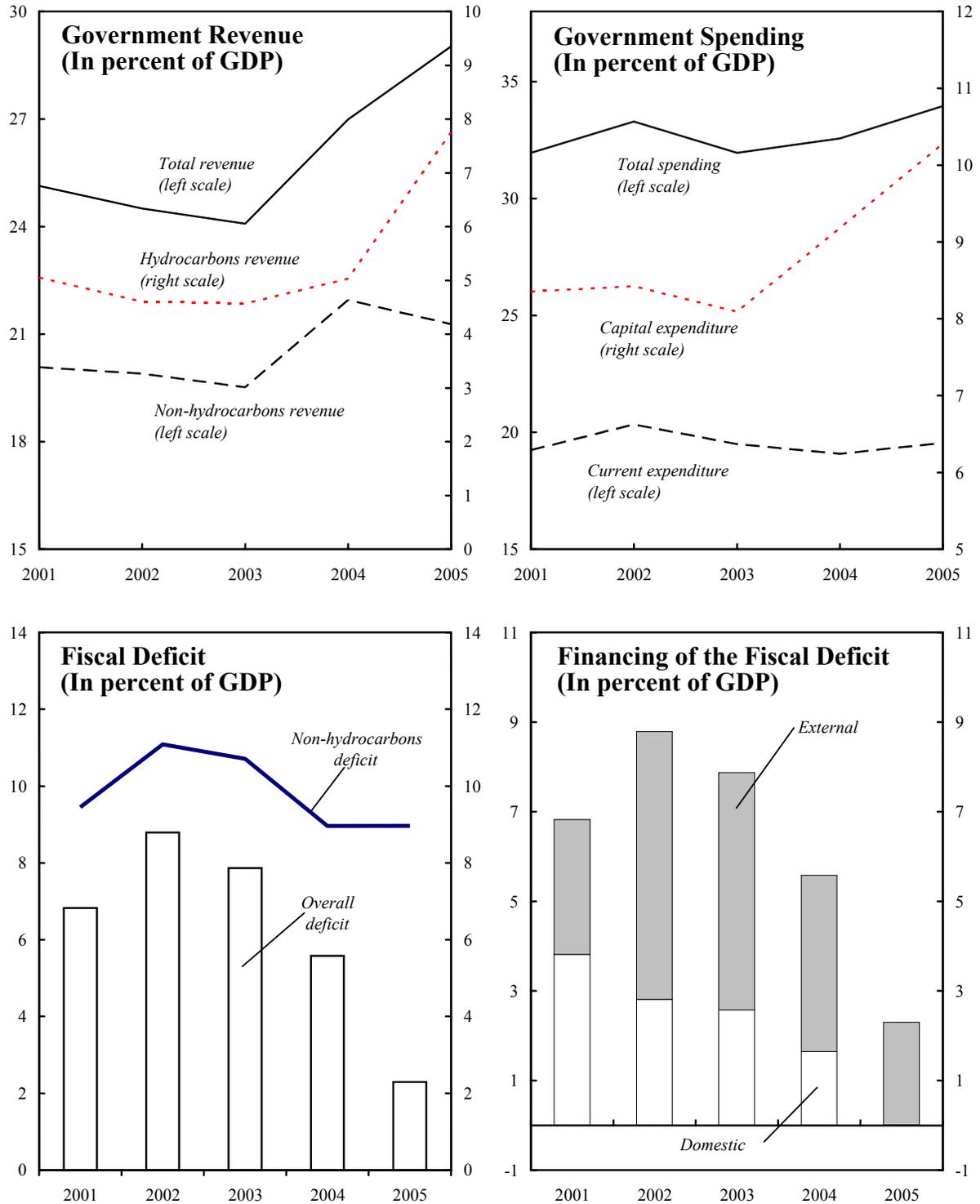
Source: Bolivian authorities

Figure 1. Bolivia: Key Economic Indicators



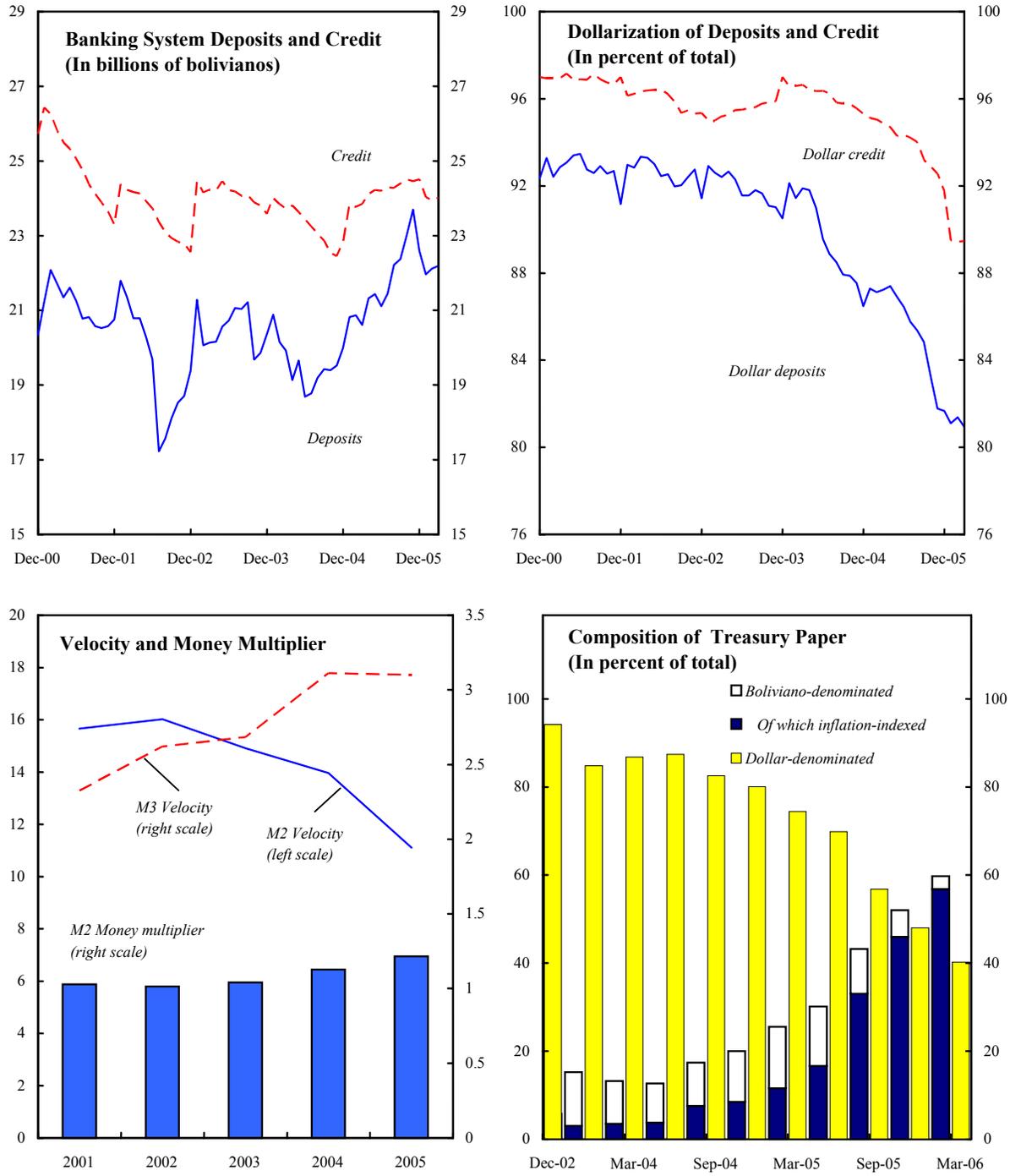
Source: Bolivian authorities.

Figure 2. Bolivia: Fiscal Developments



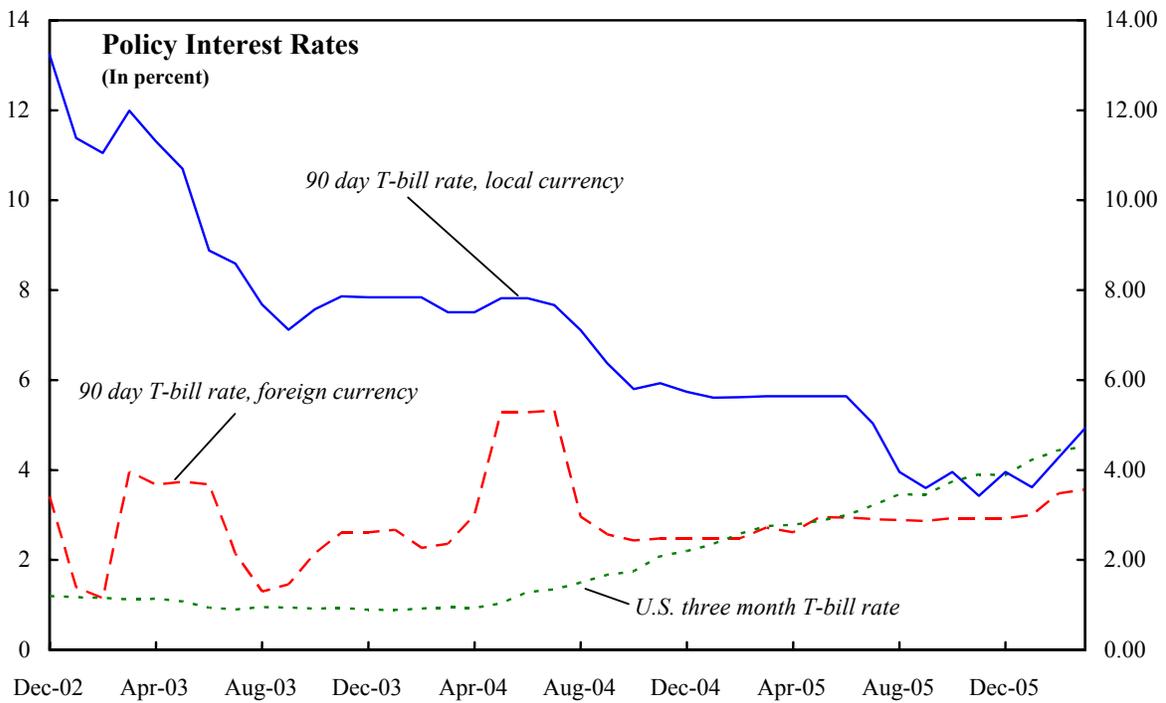
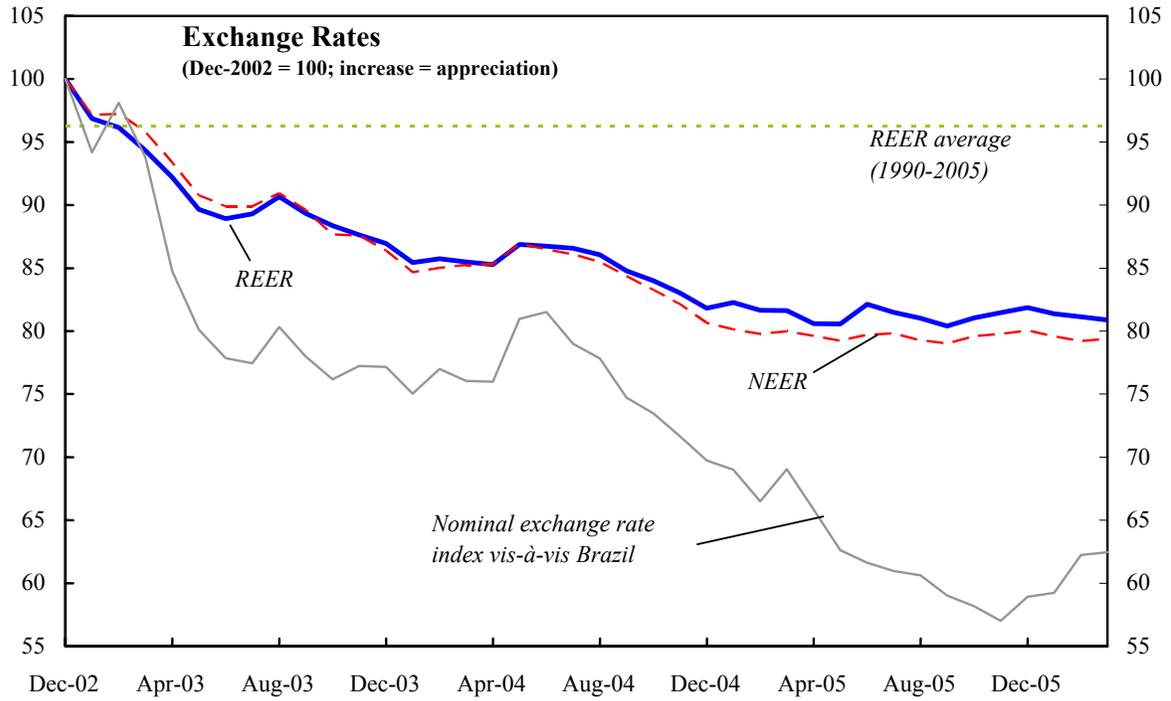
Source: Bolivian authorities.

