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BOLIVIA

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

Mr. Conable's Office

Bolivia

~~Haug~~

DATE: August 8, 1991

TO: Mr. Enzo Grilli, Acting Senior Vice-President, OPNSV

FROM: Armeane M. Choksi, Acting Vice-President, LAC

EXTENSION: 31811

SUBJECT: BOLIVIA: Structural Adjustment Credit Grey Cover Documents

1. Attached please find the Memorandum of the President and Credit Agreement for the proposed Bolivia Structural Adjustment Credit, for distribution to the Executive Directors. Negotiations for the Bolivia Structural Adjustment Credit were concluded on May 30, and we are requesting approval to present the Credit to the Board on September 3. The Government has now met all of the conditions for Board presentation.

2. As of August 7, 1991, Bolivia is 22 days overdue. A warning has been sent to the Central Bank concerning the new guidelines and the implication of overdue payments for the presentation of the Credit to the Board. The Resident Mission is following up.

3. The following changes to the credit were agreed during negotiations:

(i) At the request of the Government, and considering the strength of the adjustment program, the amount of the credit was increased from the equivalent of US$35 million to US$40 million. In addition, it was agreed that up to 20% of the credit could be used for retroactive financing, to finance elements of the program prior to effectiveness.

(ii) Elimination of all transfers from the Central Government to the public enterprises, except those on an agreed list, had been a requirement of third tranche release. Given the difficulties in defining a list of legitimate transfers, the condition was changed to require Bank approval of all remaining transfers. Transfers to the public enterprises are very small, and the remaining ones should be eliminated shortly.

(iii) Conditionality concerning the program to limit COMIBOL's losses has been modified to be consistent with the agreement on the COMIBOL program just reached between the Bank and the Government.

(iv) The Board presentation condition concerning lending by the Fondo de Desarrollo Campesino (FDC) was strengthened. Formerly, we had asked only that the Government commit in the policy letter to cease lending by the FDC. The Government agreed during negotiations to end direct lending by the FDC prior to Board presentation, and recently issued a Supreme Decree to that effect. A second Decree will be issued setting out the functions of the FDC.

4. The Governments of Switzerland, Germany, the Netherlands and the United States (for the technical assistance component) are considering cofinancing the credit, but no final decisions have been taken. Rather than delay Board presentation of the credit, we propose to finalize cofinancing arrangements at a later stage.

cw and cc: Mrs. Sara Hoffman (LEGLA)

cc: Messrs./Mmes. Aiyer, Selowsky, Fleisig, Aguilar, Quijano, Duer (LACVP); Abe, Garcia-Zamor, Vasiliades (LA3DR); Page, Morrow, Konishi, Mierau, Albert, Devan (LA3Cl); Challa, Shaw (LA3TF); Smith (LA3IE); van der Gaag (LA3HR); Forno (LA3AG); Bernard (LA3BO); Glaessner, Dorfman (LATTF); Taylor (LA1IN); Grilli, Ray (EAS); Sandstrom (EXC), Okonjo-Iweala, Lawrence (OPNSV); Shihata (LEGVP); Collell, Hoffman, Carvalho (LEGLA); Grothe, Desclaux (LOAEL); Thalwitz (PRESV); Regional Information Center; SEC Documents Office

BShaw

W#-119/wlt
Legal Department
DRAFT
July 11, 1991

CREDIT NUMBER BO

DEVELOPMENT CREDIT AGREEMENT

(Structural Adjustment Credit)

between

REPUBLIC OF BOLIVIA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated , 1991

CREDIT NUMBER BO

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated , 1991, between REPUBLIC OF BOLIVIA (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS: (A) the Association has received a letter dated ____________________, 1991, from the Borrower describing a program of actions, objectives and policies designed to achieve structural adjustment of the Borrower's economy (hereinafter called the Program), declaring the Borrower's commitment to the execution of the Program, and requesting assistance from the Association in the financing of urgently needed imports and services required during such execution;

(B) the Borrower intends to contract from the Government of Switzerland a grant in an amount of ten million Swiss francs to assist the Borrower in the execution of the Program on terms and conditions to be set forth in an agreement to be entered into between the Borrower and the Government of Switzerland; and

(C) on the basis, inter alia, of the foregoing, the Association has decided in support of the Program to provide such assistance to the Borrower by making the Credit in three tranches and for the financing of services, training and equipment as hereinafter provided;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Development Credit Agreements" of the Association, dated January 1, 1985, with the modifications thereof set forth below (the General Conditions) constitute an integral part of this Agreement:

(a) Section 2.01, paragraph 9, shall be modified to read:

"'Project' means the imports and other activities, including the Technical Assistance Program as the same is defined in the Development Credit Agreement, that may be financed out of the proceeds of the Credit pursuant to the provisions of Schedule 1 to the Development Credit Agreement.";

(b) Section 9.06 (c) shall be modified to read:

"(c) Not later than six months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Association, the Borrower shall prepare and furnish to the Association a report, of such scope and in such detail as the Association shall reasonably request, on the execution of the Program referred to in the Preamble to the Development Credit Agreement, the performance by the Borrower and the Association of their respective obligations under the Development Credit Agreement and the accomplishment of the purposes of the Credit."; and

(c) the last sentence of Section 3.02 is deleted.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) "BAB" means Banco Agrícola de Bolivia, the Borrower's Agriculture Bank;

(b) "BAMIN" means Banco Minero, the Borrower's Mining Bank;

(c) "Banco Central" means Banco Central de Bolivia, the Borrower's Central Bank;

(d) "BANEST" means Banco del Estado, the State Bank;