Figure 3. Bolivia: Monetary Developments



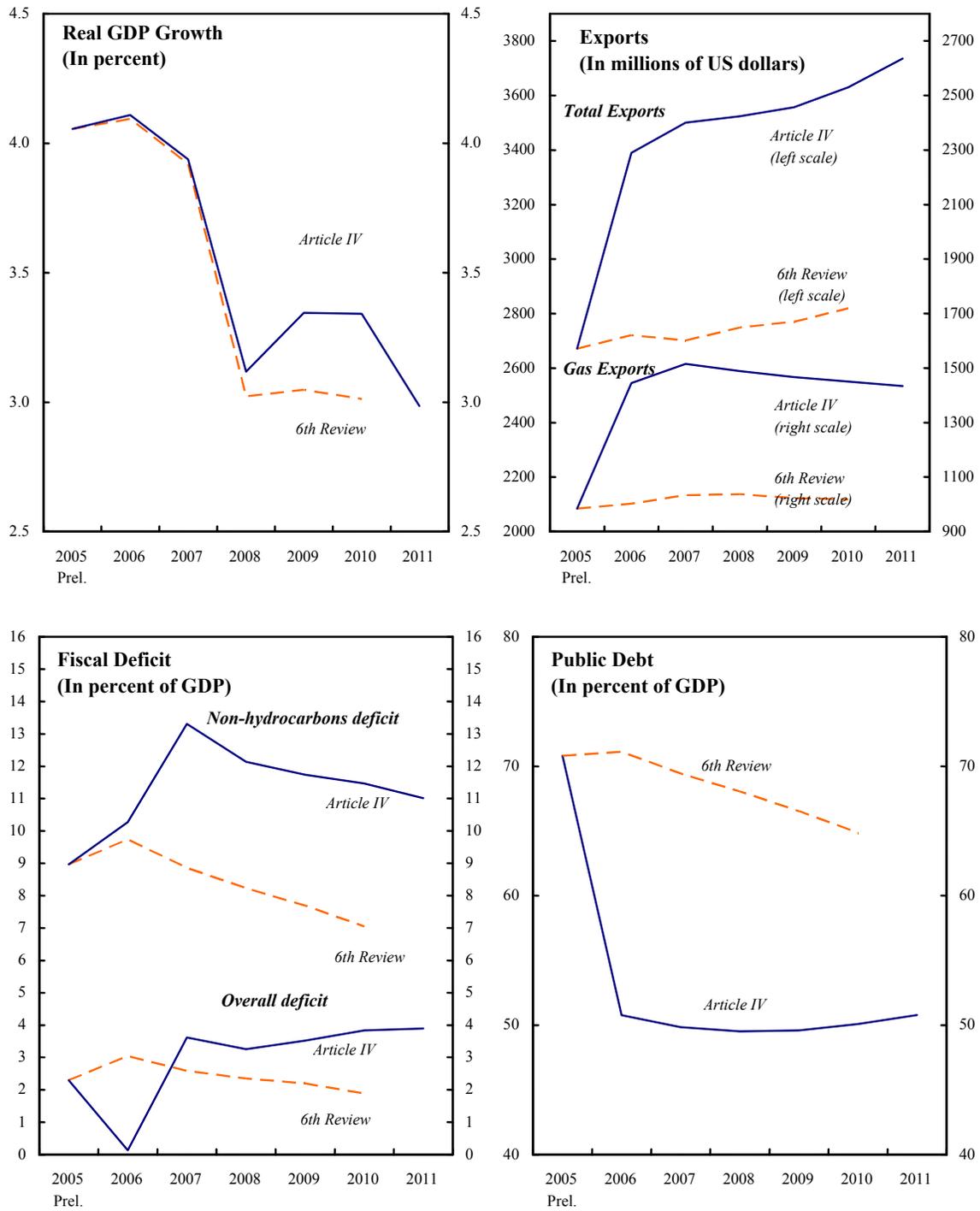
Source: Central Bank of Bolivia.

Figure 4. Bolivia: Exchange Rate and Interest Rate Developments



Sources: Bolivian authorities; and Fund staff estimates.

Figure 5. Bolivia: Medium-Term Scenarios



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

APPENDIX I. BOLIVIA—FUND RELATIONS
(As of May 31, 2006)

I. **Membership Status:** Joined December 27, 1945; Article VIII

II. General Resources Account:	SDR Million	Percent of Quota
Quota	171.50	100.0
Fund holdings of currency	172.30	100.47
Reserve position in Fund	8.87	5.17

III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	26.70	100.00
Holdings	25.80	96.63

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

V. **Financial Arrangements:**

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

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

	Expectations Basis				
	2006	2007	2008	2009	2010
Principal		2.42	4.83	2.42	
Charges/Interest	0.26	0.49	0.29	0.07	0.03
Total	0.26	2.90	5.12	2.49	0.03
	Obligations Basis				
	2006	2007	2008	2009	2010
Principal			2.42	4.83	2.42
Charges/Interest	0.26	0.51	0.49	0.29	0.07
Total	0.26	0.51	2.90	5.12	2.49

VII. Implementation of HIPC Initiative:

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

VIII. Implementation of MDRI Assistance:

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

Eligible Debt

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

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

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

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

- IX. **Safeguards Assessment.** Under the Fund's safeguards assessment policy, the Central Bank of Bolivia (CBB) was subject to an assessment with respect to the April 2, 2003 Stand-By Arrangement (SBA). A safeguards assessment was completed June 27, 2003, and while no systemic risks with the CBB's safeguards were identified, uncertainties were expressed about the de facto lack of operational independence and program monetary data. An update assessment was completed September 27, 2004 in conjunction with an augmentation of the SBA. This assessment confirmed that measures had been implemented to address all previously identified vulnerabilities, except for those requiring a change in the central bank law.
- X. **Exchange Arrangement.** The Bolivian currency is the boliviano and the exchange rate regime is a crawling peg. The central bank holds a daily foreign exchange auction, accepting all bids that are at least equal to the central bank's minimum price. If acceptable bids exceed the amount offered for auction, the lowest acceptable bids are prorated so as to exhaust the amount offered. The minimum price is adjusted from time to time in light of the evaluation of Bolivia's real exchange rate with respect to Bolivia's key trading partners. On May 31, 2006, the official selling rate was US\$8.06 per U.S. dollar.
- XI. **Article IV Consultation.** The last Article IV consultation and request for the first review under the Stand-By Arrangement was completed by the Executive Board on July 7, 2003 (Country Report No. 03/257). Bolivia is on a 12-month consultation cycle.

XII. Technical Assistance.

Department	Purpose	Date
FAD	Modernization of customs administration and follow-up missions	June 1999, May 2001, Dec. 2001
FAD	Tax administration	June 1999, Feb. 2000, June 2001
FAD	Fiscal decentralization	December 2000
MAE	Central bank operations and domestic capital markets	June 1999
MAE	Vulnerability of the banking system	Oct. 1999, April 2000, Dec. 2000
STA	Money and banking statistics	Jan 1999, Sept. 2001
STA	Balance of payments statistics	August 1999
MAE	Monetary operations, monetary, and exchange rate policy	May 2002
STA	National accounts statistics	August 2002
MAE	FSAP	Nov. 2002, Jan. 2003
FAD	Customs reform	December 2002
FAD	Tax Administration	May 2003
MFD	Training of bank supervisors on AML/CFT	July 2003
FAD	Pension reform	April 2004
LEG	Review of draft AML law (desk review)	July 2004
MFD	Banking sector	July 2004
MFD	Banking sector	August 2004
FAD	Tax policy	August 2004
FAD	Tax administration	August 2004
MFD/LEG	Financial Intelligence Unit and AML/CFT legislative advice	September 2004
FAD	PSIA	October 2004
FAD	Decentralization and public expenditure management	October 2004
MFD	Promote use of domestic currency	October 2004
FAD	Public expenditure management: the budget process	April 2005
STA	Monetary statistics	March 2006

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

APPENDIX II. BOLIVIA: EXTERNAL AND PUBLIC DEBT SUSTAINABILITY ANALYSIS (DSA)

While Bolivia's external and public debt have declined significantly in relation to GDP in recent years as a result of the sharp reduction in the fiscal deficit and implementation of the MDRI, the debt sustainability analysis points to the potential for some reversal of these gains over the long term. Bolivia's external debt (public and private) decreased significantly and is projected to fall further in the medium to about 36 percent of GDP in 2011 and stabilize in both nominal and NPV terms in the longer term (2016–26). The public external debt service to export ratio is also projected to remain at comfortable, albeit increasing levels. However, while the NPV of total public debt (external and domestic) remains stable in the period (2006–11) at about 43 percent, it shows an increasing trend in the period (2012–26) reaching about 50 percent in 2026 driven by a gradually increasing deficit as a percent of GDP that goes from about 3.9 percent of GDP in 2011 to 4.3 percent in 2026. The gradual deterioration of the deficit is driven by broadly stable hydrocarbon prices and production which imply declining hydrocarbon revenues as a share of GDP.

The outcome seems sensitive to standard stress tests, particularly to a continuation of past historical trends, permanently lower real GDP growth and to devaluation.

Solvency would be particularly compromised under adverse shocks. In particular, a decline in natural gas production and exports of 5 percent annually over the next five years (i.e., a cumulative decline of more than 20 percent), would place the debt ratio to GDP on a rising path. Conversely, debt sustainability would improve substantially under the assumption of a one-time 50 percent increase in the natural gas export prices relative to the baseline scenario. These results underscore the need of reaching mutually acceptable agreements with the private sector in the hydrocarbons sector to promote continued private investment and growth.

Main assumptions

The baseline scenario is projected for the period 2006–26. The macroeconomic framework for the period 2006–11 is detailed in the staff report tables. The baseline assumes that a negotiated agreement is reached with the nationalized companies that do not disrupt current production levels. The main assumptions for the long-term projections under the baseline scenario are:

- Average annual real GDP growth: 3.5 percent
- Inflation: 4 percent
- Export growth: 5 percent
- Gas prices: stable with a price to Brazil of 3.7 U.S. dollars per thousand cubic feet in longer term
- Gas volumes: stable at 2006 levels
- The average concessionality of the public sector borrowing is expected to decrease gradually and effective interest rate somewhat increase.
- The real effective exchange rate will remain constant.

- The evolution of domestic public debt is consistent with the path for the overall fiscal deficit percent and available domestic financing.

External debt sustainability

Bolivia is expected to maintain its external debt sustainability throughout the period in consideration. The stock of total public and private external debt-to-GDP ratio is expected to fall to about 36 percent by 2011 and stabilize at the range of 26–28 percent by 2026. At the same time, the composition of public external debt is expected to shift to less concessional sources, and therefore the speed of reduction of public external debt NPV to GDP ratio will be lower than that of the nominal debt. Also, the debt service to export ratio is expected to increase somewhat. Nevertheless, these indicators are projected to remain at comfortable levels, with NPV external public debt to GDP ratio being close to 20 percent of GDP by the end of the period.

Bolivia's risk of debt distress is low given its debt levels and the overall rating of its macroeconomic policies According to the World Bank's IDA Resource Allocation Index (IRAI) Bolivia is classified as a medium performer with respect to quality of policies and the related thresholds on NPV of debt-to-GDP and debt-to-exports ratios (40 and 150 percent, respectively) are met with ample margins under the baseline projections and even under stress scenarios.

The standardized stress tests show that Bolivia's external debt would remain sustainable under several shocks and their combinations (Table 2). Bolivia NPV to GDP ratio experiences highest increase under the 30 percent devaluation shock in 2007, but nevertheless stabilizes at around 30 percent of the GDP. The stress test assuming borrowing on less favorable terms also leads to higher, but stabilizing ratios.

The prospects for external debt sustainability, however, would be compromised under alternative adverse scenario that assumes fall in gas production (5 percent fall each year in 2007–11) (Figure 2). Assuming that related shortfalls in fiscal revenues are compensated by additional external borrowing, such scenario puts the NPV of external public debt on higher and rising path and may require adjustment measures to return to stable debt ratio. On the other hand, the positive shock assuming one time 50 percent increase in gas prices in 2007 improves the external solvency with further improvement in NPV of debt to exports ratio and debt service indicators.

Public debt sustainability

While Bolivia is expected to maintain its public debt sustainability in the short to medium term (2006–11), long term prospects would crucially depend on developments in the hydrocarbons sector. While the NPV of debt is broadly constant until 2011 and the NPV of external debt is flat given the rather constant expected external financing as a share of GDP, after 2011 the overall deficit increases slowly and this implies the need accommodate this with additional domestic financing as declining pension and investment

spending is not enough to compensate for the increasing interest bill and the reduction of hydrocarbon revenues as a share of GDP.

The standardized stress tests show that Bolivia's public debt sustainability is sensitive to several shocks (Table 4). Bolivia NPV to GDP ratio experiences highest increase under a historical pattern, a permanent reduction in growth and a 30 percent devaluation shock in 2007. The stress test assuming historical parameters is the one that shows the higher NPV of debt as a share of GDP in 2026 at a level of 77 percent of GDP.

While the prospects for public debt sustainability would be seriously compromised under an alternative adverse scenario that assumes fall in gas production (5 percent fall each year in 2007–11), a positive shock on gas prices would improve the outlook substantially. Assuming that related shortfalls in fiscal revenues are compensated by additional external borrowing, such scenario puts the NPV of external public debt on higher and rising path and may require adjustment measures to return to stable debt ratio. On the other hand, the positive shock assuming one time 50 percent increase in gas prices in 2007 raises the prospects for public debt sustainability with further improvement in the level of NPV of debt-to-revenue ratio and debt service indicators.

Table 1. Bolivia: External Debt Sustainability Framework, Baseline Scenario, 2006-2026 1/

(In percent of GDP, unless otherwise indicated)

	Actual										Projections										2012-26 Average
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012-11 Average	2016	2026					
External debt (nominal) 1/	55.3	53.2	55.2	55.9	74.9	68.4	65.5	43.7	41.2	39.6	38.2	37.1	36.2	36.2	30.7	26.6					
<i>Of which: public and publicly guaranteed (PPG)</i>	4.7	4.6	4.8	4.7	5.8	5.6	6.2	6.4	5.9	5.3	5.2	5.1	5.0	5.0	4.2	2.9					
Change in external debt	0.4	-2.1	1.9	0.7	19.0	-6.5	-2.9	-21.7	-2.5	-1.6	-1.4	-1.2	-0.8	-0.8	-2.6	24.0					
Identified net debt-creating flows	-4.9	-3.7	-3.3	-2.8	-4.7	-10.1	-6.5	-8.7	-7.5	-3.2	-3.3	-3.2	-2.7	-2.6	-2.6	0.0					
Non-interest current account deficit	4.3	3.7	1.8	2.5	-2.3	-5.5	-7.1	-7.2	-6.8	-5.6	-4.1	-3.2	-2.7	-2.7	-0.4	-1.6					
Deficit in balance of goods and services	8.2	7.3	5.6	6.2	1.1	-2.6	-2.7	-2.3	-2.7	-2.0	-0.5	0.3	0.8	0.8	2.1	2.1					
Exports	15.8	17.5	18.7	19.7	24.2	29.3	33.4	36.8	34.9	33.0	31.3	30.0	29.1	29.9	25.8	20.0					
Imports	24.0	24.8	24.3	25.9	25.3	26.6	30.7	34.5	32.1	30.9	30.8	30.3	29.9	29.9	26.6	22.1					
Net current transfers (negative = inflow)	-4.7	-4.6	-4.8	-4.7	-5.8	-5.6	-6.2	-6.4	-5.9	-5.3	-5.2	-5.1	-5.0	-5.0	-4.2	-2.9					
Other current account flows (negative = net inflow)	0.8	1.1	1.0	1.0	2.5	2.8	1.9	1.5	1.8	1.7	1.6	1.5	1.4	1.4	0.8	0.3					
Net FDI (negative = inflow)	-12.3	-8.4	-8.2	-8.5	-2.4	-0.7	3.0	-1.2	-1.1	1.7	1.2	-0.7	-0.6	-0.6	-0.4	-0.2					
Endogenous debt dynamics 3/	3.1	0.9	3.0	3.2	0.0	-3.9	-2.4	-0.3	0.5	0.8	0.6	0.6	0.7	0.5	0.5	0.6					
Contribution from nominal interest rate	1.6	1.6	1.6	1.6	1.2	1.6	2.1	2.2	2.0	2.0	1.9	1.8	1.8	1.8	1.5	1.4					
Contribution from real GDP growth	-0.2	-1.4	-0.9	-1.4	-1.6	-2.7	-2.6	-2.4	-1.6	-1.2	-1.2	-1.2	-1.0	-1.0	-1.0	-0.9					
Contribution from price and exchange rate changes	1.7	0.7	2.4	3.1	0.3	-2.8	-1.9	...	...	...	...	...	...	...	...	...
Residual 4/	5.3	1.7	5.2	3.5	23.8	3.6	3.5	-13.1	5.0	1.6	0.8	2.2	1.8	1.7	1.7	-0.2					
<i>Of which: exceptional financing</i>	-0.2	-0.2	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0					
NPV of external debt 5/	...	...	...	...	...	...	46.7	35.1	33.4	32.3	31.2	30.4	29.9	29.9	26.3	23.9
In percent of exports	...	...	...	...	...	...	139.7	95.5	95.9	97.9	99.7	101.2	102.7	101.9	101.9	119.8
NPV of PPG external debt	...	...	...	...	...	...	34.1	23.7	23.0	22.6	22.1	21.9	21.9	21.9	20.8	21.3
In percent of exports	...	...	...	...	...	...	102.0	64.5	66.0	68.5	70.7	72.9	75.2	75.2	80.5	106.5
Debt service-to-exports ratio (in percent)	25.5	23.7	22.5	26.5	21.3	18.9	16.5	13.0	11.8	11.2	11.0	11.9	12.0	12.2	16.4	14.2					
PPG debt service-to-exports ratio (in percent)	...	...	...	...	...	...	13.8	8.1	7.0	6.5	6.3	7.3	7.6	7.6	8.8	14.2
Total gross financing need (billions of U.S. dollars)	-0.3	0.0	-0.2	-0.1	0.0	0.0	0.1	-0.4	-0.4	0.0	0.1	0.0	0.0	0.1	0.1	1.4					
Non-interest current account deficit that stabilizes debt ratio	3.9	5.8	-0.1	1.8	-21.3	1.0	-4.1	14.6	-4.3	-4.0	-2.7	-2.1	-1.9	-1.9	-1.7	-0.2					
Key macroeconomic assumptions																					
Real GDP growth (in percent)	0.4	2.5	1.7	2.5	2.9	3.9	4.1	4.1	3.9	3.1	3.3	3.3	3.0	3.0	3.5	3.5					
GDP deflator in US dollar terms (change in percent)	-3.0	-1.2	-4.3	-5.3	-0.6	3.9	2.8	-1.1	6.3	5.1	4.3	3.4	3.4	3.4	4.0	4.0					
Effective interest rate (percent) 6/	2.8	3.0	2.9	2.8	2.3	2.4	3.3	3.7	5.1	5.1	5.0	5.0	5.0	4.8	5.2	5.8					
Growth of exports of G&S (US dollar terms, in percent)	-3.3	12.2	3.4	2.7	25.6	30.6	22.0	13.3	13.0	13.0	13.0	13.0	13.0	13.0	13.0	13.0					
Growth of imports of G&S (US dollar terms, in percent)	-9.6	4.5	-4.7	3.6	-0.1	13.8	23.1	24.4	1.6	3.6	6.4	5.2	4.8	4.8	7.7	5.5					
Growth of new public sector borrowing (in percent)	...	...	...	...	...	...	...	17.9	19.0	19.0	19.0	17.8	17.1	18.3	15.4	12.9
Memorandum item:																					
Nominal GDP (billions of US dollars)	8.3	8.4	8.2	7.9	8.1	8.7	9.4	10.4	11.3	12.2	13.0	13.9	14.8	14.8	21.4	44.6					

Source: Staff simulations.

1/ Includes both public and private sector external debt.

2/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

3/ Derived as $(1 - g - \rho)(1 - r - g)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

4/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes. In 2003 it reflects the inclusion of private debt in the total.

5/ Assumes that NPV of private sector debt is equivalent to its face value.