(e) "Banking Law" means the law on the regulation and supervision of the Borrower's financial system contained in the bill of law No. ____ submitted to the Borrower's Congress on ____________;

(f) "Central Bank Circular" means Banco Central's circular, dated __________________, defining eligibility criteria for access of Financial Intermediaries to development credit;

(g) "COMIBOL" means Corporación Minera de Bolivia, the Borrower's Mining Corporation;

(h) "Financial Intermediaries" means those banks and other financial institutions that are eligible for development credit from Banco Central;

(i) "First Action Plan" means the action plan described in a letter from the Borrower to the Association, dated ______, for the recovery, sale, legal adjudication or liquidation of the financial and fixed assets of BAB, BANIM and FONEM;

(j) "First Tranche" means a portion of the Credit not exceeding the equivalent of SDR [ ] to be released by the Association on or after the Effective Date;

(k) "FONEM" means Fondo Nacional de Exploración Minera, the Borrower's Mining Exploration Fund;

(l) "Large Enterprises" means the Borrower's enterprises holding fixed assets with a minimum value equivalent to $9,000,000, each one;

(m) "Ministerio de Planeamiento" means Ministerio de Planeamiento y Coordinación, the Borrower's Ministry of Planning;

(n) "PPF" means the project preparation advance granted by the Association to the Borrower pursuant to an exchange of letters dated __________ and _________, between the Borrower and the Association;

(o) "Regulations" means the regulations and Superintendency of Banks' circulars to be introduced by the Borrower to enforce the Banking Law, such regulations to be satisfactory to the Association;

(p) "Second Action Plan" means the action plan described in a letter from the Borrower to the Association dated ______ for the recovery, sale, legal adjudication or liquidation of BANEST's financial and fixed assets;

(q) "Second Tranche" means a portion of the Credit not exceeding the equivalent of SDR [ ] to be released by the Association to the Borrower on or after the date the actions set forth in Part A of Schedule 3 to this Agreement have been taken by the Borrower;

(r) "SITC" means the Standard International Trade Classification, Revision 3 (SITC, Rev. 3), published by the United Nations in Statistical Papers, Series M, No. 343 (1986);

(s) "Small Enterprises" means the Borrower's enterprises holding fixed assets with a maximum value equivalent to less than $9,000,000 and a minimum value equivalent to $1,000,000, each one;

(t) "Special Account" means the account referred to in Section 2.02 (b) of this Agreement;

(u) "Superintendency of Banks" means the Borrower's Superintendencia de Bancos;

(v) "Technical Assistance Expenditures" means the expenditures to be financed from the proceeds of the Credit pursuant to the provisions of this Agreement in respect of the Technical Assistance Program;

(w) "Technical Assistance Program" means the technical assistance program described in Section 3.03 of this Agreement;

(x) "Third Action Plan" means the action plan for the improvement and supervision of the Borrower's banking system, contained in the document signed by the Borrower and delivered to the Association dated [ ]; and

(y) "Third Tranche" means a portion of the Credit not exceeding the equivalent of SDR [ ] to be released by the Association to the Borrower on or after the date the actions set forth in Parts A and B of Schedule 3 to this Agreement have been taken by the Borrower.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to 30,000,000 Special Drawing Rights (SDR 30,000,000).[1]

Section 2.02. (a) The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement.

1/ Equivalent to $40,000,000.

Section 2.02. (a) The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement.

(b) The Borrower shall, for the purposes of the expenditures made, or, if the Association shall so agree, to be made, in respect of the reasonable cost of goods and services required for the Technical Assistance Program, open and maintain in dollars a special account in its Central Bank on terms and conditions satisfactory to the Association. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Schedule 4 to this Agreement.

(c) Promptly after the Effective Date, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and pay to itself the amount required to repay the principal amount of the PPF withdrawn and outstanding as of such date and to pay all unpaid charges thereon. The unwithdrawn balance of the authorized amount of the PPF shall thereupon be cancelled.

Section 2.03. The Closing Date shall be July 1, 1994 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or cancelled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date or at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next payment date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment and service charges shall be payable semiannually on March 15 and September 15 in each year.

Section 2.07. (a) Subject to paragraphs (b) and (c) below, the Borrower shall repay the principal amount of the Credit in semi-annual installments payable on each March 15 and September 15 commencing September 15, 2001 and ending March 15, 2031. Each installment to and including the installment payable on March 15, 2001 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (2%) of such principal amount.

(b) Whenever (i) the Borrower's gross national product per capita, as determined by the Association, shall have exceeded $790 in constant 1985 dollars for five consecutive years and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the terms of repayment of installments under paragraph (a) above by requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid. If so requested by the Borrower, the Association may revise such modification to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(c) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

Section 2.09. (a) Banco Central is designated as representative of the Borrower for the purposes of taking any action required or permitted to be taken under the provisions of Section 2.02 of this Agreement and Article V of the General Conditions in respect of expenditures for the Program other than Technical Assistance Expenditures.

(b) Ministerio de Planeamiento, is designated as representative of the Borrower for the purposes of taking any actions required or permitted to be taken under the provisions of Section 2.02 of this Agreement and Article V of the General Conditions in respect of Technical Assistance Expenditures.

(c) Without limitation or restriction to the foregoing, the Borrower hereby entrusts: (i) Banco Central with responsibility for the preparation of withdrawal applications (other than those for Technical Assistance Expenditures); and (ii) Ministerio de Planeamiento with responsibility for the preparation of withdrawal applications for Technical Assistance Expenditures; under the Credit and each such respectively for the collection of the documents and other evidence to be furnished to the Association in support of such applications; such withdrawal applications shall to the extent practicable be consolidated so as to apply for withdrawal of aggregate amounts of not less than SDR 100,000 equivalent.