6/ Current-year interest payments divided by previous period debt stock.

Table 2. Bolivia: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006-26
(In percent)

	Projections							
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of debt-to-GDP ratio								
Baseline	24	23	23	22	22	22	21	21
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	24	27	27	25	25	24	22	31
A2. New public sector loans on less favorable terms in 2007-26 2/	24	24	24	24	24	24	25	29
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	24	24	24	23	23	23	22	22
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	24	24	25	24	24	24	21	21
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	24	25	27	27	26	26	25	26
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	24	25	23	23	22	22	21	21
B5. Combination of B1-B4 using one-half standard deviation shocks	24	26	26	25	25	25	24	25
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	24	32	32	31	31	31	29	30
NPV of debt-to-exports ratio								
Baseline	65	66	69	71	73	75	81	107
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	65	77	81	80	82	82	85	155
A2. New public sector loans on less favorable terms in 2007-26 2/	65	68	72	75	79	84	98	147
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	65	66	69	71	73	75	81	107
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	65	71	79	81	83	86	87	111
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	65	66	69	71	73	75	81	107
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	65	71	70	72	75	76	81	107
B5. Combination of B1-B4 using one-half standard deviation shocks	65	65	61	63	65	67	73	98
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	65	66	69	71	73	75	81	107
Debt service ratio								
Baseline	8	7	6	6	7	8	9	14
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	8	7	8	9	10	11	10	12
A2. New public sector loans on less favorable terms in 2007-26 2/	8	7	7	7	7	7	8	16
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	8	7	7	7	8	8	8	11
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	8	7	7	8	9	9	10	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	8	7	7	7	8	8	8	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	8	7	7	7	8	9	9	11
B5. Combination of B1-B4 using one-half standard deviation shocks	8	7	6	7	7	7	7	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	8	7	7	7	8	8	8	11
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	12	12	12	12	12	12	12	12

Source: Fund staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

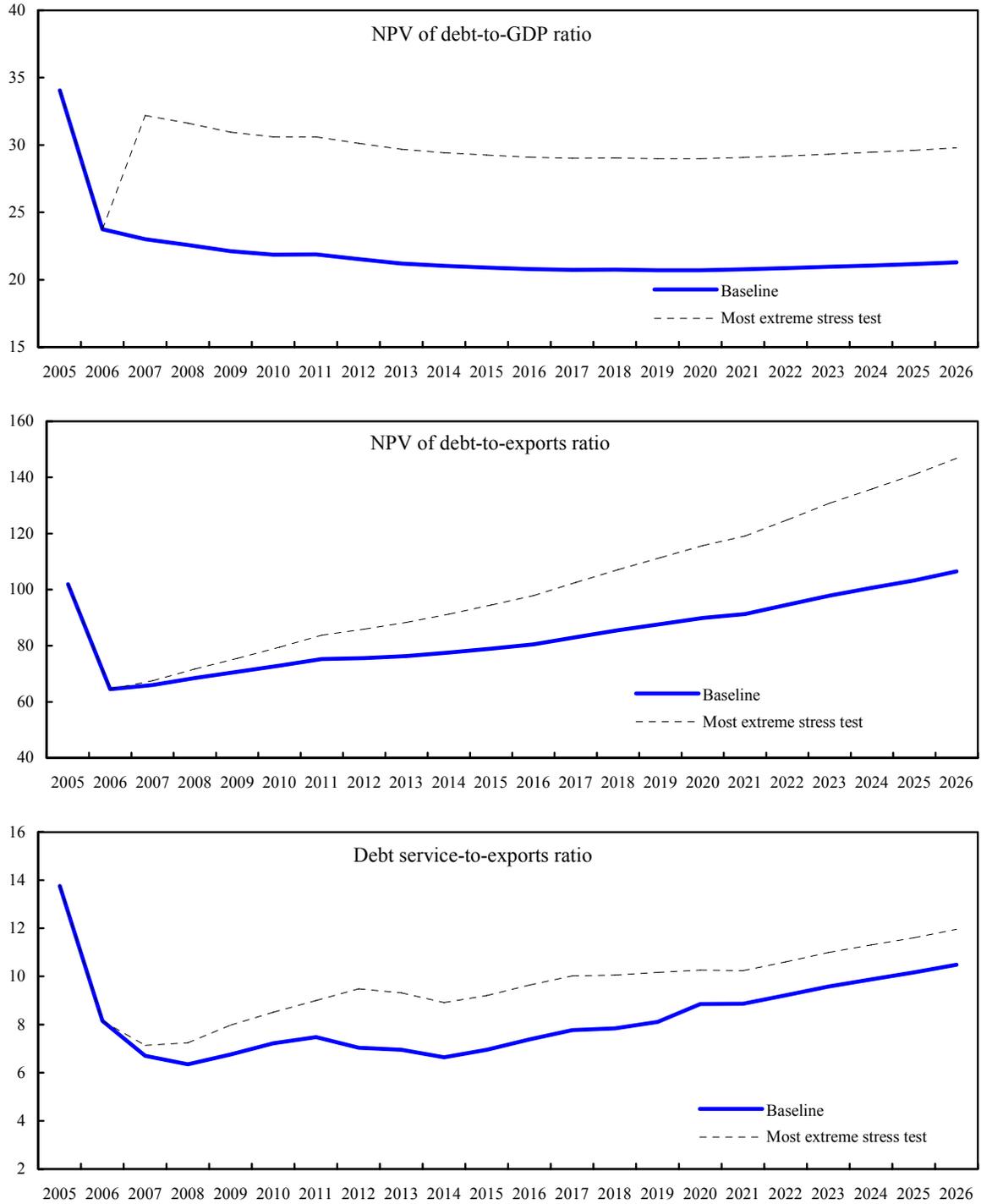
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

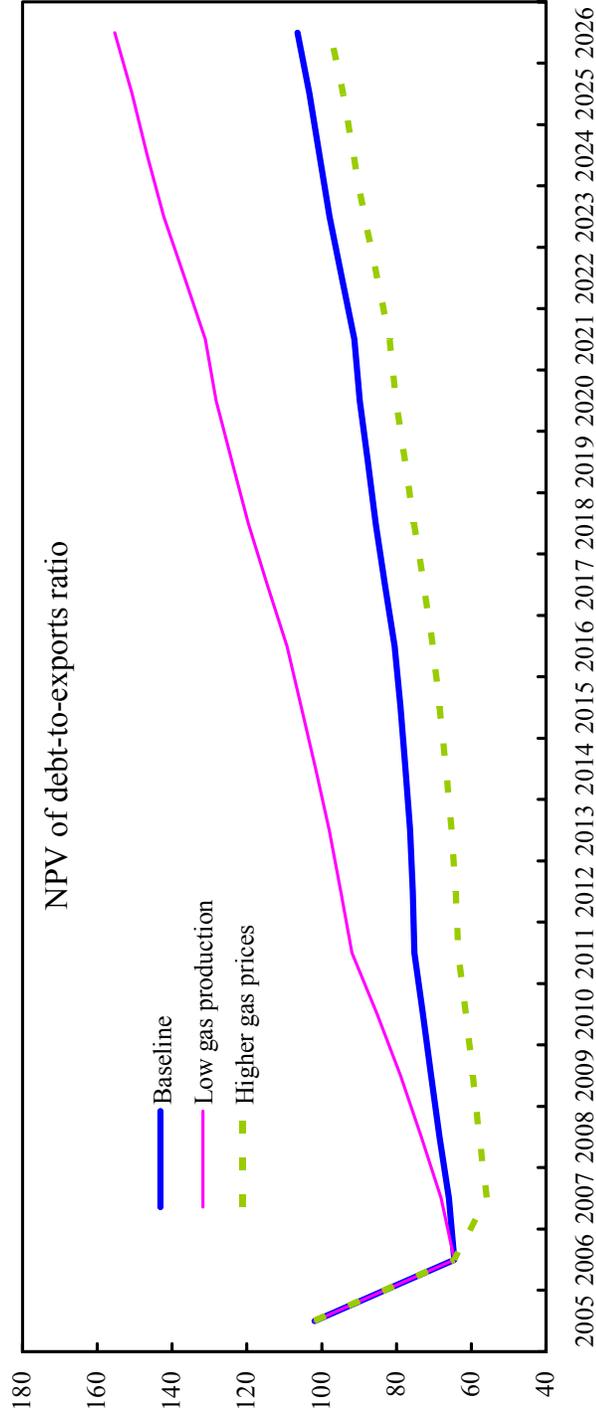
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 1. Bolivia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2005-2026 (In percent)



Source: Fund staff projections and simulations.

Figure 2. Bolivia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2005-2026 (In percent)



Source: Fund staff projections and simulations.

Table 3. Bolivia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2003–2026
(In percent of GDP, unless otherwise indicated)

	Actual										Projections										
	1999	2000	2001	2002	2003	2004	2005	Historical		Est.	2006	2007	2008	2009	2010	2011	2006–11		2012–26		
								Average 1/	Standard Deviation 1/		2006	2007	2008	2009	2010	2011	Average	2016	2026	Average	
Public sector debt 2/	60.0	69.3	74.0	77.2	70.8			50.6	49.7	49.4	49.5	49.9	50.6	50.6	52.1	55.3		
<i>Of which:</i> foreign-currency denominated	57.0	55.0	42.1	49.2	51.0	68.3	62.9			43.4	41.4	40.2	39.3	38.5	38.0	38.0	38.0	34.4	31.9		
Change in public sector debt	9.4	4.7	3.3	-6.4			-20.2	-0.9	-0.3	0.1	0.4	0.7	0.7	0.3	0.3	0.4		
Identified debt-creating flows	8.1	2.7	-2.8	-4.5			-7.4	-1.1	-0.8	-0.2	0.1	0.3	0.3	0.0	0.0	0.4		
Primary deficit	1.5	1.5	4.2	6.2	5.1	2.6	-0.8		2.6	-2.8	0.9	0.6	0.8	1.1	1.1	1.1	0.3	1.2	1.1	1.2	
Revenue and grants	25.9	25.6	25.1	24.5	24.1	27.0	31.7			36.1	35.1	33.4	32.6	31.9	31.4	31.4	28.6	25.3			
<i>Of which:</i> grants	1.8	2.2	2.4	2.3	2.9	2.5	2.2			2.9	2.9	2.0	1.9	1.8	1.7	1.7	1.1	1.1			
Primary (noninterest) expenditure	27.4	27.0	29.4	30.7	29.1	29.6	30.9			33.3	36.0	33.9	33.5	33.0	32.5	32.5	29.9	26.4			
Automatic debt dynamics	...	...	...	3.5	-0.9	-4.1	-2.6			-3.7	-1.5	-0.8	-0.5	-0.5	-0.2	-0.2	-0.9	-0.7		
Contribution from interest rate/growth differential	...	...	...	-0.1	-1.2	-2.7	-2.0			-2.0	-0.3	0.1	0.0	0.0	0.3	0.3	-0.2	-0.2		
<i>Of which:</i> contribution from average real interest rate	...	...	...	1.4	0.8	0.1	1.1			0.8	1.6	1.6	1.6	1.6	1.7	1.7	1.5	1.8		
<i>Of which:</i> contribution from real GDP growth	...	...	...	-1.5	-2.0	-2.8	-3.0			-2.8	-1.9	-1.5	-1.6	-1.6	-1.4	-1.4	-1.8	-1.9		
Contribution from real exchange rate depreciation	...	...	...	3.8	3.5	0.3	-1.4	-0.7		-1.7	-1.2	-0.9	-0.6	-0.5	-0.5	-0.5	-0.5	-0.4		
Other identified debt-creating flows	-1.0	-0.9	-1.1	-1.6	-1.5	-1.3	-1.1			-0.9	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.4	0.0			
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
Debt relief (HIPC and other)	-1.0	-0.9	-1.1	-1.6	-1.5	-1.3	-1.1			-0.9	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.4	0.0			
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
Residual, including asset changes	1.3	2.0	6.0	-1.9			-12.8	0.2	0.4	0.3	0.3	0.3	0.3	0.3	0.3	-0.1		
NPV of public sector debt	...	...	...	...	...	...	54.9			42.7	42.2	42.1	42.2	42.8	43.5	43.5	46.1	51.3		
<i>Of which:</i> foreign-currency denominated	...	...	...	...	...	...	46.9			35.4	33.9	32.9	32.1	31.3	30.9	30.9	28.4	27.9		
<i>Of which:</i> external	...	...	...	...	...	...	32.1			22.2	21.7	21.5	21.3	21.2	21.3	21.3	20.5	21.2		
NPV of contingent liabilities (not included in public sector debt)	...	...	...	...	...	...	...			...	...	...	...	...	...	...	...	...
Gross financing need 3/	3.5	3.7	6.8	8.8	9.3	15.0	12.3			5.5	7.7	7.2	7.7	8.2	8.4	8.4	9.1	10.3			
NPV of public sector debt-to-revenue ratio (in percent) 4/	...	...	...	...	...	...	173.3			118.2	120.2	126.2	129.5	133.9	138.4	138.4	161.1	202.8		
<i>Of which:</i> external	...	...	...	...	...	...	101.5			61.6	61.8	64.4	65.2	66.4	67.9	67.9	71.7	83.9		
Debt services-to-revenue ratio (in percent) 4/ 5/	7.7	8.9	10.4	10.6	11.7	35.1	31.8			20.3	18.3	19.4	20.2	21.4	22.6	22.6	26.3	34.8			
Primary deficit that stabilizes the debt-to-GDP ratio	...	...	...	...	...	...	5.6			17.4	1.8	0.9	0.8	0.7	0.4	0.4	1.0	0.7		
Key macroeconomic and fiscal assumptions	...	...	...	...	...	...	...			...	...	...	...	...	...	...	...	...
Real GDP growth (in percent)	0.4	2.5	1.7	2.5	2.9	3.9	4.1		2.9	4.1	3.9	3.1	3.3	3.3	3.0	3.0	3.5	3.5	3.5	3.5	
Average nominal interest rate on forex debt (in percent)	...	...	...	3.4	3.7	4.8	4.7	3.6	4.1	0.6	3.6	5.0	4.9	4.8	4.7	4.7	4.6	4.7	5.4	5.0
Inflation rate (GDP deflator, in percent)	2.4	5.2	1.9	3.1	6.1	8.5	3.4	4.7	4.7	2.4	5.3	4.9	4.3	3.4	3.3	3.4	4.1	4.0	4.0	4.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.6	1.3	10.4	6.9	-2.2	4.5	9.8	5.8	6.2	12.3	12.5	-2.9	1.9	2.0	1.3	1.3	4.5	1.8	2.5	2.1	
Grant element of new external borrowing (in percent)	...	...	...	...	...	...	...			17.9	19.0	19.0	19.0	17.8	17.1	17.1	18.3	15.4	12.9	...

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

1/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

2/ Coverage is for the nonfinancial public sector. Gross debt is used as a concept.

3/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

4/ Revenues including grants.

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

Table 4. Bolivia: Sensitivity Analysis for Key Indicators of Public Debt 2006-2026

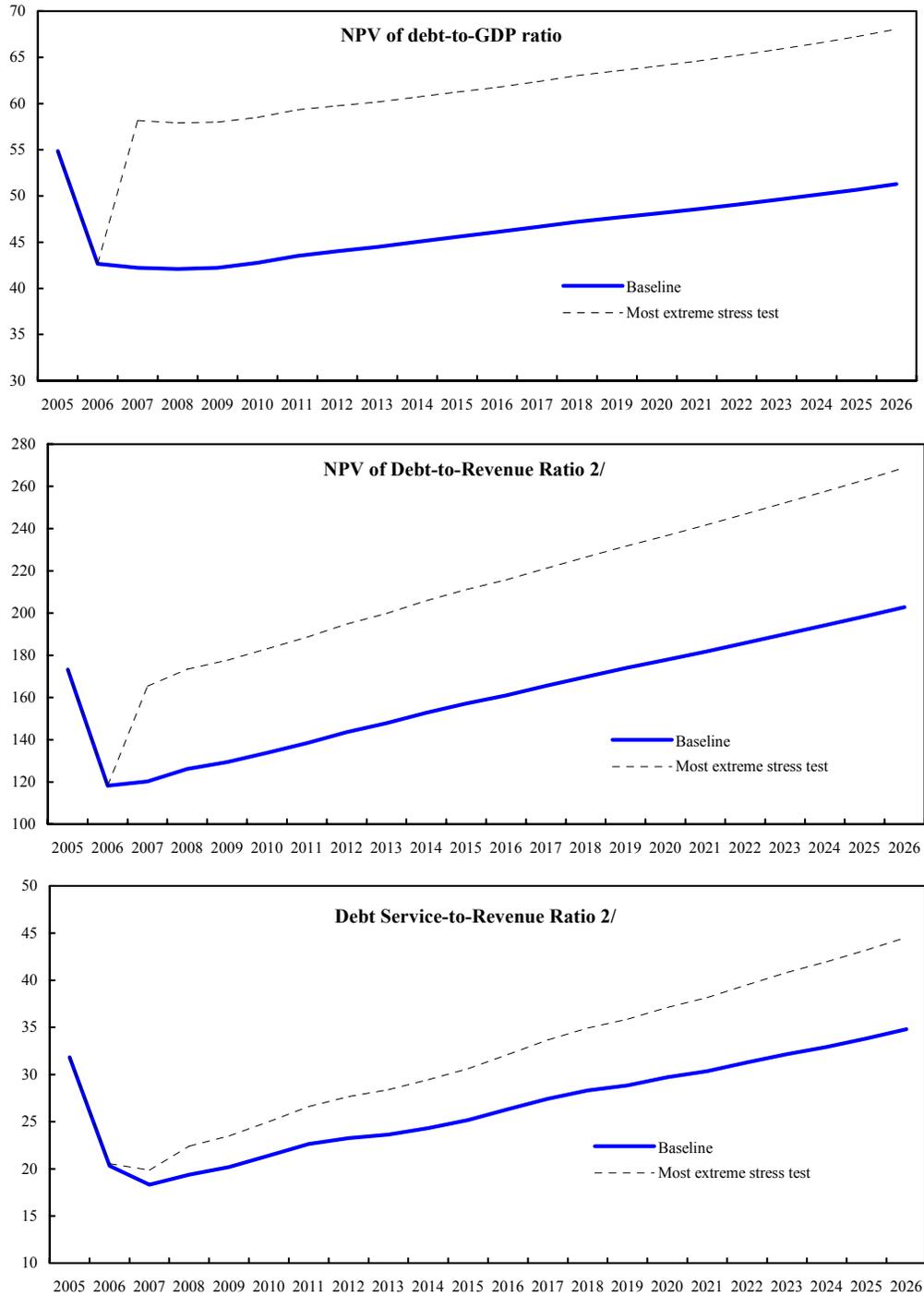
	Projections							
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of Debt-to-GDP Ratio								
Baseline	43	42	42	42	43	44	46	51
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	42	44	45	47	49	51	60	77
A2. Primary balance is unchanged from 2006	42	38	36	33	30	28	16	1
A3. Permanently lower GDP growth 1/	43	43	43	44	46	47	55	73
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	43	44	46	47	48	50	57	68
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	43	46	49	50	50	51	54	60
B3. Combination of B1-B2 using one half standard deviation shocks	43	45	49	49	50	51	54	59
B4. One-time 30 percent real depreciation in 2007	43	58	58	58	59	59	62	68
B5. 10 percent of GDP increase in other debt-creating flows in 2007	42	42	42	42	43	43	46	52
NPV of Debt-to-Revenue Ratio 2/								
Baseline	118	120	126	129	134	138	161	203
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	116	124	136	145	154	163	210	304
A2. Primary balance is unchanged from 2006	116	109	106	100	94	88	56	3
A3. Permanently lower GDP growth 1/	118	122	130	136	143	150	192	286
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	118	125	137	143	151	160	199	268
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	118	130	147	152	158	163	190	235
B3. Combination of B1-B2 using one half standard deviation shocks	118	129	145	149	155	160	187	234
B4. One-time 30 percent real depreciation in 2007	118	165	173	178	183	189	216	269
B5. 10 percent of GDP increase in other debt-creating flows in 2007	117	119	126	129	133	138	161	204
Debt Service-to-Revenue Ratio 2/								
Baseline	20	18	19	20	21	23	26	35
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	21	19	20	22	24	25	32	49
A2. Primary balance is unchanged from 2006	21	19	19	19	19	19	16	11
A3. Permanently lower GDP growth 1/	21	19	20	21	22	24	30	45
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	20	19	20	22	23	25	31	43
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	21	19	21	23	24	25	30	39
B3. Combination of B1-B2 using one half standard deviation shocks	21	19	21	23	24	25	30	39
B4. One-time 30 percent real depreciation in 2007	21	20	22	23	25	27	32	45
B5. 10 percent of GDP increase in other debt-creating flows in 2007	21	19	20	20	22	23	27	35

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

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

2/ Revenues are defined inclusive of grants.

Figure 3. Bolivia: Indicators of Public Debt Under Alternative Scenarios, 2005-2026 1/



Source: Staff projections and simulations.

1/ Most extreme stress test is test that yields highest ratio in 2016.

2/ Revenue including grants.

APPENDIX III. BOLIVIA: RELATIONS WITH THE WORLD BANK¹

The World Bank's support to Bolivia will be delivered according to the strategy spelled out in the Interim CAS, currently under preparation, to be presented to the World Bank Board on July 20, 2006. Due to the political uncertainty and risks, the Interim CAS is being designed to cover a two-year period (FY06–FY07) that will allow the Bank to implement a work program in Bolivia while these uncertainties are being clarified. It will accompany and support the new Administration that assumed power in January 2006. The Bank will seek to build a partnership with the Government to support its development strategy with lending, analytical work and technical assistance. The Interim CAS lending would include IDA resources to finance investment credits for approximately US\$50 million a year. The level of assistance in the Interim CAS would be sufficient to support an average of three projects and three pieces of ESW per year. To the extent possible, these projects and programs would be designed and implemented in a collaborative fashion with donor partners that would include drawing on financial and human resources to leverage the Bank's resources and have a greater development impact.