ARTICLE III

Particular Covenants

Section 3.01. (a) The Borrower and the Association shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program.

(b) Prior to each such exchange of views, the Borrower shall furnish to the Association for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Association shall reasonably request.

Section 3.02. Except as the Association shall otherwise agree, procurement of the goods to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 2 to this Agreement.

Section 3.03. (a) The Borrower shall carry out a technical assistance program satisfactory to the Association (the Technical Assistance Program) which shall include: (i) technical assistance and training to (A) support an improved supervision of the Borrower's banking system and establish efficient mechanisms for handling bank crises; (B) assist in the development, and the supervision of, the Borrower's capital markets; (C) assist in the reform of the Borrower's major enterprises and in the Borrower's program to privatize its enterprises; and (D) streamline the Borrower's trade and registration procedures; and (ii) acquisition and utilization of equipment for purposes of carrying out such technical assistance and training.

(b) For purposes of carrying out the Technical Assistance Program referred to in paragraph (a) above, the Borrower shall employ consultants whose qualifications, experience and terms and conditions of employment shall be satisfactory to the Association. Such consultants shall be selected in accordance with the principles and procedures satisfactory to the Association on the basis of the "Guidelines for the Use of Consultants by World Bank Borrowers and by the World Bank as Executing Agency" published by the Bank in August 1981.

(c) The Borrower shall: (i) promptly upon its completion, submit to the Association any study which shall be carried out under the Technical Assistance Program; and (ii) take into account any comment of the Association thereon when implementing the recommendations of any such study.

Section 3.04. (a) The Borrower shall maintain or cause to be maintained records and separate accounts adequate to reflect in accordance with consistently maintained sound accounting practices the expenditures financed out of the proceeds of the Credit.

(b) The Borrower shall:

(i) have the records and accounts referred to in paragraph (a) of this Section, including those for the Special Account, audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association;

(ii) subject to paragraph 6 of Part A of Schedule 3 to this Agreement in relation to the Second Tranche, and paragraph 6 of Part B of Schedule 3 to this Agreement in relation to the Third Tranche, furnish to the Association as soon as available, but in any case not later than ninety days after the last withdrawal from the Credit Account has been made under each of the First, Second and Third Tranches, a certified copy of the report of the audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested;

(iii) furnish to the Association as soon as available, but in any case not later than four months after the end of each fiscal year the report of the audit of the accounts referred to in paragrap (a) of this Section, including those of the Special Account by said auditors, of such scope and is such detail as the Association shall have reasonably requested; and

(iv) furnish to the Association such other information concerning said records and accounts and the audit thereof as the Association shall from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of statements of expenditure, the Borrower shall:

(i) maintain or cause to be maintained, in accordance with paragraph (a) of this Section, records and accounts reflecting such expenditures;

(ii) retain, until at least one year after the Association has received the audit report for the fiscal year in which the last withdrawal from the Credit Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;

(iii) enable the Association's representatives to examine such records; and

(iv) ensure that such records and accounts are included in the annual audits referred to in paragraph (b) of this Section and that the report of such audit contains a separate opinion by said auditors as to whether the statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals.

ARTICLE IV

Additional Event of Suspension

Section 4.01. Pursuant to Section 6.02 (h) of the General Conditions, the following additional event is specified, namely, that a situation has arisen which shall make it improbable that the Program, or a significant part thereof, will be carried out.

ARTICLE V

Termination

Section 5.01. The date ____________________________[2] is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. Except as provided in Section 2.09 (a) of this Agreement, the Minister of Planning and Coordination of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministerio de Planeamiento y Coordinación
La Paz
Bolivia

Cable address:	Telex:
MINPLANEACION La Paz, Bolivia	3280 (MINCORD BV)

For the Association:

International Development
Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

2/ A date 90 days after the date of the Agreement.

Cable address:	Telex:
INDEVAS Washington, D.C.	248423 (RCA) 82987 (FTCC) 64145 (WUI) or 197688 (TRT)

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

REPUBLIC OF BOLIVIA

By

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By

Regional Vice President
Latin America and the Caribbean

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

1. Subject to the provisions set forth or referred to in this Schedule, the proceeds of the Credit may be withdrawn from the Credit Account for expenditures made (or, if the Association shall so agree, to be made) in respect of: (i) the reasonable cost of goods required during the execution of the Program; (ii) the reasonable cost of goods and services for the Technical Assistance Program up to an aggregate amount not to exceed the equivalent of SDR 2,800,000[3]; and (iii) repayment of the principal amount of the PPF withdrawn and outstanding and payment of all charges thereon as provided in Section 2.02 (b) of this Agreement, all to be financed out of the proceeds of the Credit.

2. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of:

(a) expenditures for goods included in the following SITC groups or subgroups, or any successor groups or subgroups under future revisions to the SITC, as designated by the Association by notice to the Borrower:

Group	Subgroup	Description of Items
112	--	Alcoholic beverages
121	--	Tobacco, unmanufactured, tobacco refuse
122	--	Tobacco, manufactured (whether or not containing tobacco substitutes)
525	--	Radioactive and associated materials
667	--	Pearls, precious and semiprecious stones, unworked or worked

[3] An amount equivalent to $3,623,000 will be inserted here.

718	718.1	Nuclear reactors, and parts thereof, fuel elements (cartridges), nonirradiated for nuclear reactors
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971	--	Gold, nonmonetary (excluding gold ores and concentrates)

(b) expenditures, other than Technical Assistance Expenditures, in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;

(c) payments made for expenditures prior to the date of this Agreement except that withdrawals, in an aggregate amount not exceeding the equivalent of SDR 6,000,000[4] may be made on account of payments made for expenditures (other than Technical Assistance Expenditures) before that date but after March 20, 1991;

(d) expenditures for goods procured under contracts costing less than $5,000 equivalent;

(e) expenditures for goods supplied under a contract which any national or international financing institution or agency other than the Association shall have financed or agreed to finance;

(f) expenditures for goods intended for a military or paramilitary purpose or for luxury consumption; and

(g) Technical Assistance Expenditures when the aggregate withdrawals in respect of such Expenditures shall have reached the equivalent of SDR 2,800,000.[5]

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[4] A dollar amount equivalent to 20% of the Credit Amount will be inserted here.

[5] The equivalent of $3,623,000.

3. (a) Withdrawals for expenditures (other than Technical Assistance Expenditures) under contracts for the procurement of goods estimated to cost less than the equivalent of $1,000,000 (one million dollars) may be permitted by the Association upon the basis of statements of expenditure under such terms and conditions as the Association shall specify.

(b) Withdrawals for Technical Assistance Expenditures under contracts for the procurement of goods estimated to cost less than the equivalent of $25,000 (twenty-five thousand dollars) up to an aggregate amount not exceeding $150,000 equivalent, may be permitted by the Association upon the basis of statements of expenditure under such terms and conditions as the Association shall specify.

4. No withdrawal shall be made and no commitment shall be entered into to pay amounts to or on the order of the Borrower in respect of expenditures, other than Technical Assistance Expenditures, to be financed out of the proceeds of the Credit after the aggregate of the proceeds of the Credit (excluding from such aggregate amounts paid to or on the order of the Borrower in respect of Technical Assistance Expenditures) withdrawn from the Credit Account and the total amount of such commitments shall have reached:

(a) the equivalent of SDR 11,200,000, unless the Association shall be satisfied, after an exchange of views as described in Section 3.01 of this Agreement based on evidence satisfactory to the Association: (i) with the progress achieved by the Borrower in the carrying out of the Program; (ii) that the actions described in Part A of Schedule 3 to this Agreement have been taken in form and substance satisfactory to the Association; and (iii) that the macroeconomic policy framework of the Borrower is consistent with the objectives of the Program; and

(b) the equivalent of SDR 22,400,000, unless the Association shall be satisfied, after an exchange of views as described in Section 3.01 of this Agreement based on evidence satisfactory to the Association: (i) with the progress achieved by the Borrower in the carrying out of the Program; (ii) that the actions described in Parts A and B of Schedule 3 to this Agreement have been taken in form and substance satisfactory to the Association; and (iii) that the macroeconomic policy framework of the Borrower is consistent with the objectives of the Program.

5. If, after the exchange of views described in paragraph 4 above, the Association shall have given notice to the Borrower that

the progress achieved in the carrying out of the Program or the actions taken pursuant to Schedule 3 to this Agreement are not satisfactory, or that the macroeconomic policy framework of the Borrower is not consistent with the objectives of the Program, and, within 90 days after such notice, the Borrower shall not have achieved progress and taken actions satisfactory to the Association, or the Borrower's macroeconomic policy framework continues to be not consistent with the objectives of the Program, then the Association may, by notice to the Borrower, cancel the unwithdrawn amount of the Credit or any part thereof.

SCHEDULE 2

Procurement

1. (A) (i) Contracts entered into for the procurement of goods (other than contracts entered into for the procurement of goods for the Technical Assistance Program) estimated to cost the equivalent of $5,000,000 or more each; and (ii) contracts for the procurement of goods estimated to cost the equivalent of $100,000 or more each and to be used for the Technical Assistance Program, shall be awarded through international competitive bidding in accordance with procedures consistent with those set forth in Sections I and II of the "Guidelines for Procurement under IBRD Loans and IDA Credits" published by the Bank in May 1985 (the Guidelines), and, other than in the case of goods to be used for the Technical Assistance Program and referred to in subparagraph (ii) hereof, subject to the following modifications:

(a) Paragraph 2.8 of the Guidelines is deleted and the following is substituted therefor:

"2.8 <u>Notification and Advertising</u>

The international community should be notified in a timely manner of the opportunity to bid. This will be done by advertising invitations to apply for inclusion in a bidder's invitation list, to apply for prequalification, or to bid; such advertisements should be placed in at least one newspaper of general circulation in the Borrower's country and, in addition, in at least one of the following forms:

(i) a notice in the United Nations publication, Development Forum, Business Edition; or

(ii) an advertisement in a newspaper, periodical or technical journal of wide international circulation; or

(iii) a notice to local representatives of countries and territories referred to in the Guidelines, that are potential suppliers of the goods required."

(b) The following is added at the end of paragraph 2.21 of the Guidelines:

"As a further alternative, bidding documents may require the bidder to state the bid price in a single currency widely used in international trade and specified in the bidding documents."

(c) Paragraphs 2.55 and 2.56 of the Guidelines are deleted.

(B) In the procurement of goods in accordance with the procedures described in paragraph 1 (A) (ii) above, goods manufactured in Bolivia may be granted a margin of preference in accordance with, and subject to, the provisions of paragraphs 2.55 of the Guidelines and paragraphs 1 through 4 of Appendix 2 thereto.