The World Bank's program in Bolivia has nine projects currently being executed – seven investment projects, a GEF project and a rapid disbursement project—for a total of US\$372 million. Of this amount, only US\$15 million are nonconcessional funds. These projects finance interventions in various sectors including education, health, rural development, institutional strengthening and road construction. The World Bank program in Bolivia includes two trust funds: a grant for US\$300,000 aimed at the institutional strengthening of the Technical Secretariat of the Constituent Assembly; and a grant amounting to US\$212,000 intended for the strengthening of the Congress Budget Commission.

The Bank is discussing with the Government the possible following program for FY–07:

- The **Secondary Education pre-SWAP**, for US\$10 million, whose objective is to support the Government's education strategy which aims to expand secondary education coverage and retention of disadvantaged groups, improve the quality of education services in targeted areas where secondary enrollments are particularly low, and strengthen decentralized education management.
- The **Urban Infrastructure for Poor Project**, for US\$30 million, which aims to increase the effective and sustainable use of infrastructure services in the cities of La Paz, El Alto and Santa Cruz. In La Paz, the project will finance a package of demand-driven local investments at the neighborhood level. In El Alto it will finance infrastructure investment for paving, drainage and measures to implement a massive transit policy. In Santa Cruz, it will finance infrastructure investment for the interconnection of water wells and the southern water pumping station.

¹ Prepared by World Bank staff.

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

Recent and ongoing technical assistance and economic sector work includes:

- The **Country Economic Memorandum**, completed in July 2005, focuses on employment-generating economic growth and policies aimed at improving the investment climate and boosting exports. This study has been widely disseminated among the Government, the civil society, the productive sectors, and the international community.
- The World Bank has produced **Discussion Sectorial Notes** on 23 different economic and social issues that will be published in Spanish and in English. These notes are a result of technical discussions that the Bank held with all major political parties starting in August 2005 and including, President Morales's party (MAS). The Bank presented these draft notes to the Government in March 2006.
- The **Country Social Analysis**, under preparation, combines a quantitative and qualitative approach besides participatory methods; it seeks to explain at the macro level the social, economic, cultural, and institutional environment for development.
- The **Institutional Governance Review**, under preparation, analyses the decentralization issue. Alternative scenarios are presented and their implementation analyzed in a sequence of approximately five years.

APPENDIX IV. BOLIVIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK¹

As of December 31, 2005, the Inter-American Development Bank (IDB) had approved loans to Bolivia amounting to US\$3.77 billion, with disbursements totaling US\$3.14 billion. Bolivia's outstanding debt to the IDB was US\$1.77 billion. During the first half of the decade, net cash flows to the country were mostly positive, owing in large measure to debt relief provided by the IADB under the HIPC Initiative and other extraordinary financing disbursed in 2003. The IADB's portfolio in Bolivia also includes active nonreimbursable technical cooperation projects amounting to US\$23 million (US\$15.6 million undisbursed), and US\$8.3 million in credits for small and micro projects.

Sustainable poverty reduction is the overarching objective of the Bank's country strategy with Bolivia. In pursuit of this objective, the Bank is supporting government-led efforts to overcome the country's economic and social development challenges in three main areas: (a) improving the managerial capacity and transparency of the State, (b) supporting competitiveness and sustainable development of the private sector; (c) enhancing efficiency and equity in basic services delivery. The IADB is updating its country strategy on the basis of the priorities of the new government inaugurated in January 2006 and the policy framework envisaged for the medium term under the National Development Program that is expected to be announced next April.

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

From the operational standpoint, the Bank's portfolio in Bolivia represents a valuable resource base from which to implement the strategy. As of March 15, 2006, undisbursed balances amounted to US\$409 million. The IADB's lending program will continue providing Bolivia in 2006 with concessional resources to support fiscal sustainability, while protecting investments that are critical for achieving the Millennium Development Goals. The proposed IADB lending program for Bolivia for FY2006 consists of three loans amounting to approximately US\$100 million (in support of basic infrastructure, institutional reforms in the public sector and competitiveness).

¹ Prepared by IDB staff.

Discussions among Bank shareholders regarding the possibility of Bank participation and the potential scope for MDRI type debt relief are ongoing. In the event that such a scheme were to be approved, additional debt relief to that already being provided by the Bank to Bolivia under the HIPC Initiative could become effective in 2007.

APPENDIX V. BOLIVIA: STATISTICAL ISSUES

The timeliness and coverage of economic statistics in Bolivia is generally adequate for monitoring purposes. Significant advances have been made in recent years, but improvements are still needed in a number of areas, as noted below. Many national agencies, including the National Institute of Statistics (INE), post statistical information on the Internet. Bolivia has participated in the GDSS since November 2000 and plans to subscribe to the SDDS in FY07 are in the advance stages.

I. REAL SECTOR

- **National accounts.** The INE plans to initiate in 2006 a thorough revision of the national accounts statistics, including a revision of the base year. This process is expected to be completed over the next 3 years. A 2002 STA mission on national accounts statistics found that efforts to improve the quality of the real sector statistics were hampered by an inadequate statistical law and insufficient resources to undertake censuses and surveys.
- **Labor market.** The quality of the household and employment surveys has deteriorated in the last few years, due mainly to financial constraints. The Survey of Improvement in Living Conditions (MECOVI), which replaced earlier household surveys, was last conducted in November 2002. In addition, some important surveys have been discontinued such as the annual manufacturing survey (in 2001) and the employment survey (in 2003), leading to a lack of quarterly information on employment and wages. However, plans to reestablish these surveys are underway.
- **Prices.** The consumer price index (CPI) covering the four largest cities has a base year of 1991, and was revised on the basis of a household budget survey that was conducted over a 12-month period that began in June 2, 2003. Industrial producer price indices and external trade unit values are compiled by INE, but are in need of revision as regards their coverage, product breakdown, and base year (1990=100).

II. FISCAL SECTOR

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

III. EXTERNAL SECTOR

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

The authorities are working on a data base on gross flows of short and medium-term private debt. However, there is some concern about the quality of private capital flows as the foreign direct investment survey was discontinued in the third quarter of 2004.

IV. MONETARY SECTOR

Monetary data are provided on the balance sheets of the central bank, commercial bank, nonbank financial institutions, and two state-owned second-tier banks, *Nacional Financiera Boliviana (NAFIBO)*, and *Fondo de Desarrollo del Sistema Financiero (FONDESIF)*. Data on the monetary survey are available with a short lag. Commercial bank data are collected by the Superintendency of Banks and they become available with a lag of six to eight weeks. The coverage of banks in the monetary survey is comprehensive. A STA mission in April 2006 found that the central bank has implemented most of the recommendations of the 2001 STA advisory mission, and monetary statistics are now broadly in line with the Monetary and Financial Statistics Manual. The mission found weaknesses in data provided by deposit institutions, which could be improved with the implementation of the new standardized report forms.

BOLIVIA: INDICATORS REQUIRED FOR SURVEILLANCE
(As of June 9, 2006)

	Date of latest observation	Date received	Frequency of Data ¹	Frequency of Reporting ¹	Frequency of publication ¹
Exchange Rates	May 2006	Jun. 2006	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ²	Jun. 2006	Jun. 2006	D	D	M
Reserve/Base Money	Apr. 2006	Apr. 2006	M	M	M
Broad Money	Apr. 2006	Apr. 2006	M	M	M
Central Bank Balance Sheet	Apr. 2006	Apr. 2006	M	M	M
Consolidated Balance Sheet of the Banking System	Mar. 2006	Mar. 2006	M	M	M
Interest Rates ³	May 2006	May 2006	W	W	M
Consumer Price Index	May 2006	Jun. 2006	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ⁴ – General Government ⁵	Mar. 2006	May 2006	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ⁴ – Central Government	Dec. 2005	May 2006	M	M	M
Stocks of Non Financial Public Sector-Guaranteed Debt ⁶	Dec. 2005	Mar. 2006	M	M	M
External Current Account Balance	Mar. 2006	Jun. 2006	Q	Q	Q
Exports and Imports of Goods and Services ⁷	Mar. 2006	May 2006	M	M	M
GDP/GNP	Mar. 2006	Apr. 2006	Q	Q	Q
Gross External Debt	May 2006	Jun. 2006	M	M	M

¹ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

² Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

³ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

⁴ Foreign, domestic bank, and domestic nonbank financing.

⁵ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁶ Including currency and maturity composition.

⁷ Monthly frequency for goods only.

Statement by the IMF Staff Representative
July 17, 2006

The information below, which has become available following the issuance of the Staff Report, does not alter the thrust of the staff appraisal.

1. **Elections for the constitutional assembly and referendums on regional autonomy.** In the elections held on July 2, the governing party Movimiento al Socialismo (MAS) obtained 51 percent of the vote, and as a result will be represented by 137 of the 255 delegates to the constitutional assembly. As a two-thirds majority is required to approve constitutional reforms, consensus building with other political groups will be needed. In the regional referendums, four of the nine departments favored autonomy. The specific modalities whereby greater autonomy will be granted to these departments will be defined by the constitutional assembly, which will begin deliberations on August 6 and is also expected to consider a wide range of possible institutional changes in the political and economic areas, including with respect to the economic role of the state, land tenure, and property rights.

2. **National Development Plan.** The government has finalized the National Development Plan (NDP), which is aimed at raising growth and reducing poverty and inequality, and sets out policies towards these objectives. The main points include:

- **Key objectives.** For the period 2006-11, the NDP targets an average real GDP growth of 6.3 percent; a 9 percentage point reduction in poverty (to 50 percent); and a sharp decline in the unemployment rate, to 4 percent.
- **Policy approach.** In line with the views advanced by the authorities during the Article IV discussions, the NDP advocates a greater state role in the economy and support for small- and medium scale producers, including through development banking. Regarding the role of the state in the economy, the government would recover control of all the enterprises privatized in the mid-1990s (except the former national airline), which implies that—although no related legislation is yet in place—the nationalization process for the hydrocarbons sector described in the Staff Report would eventually be extended to the telecommunications, electricity, and water sectors. The independent regulatory agencies would be abolished, except for the superintendency of banks. A new framework for FDI would introduce new requirements regarding financial information, technology transfer, minimum employment creation, and use of local inputs and services.
- **Macroeconomic framework.** The higher growth rates than in the staff's baseline scenario would come from projections of strong growth in the hydrocarbons sector (as opposed to unchanged production in the staff's scenario) and larger public investment and FDI. Under the additional assumption of much higher hydrocarbons-based revenues, the fiscal deficit would trend downwards beyond 2008. However, the external current account would be somewhat weaker than under the staff's scenario due to stronger import growth. The NDP expresses a firm commitment to

macroeconomic stability, also reflected in low projected inflation, and vows continued openness in the exchange system under an unchanged exchange rate regime. A special fund would be created to absorb extraordinary hydrocarbons revenues.