2. Contracts for the procurement of goods (except the goods referred to in paragraph 3 below) estimated to cost the equivalent of less than $5,000,000 shall be awarded:

(a) by purchasers required to follow the Borrower's public procurement procedures for the importation of goods, on the basis of such procedures, provided that such procedures shall have been found acceptable by the Association;

(b) by other purchasers, in accordance with established commercial practice, provided that such contracts may be awarded on the basis of evaluation comparison of quotations obtained from at least two suppliers eligible under the Guidelines, except that direct contracting procedures acceptable to the Association may be used where considered appropriate under paragraph 3.5 of the Guidelines; and

(c) by any purchasers, for the supply of commodities, on the basis of evaluation and comparison of quotations obtained from more than one supplier.

3. Contracts for the procurement of goods estimated to cost less than the equivalent of $100,000 but more than the equivalent of $25,000, up to an aggregate amount not exceeding $300,000 equivalent, for the Technical Assistance Program may be procured under contracts awarded on the basis of competitive bidding, advertised locally, in accordance with procedures satisfactory to the Association.

4. Contracts for the procurement of goods estimated to cost the equivalent of $25,000 or less up to an aggregate amount not exceeding $150,000 equivalent, for the Technical Assistance Program may be awarded on the basis of comparison of price quotations obtained from a list of at least three suppliers eligible under the Guidelines, in accordance with procedures acceptable to the Association.

5. With respect to each contract referred to in paragraph 1 of this Schedule, the Borrower shall furnish to the Association, prior to the submission to the Association of the first application for withdrawal of funds from the Credit Account in respect of such contract, two conformed copies of such contract, together with the analysis of the respective bids and recommendations for award, a description of the advertising and tendering procedures followed and such other information as the Association shall reasonably request.

6. With respect to each contract referred to in paragraphs 2 and 3 of this Schedule, the Borrower shall furnish to the Association, prior to the submission to the Association of the first application for withdrawal of funds from the Credit Account in respect thereof, such documentation and information as the Association may reasonably request to support withdrawal applications in respect of such contract.

7. The provisions of the preceding paragraph 5 of this Schedule shall not apply to contracts on account of which the Association has authorized withdrawals from the Credit Account on the basis of statements of expenditure.

SCHEDULE 3

Actions Referred to in Paragraphs 4 (a) and 4 (b) of Schedule 1 to this Agreement

Part A: Second Tranche

1. BAB, BAMIN and FONEM have: (a) either been sold to the private sector; or (b): (i) had their operations closed; (ii) their employees not involved in loan recuperation or liquidation have been released; and (iii) complied with the First Action Plan.

2. Either: I. (a) BANEST's branches which, in the opinion of the Association, are not cost effective or justifiable, have been closed or sold to the private sector.

(b) BANEST's functions which, in the opinion of the Association, can be handled efficiently by the private sector have been transferred to the private sector.

(c) The Second Action Plan is being complied with.

Or II. BANEST, in its entirety, has been sold to the private sector.

3. The Banking Law has been enacted and put into effect.

4. (a) A plan for the reorganization of COMIBOL has been completed.

(b) COMIBOL's mines, which in the opinion of the Association are not profitable, have been closed.

5. (a) Approval for privatization, completion of asset valuations and sales documentation and offer for sale of at least 51% of the voting shares held by the Borrower have been made in respect of: either (i) the Lloyd Aéreo Boliviano, 2 Large Enterprises and 3 Small Enterprises; or (ii) 3 Large Enterprises and 5 Small Enterprises.

(b) An agenda has been furnished to the Association for the sale to the private sector or closure of the Borrower's enterprises which will be offered for sale or closed before the actions under Part B hereof are taken.

6. A certified copy of the audit report referred to in Section 3.04 (b) (ii) of this Agreement in respect to the expenditures financed out of the proceeds of the First Tranche has been furnished to the Association.

7. The Third Action Plan has been carried out.

8. The Regulations are being implemented in a manner satisfactory to the Association.

9. The Central Bank Circular is being implemented, in a manner satisfactory to the Association, and the Superintendency of Banks and the Central Bank are supervising the Financial Intermediaries in a manner satisfactory to the Association.

Part B: Third Tranche

1. The First Action Plan is being complied with, to the extent applicable.

2. The Second Action Plan is being complied with.

3. (a) Transfers from the Borrower's budget to national and regional public enterprises (except those for which the Borrower has obtained the prior written consent of the Association) have been eliminated.

(b) The arrears in the payment of debts among the Borrower's enterprises have been eliminated.

4. Commercial banks in Bolivia have been required to make provisions in amounts equivalent to 10% of their Class 3 loans (as such term is defined in the Superintendency of Banks' Circular dated ________________).

5. Approval for privatization, completion of asset valuations and sales documentation and offer for sale of at least 51% of the voting shares held by the Borrower have been made in respect of: either (a) the Lloyd Aéreo Boliviano, 4 Large Enterprises and 5 Small Enterprises; or (b) 5 Large Enterprises and 6 Small Enterprises.

6. Certified copies of the audit reports referred to in Section 3.04 (b) (ii) of this Agreement in respect to the expenditures

financed out of the proceeds of the First Tranche and the Second Tranche have been furnished to the Association.

7. The Regulations are being implemented in a manner satisfactory to the Association.

SCHEDULE 4

Special Account

1. For the purposes of this Schedule:

(a) the term "Eligible Category" means goods and services for the Technical Assistance Program;

(b) the term "Eligible Expenditures" means expenditures in respect of the reasonable cost of goods and services required for the Technical Assistance Program and to be financed out of the proceeds of the Credit allocated from time to time to the Eligible Category; and

(c) the term "Authorized Allocation" means an amount equivalent to $400,000 to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 3 (a) of this Schedule.

2. Payments out of the Special Account shall be made exclusively for Eligible Expenditures in accordance with the provisions of this Schedule.

3. After the Association has received evidence satisfactory to it that the Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Association a request or requests for a deposit or deposits which do not exceed the aggregate amount of the Authorized Allocation. On the basis of such request or requests, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit in the Special Account such amount or amounts as the Borrower shall have requested.

(b) (i) For replenishment of the Special Account, the Borrower shall furnish to the Association requests for deposits into the Special Account at such intervals as the Association shall specify.

(ii) Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to paragraph 4 of this Schedule for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for Eligible Expenditures.

All such deposits shall be withdrawn by the Association from the Credit Account under the respective Eligible Category, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for Eligible Expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Association shall not be required to make further deposits into the Special Account:

(a) if, at any time, the Association shall have determined that all further withdrawals should be made by the Borrower directly from the Credit Account in accordance with the provisions of Article V of the General Conditions and paragraph (a) of Section 2.02 of this Agreement; or

(b) once the total unwithdrawn amount of the Credit allocated to the Eligible Category, less the amount of any outstanding special commitment entered into by the Association pursuant to Section 5.02 of the General Conditions with respect to the Technical Assistance Program, shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit allocated to the Eligible Category shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for Eligible Expenditures.

6. (a) If the Association shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association: (A) provide such additional evidence as the Association may request; or (B) deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless the Association shall otherwise agree, no further deposit by the Association into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for Eligible Expenditures, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Association made pursuant to paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.

Report No. P- 5586-BO

REPORT AND RECOMMENDATION

OF THE

PRESIDENT OF THE

INTERNATIONAL DEVELOPMENT ASSOCIATION

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 30 MILLION

(US$40 MILLION EQUIVALENT)

TO THE

REPUBLIC OF BOLIVIA

FOR A

STRUCTURAL ADJUSTMENT PROGRAM

August 12, 1991

Fiscal Year

January 1 to December 31

CURRENCY EQUIVALENTS

Currency Unit = Boliviano (Bs)
Exchange Rate Effective March 1991
US$1.00 = Bs 3.51
Bs 1.00 = $0.28

ABBREVIATIONS

AFP	-	Administradores de Fondos de Pensiones (Pension Fund Administrators)
BAB	-	Banco Agrícola de Bolivia (Bolivian Agriculture Bank)
BAMIN	-	Banco Minero (Mining Bank)
BANEST	-	Banco del Estado (State Bank)
CEDES	-	Central Bank Certificates of Deposit
COMIBOL	-	Corporación Minera de Bolivia (Bolivian Mining Corporation)
CNV	-	Comisión Nacional de Valores (Stock Exchange Commission)
CRA	-	Certificado Reintegración Arrancelaria (Customs Certificate)
ENDE	-	Empresa Nacional de Electricidad (National Electricity Company)
ENFE	-	Empresa Nacional de Ferrocarriles (National Railways Corporation)
ENTEL	-	Empresa Nacional de Telecomunicaciones (National Telecommunications Company)
ESAF	-	Enhanced Structural Adjustment Facility
ESF	-	Emergency Social Fund
ESW	-	Economic and Sector Work
FDC	-	Fondo de Desarrollo Campesino (Peasant Development Fund)
FONEM	-	Fondo Nacional de Exploración Minera (National Mining Exploration Fund)
FSAC	-	Financial Sector Adjustment Credit
GSF	-	Gerencia de Sistema Financiero (Financial System Unit)
GTZ	-	German Aid Agency
IBRD	-	International Bank for Reconstruction and Development
IBSS	-	Instituto Boliviano de Seguridad Social (Bolivian Social Security Institute
ICI	-	Institution Eligible to Intermediate Development Credit
IDA	-	International Development Association
IDB	-	Inter-American Development Bank
IMF	-	International Monetary Fund
LAB	-	Lloyd Aereo Boliviano (Bolivian Airline)
SAFCO	-	Sistema Integrado de Administración Financiera y Control (Integrated System of Financial Administration and Control)
SBEF	-	Superintendencia de Bancos (Superintendency of Banks)
SDR	-	Special Drawing Right
SNSR	-	Superintendencia Nacional de Seguros y Reaseguros (Superintendency of Insurance)
USAID	-	United States Agency for International Development
YPFB	-	Yacimientos Petrolíferos Fiscales Bolivianos (Bolivian Petroleum Corporation)

PRESIDENT'S REPORT

BOLIVIA: STRUCTURAL ADJUSTMENT CREDIT

CREDIT AND PROGRAM SUMMARY

Borrower: Republic of Bolivia

Amount: SDR 30 million (equivalent to US$40 million)

Terms: Standard IDA terms

Credit Objectives: The objective of the proposed Structural Adjustment Credit is to increase the level and efficiency of investment through improving the regulation and supervision of the financial system, improving the allocation of resources by the financial system and capital markets, reducing the share of production carried out by the public sector, improving the performance of public sector investment and enterprises, reducing the burden of bureaucratic impediments to investment and increasing resources devoted to human resource development.