Bolivia: Medium-Term Scenarios

	Staff Baseline						National Development Plan					
	2006	2007	2008	2009	2010	2011	2006	2007	2008	2009	2010	2011
Income and prices (percent growth)												
Real GDP	4.1	3.9	3.1	3.3	3.3	3.0	4.1	5.3	6.4	6.9	7.5	7.6
<i>Of which</i> : Hydrocarbons	9.1	0.0	0.0	0.0	0.0	0.0	9.1	19.4	14.8	14.6	14.7	7.2
Construction	16.8	10.0	0.0	6.0	6.0	6.0	16.8	36.1	21.5	2.5	13.8	24.7
CPI inflation (period average)	4.1	4.0	4.0	4.0	4.0	4.0	4.0	3.0	3.0	3.0	3.0	3.0
Combined public sector (percent of GDP)												
Revenue	35.9	35.1	33.4	32.6	31.9	31.4	34.2	38.2	38.6	39.9	39.8	39.3
<i>Of which</i> : Hydrocarbons	12.5	11.9	11.0	10.3	9.6	9.0	11.2	13.8	14.5	15.4	15.6	15.3
Expenditure	36.1	38.7	36.6	36.1	35.8	35.3	37.6	41.9	42.1	42.7	42.2	41.4
<i>Of which</i> : Capital expenditure	11.1	13.4	11.8	11.8	11.6	11.2	11.3	14.1	14.4	15.4	15.4	15.2
Overall balance	-0.1	-3.6	-3.3	-3.5	-3.8	-3.9	-3.4	-3.7	-3.5	-2.8	-2.4	-2.1
External sector (US\$ billion)												
Exports, f.o.b.	3.39	3.50	3.52	3.56	3.63	3.74	3.22	3.74	4.36	5.08	5.74	6.36
Imports, c.i.f.	-3.00	-3.03	-3.13	-3.34	-3.51	-3.68	-2.93	-3.60	-4.20	-5.03	-6.10	-6.88
Current account balance (percent of GDP)	5.0	4.8	3.5	2.0	1.3	0.8	4.5	3.1	2.4	2.2	-0.9	-1.5
Foreign direct investment (net)	0.13	-0.20	-0.16	0.09	0.09	0.10	0.08	0.42	0.72	0.64	1.01	1.28

Sources: Bolivian authorities and Fund staff estimates and projections.

- Sectoral policies.** The NDP envisages employment programs, increases in public investment, and improvements in public services. It specifies detailed sectoral policies in education; health and sanitation; justice and security; culture and technology; social safety net and community development. In addition, the plan outlines industrial policies for hydrocarbons, mining, manufacturing, telecommunications, power, transport, agriculture, housing, and tourism. Land reform is expected to expand access to land by small-scale farmers. In the trade area, the NDP would support export promotion policies and selective import restrictions to promote domestic industries.
3. **Natural gas exports to Argentina.** The governments of Bolivia and Argentina have reached understandings on an increase in the price of natural gas, from US\$3.63 to US\$5.00 per million British Thermal Units (BTU)—with effect from July 15, 2006, and up to an export volume of up to 7.7 million cubic meters per day (currently, Argentina imports 5.5 million cubic meters per day).
- Bilateral negotiations.** The governments will designate representatives for the purpose of negotiating, by December 31, 2006, a 20-year agreement whereby the export price would be updated annually (with effect from January 1), according to a formula to be specified, and the volume could increase to up to 27 million cubic meters per day by 2026. The understandings envisage joint investments to support the higher export volumes as well as production in Bolivia of natural gas derivatives and gas-based electricity.

- ***Economic impact.*** In 2006, the higher natural gas price to Argentina is expected to yield additional fiscal and export revenues amounting, respectively, to 0.5 and 0.8 percent of GDP. Over the medium term, the revenue impact will hinge on the extent to which the joint investments materialize, but is likely to at least double reflecting the full-year effect. The associated long-term paths of the ratios of the external and public debts to exports and GDP would likely fall within the range associated with the positive shock (across-the-board 50 percent price increase on all exports of natural gas) assumed in the debt sustainability exercise.



INTERNATIONAL MONETARY FUND

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International Monetary Fund
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IMF Executive Board Concludes 2006 Article IV Consultation with Bolivia

On July 17, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bolivia.¹

Background

Despite wide-ranging economic reforms over the past two decades, the accomplishment of macroeconomic stability, and a major expansion of the hydrocarbons sector, Bolivia has achieved only modest gains in poverty reduction and inequality has remained high. The reform process, which encompassed privatizations and liberalization of the exchange and trade systems, contributed to a major decline in inflation and to an increase in growth in the 1990s. However, the growth performance deteriorated during 1999–2003 in the context of rising social tensions and political instability, and the partial recovery of the last two years has been concentrated in the highly capital-intensive hydrocarbons sector. As a result, Bolivia's key social indicators have continued to lag.

Over the past year, Bolivia has experienced major political changes, against the background of entrenched dissatisfaction with the country's poor social indicators and weak governance. Following a protracted political crisis, the constitution was amended in June 2005 to allow early presidential and congressional elections for a new full five-year period in December 2005, together with the first direct elections for regional governors. Agreement was also reached on calling a constitutional assembly and a referendum on regional autonomy in July 2006.

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

The elections resulted in a major renewal of Congress and in a landslide victory for Evo Morales, the first indigenous head of state in Bolivian history.

The new government has inherited a favorable macroeconomic situation, associated in large measure with the extremely favorable international environment. In 2005, GDP growth was just above 4 percent and the fiscal deficit narrowed to 2.3 percent of GDP. Inflation was contained below 5 percent following an acceleration early in the year due to petroleum price increases, supply disruptions, and imported inflation. Financial sector stability improved as deposits and credit increased for the first time in several years, and the balance of payments remained strong with official foreign exchange reserves rising to historic highs. Financial dollarization declined, due to expectations of exchange rate appreciation as well as prudential and tax measures that have increased the cost of holding foreign currency. The Multilateral Debt Relief Initiative has resulted in a substantial reduction of the public debt burden.

Thus far in 2006, the economy has kept the positive trends observed in 2005. Economic activity has been led by high export values of hydrocarbon and mining products, which have contributed to a strong external current account surplus. Inflation has continued in the low single digits, following a decreasing trend that started in the fourth quarter of 2005, and the overall fiscal position is in surplus. In particular, sub-national governments have been accumulating sizable deposits at the central bank, thereby helping sterilize the monetary impact of the rapid international reserve accumulation. Indicators of banking system soundness have been broadly stable, with high liquidity and capital adequacy ratios above mandatory levels.

The economic outlook for the remainder of 2006 remains positive, helped in large part by continued highly favorable external conditions, notably high energy prices. Real GDP growth is expected at just above 4 percent, with inflation in the low single digits. The combined public sector is expected to record a near balance for the year as a whole as the temporary extra revenues accrued from the new hydrocarbons policy framework would not be translated immediately into investment spending by Yacimientos Petrolíferos Fiscales Bolivianos (YPFB). Reflecting debt relief under the Multilateral Debt Relief Initiative (see Press Release No. 05/286), the ratio of public debt to GDP is projected to decline from 71 percent at end-2005 to 51 percent by end-2006. Accumulation of official reserves is projected to continue, reflecting a strong external current account surplus associated with high international prices of fuels and minerals.

Executive Board Assessment

Executive Directors noted that, benefiting from prudent macroeconomic policies and a very favorable external environment, the Bolivian economy sustained a strong performance in 2005 and so far in 2006. This performance reflected satisfactory GDP growth, a strong balance of payments, low inflation, improvements in the fiscal position, and historically high levels of international reserves. Despite periods of political uncertainty, the banking system has remained stable and dollarization has declined somewhat. Reflecting debt relief under the MDRI, the burden of the public debt has been substantially reduced.

Looking ahead, Directors noted that Bolivia's short-term prospects are favorable but medium-term challenges remain. They encouraged the government to take advantage of its strong mandate to push forward with the necessary policies for cementing the recent macroeconomic gains, enhancing the business climate, and promoting higher, diversified, and more equitable growth. In this context, Directors welcomed the authorities' emphasis on safeguarding macroeconomic stability and strengthening governance.

Directors stressed the importance of fiscal prudence and strengthened public expenditure management to ensure fiscal sustainability. The combined public sector is projected to be close to balance in 2006 reflecting mostly strong revenues from the hydrocarbon sector. However, the deficit would re-emerge in 2007 in the absence of another exceptional hydrocarbon revenue yield, and also reflecting higher YPFB investments and payments for the acquisition of shares in the nationalized companies. Directors noted that this could have possible implications for debt sustainability. The authorities were therefore encouraged to strengthen expenditure management at all levels of government. In this context, Directors welcomed the government's firmness in containing wage increases to manageable levels. However, some Directors observed that salary compression at the higher levels appears at odds with the government's economic strategy that may require an upgrading of the management of public entities. It was also stressed that the resources made available as a result of debt relief under the MDRI should be spent effectively.

Directors stressed that enhancing fiscal transparency and accountability at all levels of government will require strengthening the budget process and intergovernmental fiscal relations. The authorities were encouraged to resubmit to Congress the draft budget framework law. Regarding intergovernmental relations, the current revenue sharing and expenditure allocation system should be reassessed in light of the capacity to generate revenue at the subnational level, and made consistent with an agreed allocation of spending responsibilities across the different layers of government.

Directors expressed concern at rigidities in domestic petroleum pricing that generate inordinately large explicit and implicit subsidies. Accordingly, they stressed the need to move domestic petroleum product prices to international market-based levels, which could be undertaken gradually while using part of the resulting fiscal savings to protect vulnerable groups. Reflecting these subsidies explicitly and transparently in the budget would increase the public's awareness of their cost and support for their rationalization.

Directors recommended that attention be given to enhancing domestic taxation. Current plans to reduce exemptions and special regimes, rationalize the free trade zones legislation, and modify the VAT refund system to reduce fraud are welcome. Directors encouraged the authorities to revisit the scope for introducing a tax on high personal incomes, which would exclude the bulk of the population and thereby spread the tax burden more fairly. In the mining sector, where the government is considering an increased tax take, they noted the importance of ensuring that revenue measures do not discourage additional private investment. Directors commended the central bank for continuing to pursue a cautious monetary policy stance. However, to better address inflationary concerns and improve the economy's ability to weather external shocks, many Directors recommended that the authorities consider a gradual and well-sequenced move towards greater exchange rate flexibility, which could be achieved

in the context of a managed float. Such a move would require an adaptation of the monetary policy framework to monetary or inflation targeting. In this context, a number of Directors noted that it would be premature to adopt an inflation targeting regime especially in view of the challenges associated with Bolivia's still dollarized economy. Some other Directors considered that, instead of moving to a managed float, it could be preferable to improve the operation of the current exchange rate regime.

Directors cautioned that, while the financial sector has strengthened notably, important challenges remain. In particular, care must be taken that the proposed public development banking system does not introduce distortions in the banking system, and that any related fiscal costs are clearly included in the budget.

Directors welcomed the government's emphasis on greater equity, transparency, and accountability. However, they saw the parallel emphasis on an elevated role for the state as risking the environment for private investment. Directors recommended that the authorities should therefore maintain a careful balance between government interventions in the economy and the preservation of appropriate incentives for private investment that remains critical to support growth and raise employment and living standards.

Directors observed that considerable uncertainty prevails in the hydrocarbons sector regarding the modalities for implementing the recent nationalization decree. They urged the authorities to work to achieve mutually acceptable arrangements with the concerned oil companies. Moreover, Directors noted that the expanded role newly assigned to YPFB will call for high-quality management and full transparency, consistent with international accounting and auditing standards.