Credit Description: The Credit would support a set of reforms directed at reaching the above-mentioned objectives. These reforms include: (i) maintenance of a coherent macroeconomic policy aimed at continued stability; (ii) financial sector reform to strengthen banking supervision, privatize or close and liquidate loss-making public banks, improve the allocation of donor-financed credit, establish a mechanism for handling bank crises and improve the laws and regulations governing pensions, insurance, and securities markets; (iii) signature of performance contracts and improvements in operation of the major state enterprises, including elimination of transfers to, and arrears of, state enterprises; (iv) a comprehensive privatization program with the medium-term goal of divesting all state enterprises in productive sectors (with the exception of mining and hydrocarbons due to Constitutional restrictions); (v) streamlining of trade and registration procedures, including customs reform, a duty drawback system, simplification of export approvals and simplification of firm registration and control mechanisms; (vi) cooperation with the Bank in improving public sector investment project selection; and (vii) increases in the share of current expenditures devoted to primary health care and primary education.

In addition, there is a technical assistance component to support improved supervision of the banking system, establish a mechanism for handling bank crises, assist in determining reforms to facilitate capital market development, assist in the reform of major public sector enterprises and in the privatization program and support efforts to streamline trade and registration procedures.

A policy matrix spelling out the objectives of the proposed Credit, measures already taken, measures to be taken under the Credit and proposed timing, is provided as Annex IV.

Benefits

The proposed operation would increase the efficiency and level of investment and thus permit an acceleration of growth, after the disastrous declines in output in the early 1980s and four years of stagnation in per capita income. These benefits would result from the elimination of loss-making public banks, improved efficiency of the banking system through stronger regulation and supervision, a reduction in the cost of financing through increasing the role of equities markets as opposed to expensive financing from commercial banks, improved efficiency in the operation of major public enterprises that control a substantial share of production in the Bolivian economy, improved efficiency of production of privatized enterprises, reduced transactions costs facing private sector companies, avoidance of wasteful public sector investments and a more efficient allocation of health and education expenditures that is essential to the long-term growth of the Bolivian economy.

Risks

The proposed Credit would involve a number of risks. Given the political sensitivity of some of the proposed reforms, there is a risk that the Government may not be able to carry out the program with the required speed and thoroughness. However, the economic team is firmly committed to the program, has obtained the support of the President and already has taken many of the most politically difficult measures. The short-term effects of stricter prudential requirements could result in a decline in financial intermediation by some banks. Any fall in credit should be mitigated by a continued reduction in the public sector's claims on resources (due to privatization, closure of state banks and increased fiscal revenues), which would encourage a decline in interest rates and facilitate increased private sector lending. The Government's lack of resources may slow achievement of the proposed reforms, although the technical assistance component in conjunction with complementary efforts by other donors should help to reduce this problem. Finally, any failure to maintain macroeconomic stability could endanger the success of the reform process. This risk is judged to be low, since the Government has maintained stability since taking office and the program has broad support across the major political parties. Conditions of tranche release will include maintenance of a macroeconomic program acceptable to the Bank.

Estimated Disbursements: Except for the technical assistance component, the Credit would be disbursed in three tranches. A special account will be set up for the technical assistance component. Retroactive financing will be permitted for those eligible imports made before the date of the loan agreement but not before March 20, 1991, up to an amount equal to US$8 million.

Schedule of Disbursements:

Bank Fiscal Years	FY92	FY93	FY94
	- - - US$ millions- - -		
Annual	16.8 a/	16.8	6.4
Cumulative	16.8	33.6	40.0

a/ Includes retroactive financing.

Financing Plan: The Inter-American Development Bank is considering two loans with conditionality identical to the financial sector component of this Credit: a balance of payments support operation and a multi-sectoral credit line. The Government of Switzerland is considering cofinancing equivalent to approximately US$7 million, and USAID may cofinance the technical assistance program. In addition, we are exploring the prospects for cofinancing by other bilateral donors. The tentative financing plan would be as follows:

IDA	US$40.0 million
USAID	US$ 0.7 million
IDB (balance of payments loan)	US$40.0 million
(multi-sectoral credit operation)	US$80.0 million
Switzerland	US$ 7.0 million
Total	US$167.7

PRESIDENT'S REPORT

BOLIVIA: STRUCTURAL ADJUSTMENT CREDIT

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REPORT AND RECOMMENDATION OF THE PRESIDENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION TO THE EXECUTIVE DIRECTORS ON A PROPOSED CREDIT TO THE REPUBLIC OF BOLIVIA FOR A STRUCTURAL ADJUSTMENT PROGRAM

1. I submit the following report and recommendation on a proposed credit to the Republic of Bolivia for SDR 30 million (the equivalent of US$40 million) on standard IDA terms in support of a program of structural adjustment. The Inter-American Development Bank is considering two parallel loans for a total of US$120 million. USAID may provide cofinancing for the technical assistance program. We are continuing discussions with other donors, who may cofinance the Credit at a later stage.

I. COUNTRY POLICIES AND BANK GROUP ASSISTANCE STRATEGY

Introduction

2. Bolivia is one of the poorest countries in Latin America with a per capita income of US$620. The education level of its 7.3 million inhabitants is very limited; and health indicators are among the worst in the continent. Bolivia's landlocked position and mountainous terrain render transport costs high and access difficult. Both internal communications and links to neighboring countries are poorly developed. About one-half of the economically active population is employed in agriculture, primarily on the highlands of the altiplano where subsistence farming predominates. Although the mountains are rich in minerals, there has been insufficient exploratory work to exploit new minerals. Bolivia has important hydrocarbon resources, in particular, natural gas, but export prospects are uncertain. The manufacturing sector is small and dominated by a few agro-industrial enterprises.