Directors underscored that Bolivia may face a more competitive external environment for its nontraditional exports in the period ahead, including with the prospect of an erosion of preferential access to important markets. The authorities will therefore need to intensify their efforts to expand Bolivia's access to external markets. In addition, Directors considered that the medium-term outlook hinges crucially on the maintenance of a stable legal framework, notably with regard to property rights, which takes on added relevance in light of the land reform initiative and the potential for major institutional changes in the context of the forthcoming constitutional assembly.

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

Bolivia: Selected Economic Indicators

	2001	2002	2003	Prel.		Proj.
				2004	2005	2006
	(Annual percentage changes)					
Income and prices						
Real GDP	1.7	2.5	2.9	3.9	4.1	4.1
GDP deflator	1.7	2.8	6.2	7.4	4.6	5.3
CPI inflation (period average)	1.6	0.9	3.3	4.4	5.4	4.1
CPI inflation (end-of-period)	0.9	2.4	3.9	4.6	4.9	4.0
	(In percent of GDP)					
Combined public sector						
Revenues and grants	25.1	24.5	24.1	27.0	31.7	35.9
<i>Of which:</i>						
Royalties on hydrocarbons	2.6	2.3	2.8	3.4	6.7	10.1
Expenditure	32.0	33.3	32.0	32.6	33.9	36.1
Overall balance	-6.8	-8.8	-7.9	-5.6	-2.3	-0.1
Total public debt	60.0	69.3	74.0	77.2	70.8	50.8
External sector						
Current account	-3.4	-4.1	1.0	3.9	5.0	5.0
Merchandise exports	15.8	16.4	19.7	24.5	28.5	32.7
<i>Of which:</i> Natural gas	2.9	3.4	4.7	7.1	10.5	14.0
Merchandise imports	20.9	22.4	19.9	21.1	25.0	29.0
Gross international reserves ^{1/}						
In millions of U.S. dollars	1,375	1,085	1,266	1,474	2,019	2,564
In percent of broad money	39.1	36.7	42.0	49.6	57.2	64.7
	(Changes in percent of broad money at the beginning of the period)					
Money and credit						
NFA of the banking system	11.8	-11.4	3.5	3.8	25.2	...
NDA of the banking system	-9.3	0.8	-4.7	-5.5	-8.0	...
<i>Of which:</i> Credit to the private sector (in percent of GDP)			38.9	33.7	32.2	...
Broad money	2.6	-10.7	-1.2	-1.7	17.2	...
Interest rates (percent, end-of-period)						
Yield on treasury bills in local currency	12.9	17.2	10.9	10.6	7.9	...
Yield on treasury bills in U.S. dollars	5.6	4.9	6.2	4.3	7.4	...

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

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

**Statement by Javier Silva-Ruete, Alternate Executive Director for Bolivia
and Javier Cuevas, Advisor to Executive Director
July 17, 2006**

1. The Bolivian authorities share the staff's appraisal that despite two decades of significant structural reforms—which formed part of the conditionality in successive programs with the Fund— economic growth was insufficient and poverty and inequality remain high. It is imperative to change this situation; the unprecedented and widened majority reached in the general elections gives the new government the legitimacy and the great opportunity to make fundamental economic and social reforms to achieve higher and more equitable growth.

Recent Political and Economic Developments

2. On the political front, the election of constituents for the Constitutional Assembly and the referendum on departmental autonomy were held on July 2. The political party of President Morales reached 50.7 percent of total ballots and obtained 137 of 255 seats in the Constitutional Assembly. The “no” to departmental autonomy won with 57.6 percent at national level, even though the “yes” in favor of departmental autonomy won in four departments.¹ The Constitutional Assembly will be installed on August 6 with the objective of discussing departmental autonomy and elaborating a new constitution in the coming twelve months.

3. On the economic front, the satisfactory economic performance observed last year is continuing in 2006, helped in part by favorable external conditions. Real GDP growth was 4.3 percent in the first quarter; inflation is low and is expected to stay within the band envisaged by the central bank in the period ahead; international reserves increased strongly between January and May; fiscal surplus rose to 3.9 percent of GDP during the same period; and the public debt-GDP ratio reduced, reflecting relief under the MDRI. The government has announced a land reform to involve the redistribution of land that is unproductive or was obtained illegally. The authorities concluded the international bid process to exploit and industrialize the great deposits of iron in the east of the country and they are analyzing the winning company's offer. Furthermore, the government has launched its National Development Plan which covers the next five years and is based on four strategies: an economic strategy aimed to increase productivity and competitiveness; a social-community strategy oriented to improve life conditions and reduce poverty through the enhancement of education, health, sanitation and the social safety net; an international relationship strategy aimed to enhance the external sector in economic, political, and cultural ambits; and a social power strategy oriented to strengthen democracy through promoting social inclusion. The

¹ Bolivia is divided into nine departments.

authorities stress that these strategies will be developed in a consistent manner with prudent fiscal and monetary stances and emphasize their commitment to maintain macroeconomic stability, which is considered an asset of Bolivian society.

4. With respect to the hydrocarbon nationalization process, the government has reached a new agreement with Argentina to increase the price and volume of natural gas exports. The new agreement involves an increase in price from US\$3.63 to US\$5 per million British thermal units (BTU) for the current contract of 7.5 million cubic meters per day. The new price will be in effect from July 15 to December 2006, while a technical commission from both countries will study a formula to establish the price of natural gas for 2007 onwards. Moreover, the agreement includes the sale of an additional 20 million cubic meters per day in the next 20 years once a new pipeline to Argentina has been built. The negotiation with Brazil on the new price is underway and the government is conducting audits in the projects involved to establish whether companies fulfilled their investment commitments in order to evaluate the value of the nationalized assets and determine possible new participations in the new contracts.

Economic Policies

5. The authorities highlight the need to attain greater equity, transparency, and accountability underpinned by cautious macroeconomic policies. They assign a greater state role in mining and hydrocarbons activities and the receipts from these sectors will be used to improve education, health, and infrastructure in order to reduce poverty and inequality and enhance competitiveness. The authorities are aware that private investment is important to growth and job creation, so they emphasize that public investment in other economic sectors will be complementary to private investment. In this vein, the government supports the growth of small and medium companies, through facilitating credit access. These sectors are labor intensive and their expansion would help reduce high unemployment, which is the major cause of the rise in poverty.

Fiscal Policy

6. According to preliminary information, budget execution showed an overall surplus of 3.9 percent of GDP in the first five months of 2006, reflecting a prudent management, strong hydrocarbons revenues associated to higher oil and gas prices, and low seasonal expenditures. A fiscal surplus of 1.4 percent of GDP remains, even if the receipts from the new hydrocarbon law and the nationalization decree are not taken into account. Moreover, the higher natural gas price to Argentina would generate additional fiscal receipts of 0.5 percent of GDP. Therefore, public finance would show an overall fiscal surplus in 2006. However, this exceptional fiscal outcome will not be repeated next year because the state oil company, YPFB², and sub-national governments will begin to execute their investment

² Yacimientos Petrolíferos Fiscales Bolivianos.

prospects. In this regard, the authorities envisage higher deficits of approximately 3 percent of GDP in the National Development Plan for the period 2007–2011, which will be manageable, according to the staff's evaluation.

7. The authorities are concerned that the current revenue sharing and expenditure allocation system creates structural imbalances between central government and sub-national governments and undermines the scope for fiscal management. In this regard, the authorities' objective is to reduce the earmarking problem and their intention is that part of the receipts from the difference between the new and current prices of natural gas exports to Argentina and Brazil will be deposited in a fund of stabilization and development to partially address the current imbalance and prevent future exogenous shocks.

8. The authorities are working on a tax reform to broaden the tax base, improve equity, and increase revenues. Moreover, the authorities will eliminate the financial transactions tax (ITF) on boliviano deposits and make it permanent for short-term dollar deposits above US\$2000. The authorities consider that the FTT and exchange rate appreciation have created incentives for dedollarization; therefore, they prefer maintaining this tax as it was described. The FTT has existed in some neighboring countries for many years and there is no clear and empirical evidence on its negative effects on the financial sector.

9. With regards to spending, the main problem is high fuel subsidies, which have been increasing and the staff stresses the need to phase them out. However, despite the fact that subsidies are inefficient and give rise to smuggling, it is very difficult to reduce subsidies in the near term, particularly when there is a very hard political agenda to undertake. In this respect, the authorities are planning to change the energy matrix over the medium term in order to increase natural gas consumption and gradually reduce fuel subsidies and smuggling.

Monetary, Exchange Rate, and Financial Policies

10. International reserves have continued growing strongly during the first half of the year and they were sterilized by an accumulation of public deposits at the central bank. The base money expansion remains high, but it has been matched partially by an increase in real demand for bolivianos and the central bank has absorbed liquidity, mostly in instruments denominated in domestic currency and with longer maturities. Looking forward, the authorities are conscious that an abrupt change in public finance from a surplus to deficit could jeopardize the central bank's ability to contain pressures of inflation. Nevertheless, it has demonstrated the capacity and flexibility to adjust the interest rate, despite episodes of great economic and political instability in the previous four years.

11. The crawling peg regime has contributed to maintaining competitiveness and the minor devaluations were prudent and necessary in order to preserve the health of a highly dollarized financial system. Nonetheless, the high cost of transport and deficient basic infrastructure are undermining the competitiveness of nontraditional exports, which will be

more affected by the erosion of preferential access to U.S. and Andean countries' markets. In this regard, a mission led by the Vice-President, Garcia-Linera, will be in Washington, D.C. to try to extend the Andean Trade Promotion and Drug Eradication Act (ATPDEA), which ends in December 2006. Given that there are problems and uncertainty that weaken competitiveness, the authorities consider it prudent to maintain the managed float regime and exercise more exchange rate flexibility, as needed to prevent inflationary pressures. In addition, possible appreciation pressures on the exchange rate arising from high hydrocarbons revenues will be contained through cautious fiscal and monetary policies.

12. Financial sector stability has improved. Nonperforming loans, as a percentage of total loans, have reduced from 18 percent in 2002 to 11 percent in 2005, and provisions, as a percentage of nonperforming loans, have increased from 64 percent to 81 percent during the same period. However, profitability is still low and financial dollarization remains high, even though the latter has fallen between 2003 and 2005 due to the introduction of ITF and exchange rate appreciation. Furthermore, the authorities consider that land reform will not be a source of vulnerability for the banking system since most loans are collateralized with urban real estate rather than rural land.

Medium-Term Outlook

13. The medium-term economic outlook remains favorable, although the fiscal outlook is highly dependent on hydrocarbons-based revenues. To reduce this vulnerability, the authorities are working on a tax reform to widen the base tax and increase revenues. In addition, YPFB is working on new investment settlements in order to sustain production of hydrocarbons at current levels. The government attaches great importance to the diversification of the economy to gradually reduce the high dependence on hydrocarbons and mining sectors and, consequently, to lessen the vulnerability of external shocks.

14. Finally, on behalf of the Bolivian authorities, we would like to thank the Fund for the debt relief under the MDRI. We would also like to underscore that the authorities attach great importance to the longstanding relationship with the Fund and thank the staff for the candid dialogue.