3. Buoyant commodity prices and relative political stability provided easy access to foreign financing in the 1970s. Fixed investment increased to more than 20% of GDP in the mid-70s, and for several consecutive years, Bolivia's GDP expanded at over 5% per year. The growth of investment reflected, primarily, large-scale public investment projects, many of which were highly questionable in terms of social payoff. Investment, as a proportion of GDP, began to decline in the late 1970s. Public and private savings declined at an even faster rate, increasing external borrowing (particularly from commercial banks) and rapidly increasing the external debt. By the early 1980s, severe internal and external imbalances had become apparent. Savings, investment, and with them GDP, began to contract (in absolute value) and external financing sources began to dry up. At the same time, tax collections dropped off sharply, as rapidly rising inflation eroded the real value of tax receipts, tax collection efforts deteriorated and the real tax base shrunk. With the authorities trying to maintain the size and wage levels of the public sector, the public sector deficit widened from 7% of GDP in 1980 to 23% of GDP in 1984. Given the absence of open market instruments, the impact of widening deficits could not be softened by substituting private for public savings. Instead, domestic credit expansion fueled inflation, which ran at a rate of almost 24,000% during the 12-month period preceding September 1985. Maintenance of a fixed exchange rate system with periodic maxi-devaluations, in the face of hyperinflation, led to a

massive overvaluation of the peso with the parallel rate being, at times, as much as 15 times the official rate.

4. Behind the poor economic performance of the early 1980s lay deep-seated structural problems. Of primary importance was the increased role of the state and its declining effectiveness. After the 1952 revolution, the Government share in the economy started to assume large proportions. Numerous state enterprises were created which operated in an unclear policy environment without proper controls or support. Frequent changes of governments exacerbated uncertainties about the policy framework, organization, and procedures. Public sector management was exceptionally weak. These problems led to declining Government revenues, uncontrolled current expenditures, and poor investment project performance. The financial system was characterized by a decreasing level of resource mobilization, distorted credit allocation to finance the public sector, growing solvency problems of the commercial banks, and an increasing decapitalization of the state banks. The environment for private investment was poor, and the private sector focused on trading and other short-term activities. Capital flight was substantial and capacity was under-utilized by widening margins.

The Adjustment Process

5. Following several years of declining output, culminating in hyperinflation of over 24,000% in annual terms, the Government in late 1985 launched its New Economic Policy which stopped the hyperinflation and undertook a long-term adjustment program to reduce the role of the state and to rebuild a free market economy. The exchange rate was freed and set through an auction system, which resulted in an immediate devaluation of the official rate by 93%; strict budgetary controls were introduced to keep expenditures to the levels of revenues; most price controls were eliminated and specific prices and tariffs increased to bring them close to international levels (for gasoline, electricity and transport); far-reaching reform of the tax system reduced the basic tax categories from 400 to nine; the trade regime was liberalized, including elimination of most quantitative trade restrictions and reduction of tariff rates; and steps were taken to reorganize some public enterprises and abolish or reduce others (COMIBOL, the state mining company, was reduced in size by the dismissal of 23,000 workers). The financial system was liberalized, removing regulatory constraints on financial transactions and freeing the determination of interest rates. An important start was made to improve public sector administration by establishing the Financial Administration and Control System (SAFCO) for monitoring public expenditures and better data systems for planning and monitoring public investment. In early 1987, the Government launched an ambitious program to alleviate the impact of the economic crisis on the poorest groups through the Emergency Social Fund, which supports small sub-projects to generate productive employment and social assistance efforts (e.g. maternal health care and school feeding). The Government sustained the adjustment program in the face of the collapse of the international tin price in 1985/86 and difficulties caused by delays in payment by Argentina for Bolivian gas shipments. The new policy stance succeeded quickly in restoring macroeconomic stability. Immediately following the introduction of the New Economic Policy, inflation fell dramatically and has generally remained between 10% and 20%.

6. Despite the remarkable achievements of the former administration, the new Government faced a near financial crisis upon taking office in August

1989, created by arrears in Argentine payments for gas shipments, the settlement of large obligations with foreign oil contractors, a deteriorating fiscal position, and an outflow of short-term capital due to election-related political uncertainty. The Government took decisive steps to restore confidence and increase revenues through large increases in public prices and tight controls on expenditures. This program has been successful. The fiscal deficit has remained within agreed IMF targets, falling from 6.7% of GDP in 1988 to 3.3% of GDP in 1990. The consumer price index rose by 18% in 1990.

7. The Government has achieved considerable success in its negotiations with foreign creditors, including elimination of Bolivia's debt to Argentina in return for canceling Argentina's arrears on gas payments, further progress in retiring Bolivia's commercial bank debt, establishment of a new mechanism for retiring a portion of Bolivia's debt with Brazil and the receipt of a highly-concessional debt rescheduling agreement from the Paris Club, including the so-called Toronto terms. Altogether, these agreements reduced Bolivia's debt to GDP ratio from 102% at end-1987 to 79% by end-1990, despite a total net inflow of almost 7% of GDP estimated over this period. Debt service fell to 42% of exports in 1990, compared to 72% in 1987.

8. The IMF has supported the Government program through the Enhanced Structural Adjustment Facility (ESAF). The third-year ESAF arrangement was approved by the IMF Board on July 3, 1991. A joint Bank/Fund/Government Policy Framework Paper has served as the basis for the adjustment program in each of the previous three years. The IMF and the Bank have cooperated very closely on the Bolivian program. IMF staff participated in discussions during development of this Credit, and our policy recommendations are identical.

9. Despite the high quality of macroeconomic policy, the recovery from the 1980-85 economic crisis has been slow. GDP grew for the first time in six years in 1987, but by only 2.1%. GDP growth has averaged only 2.8% in the period 1988-89, and GDP per capita has stagnated in real terms since 1986. A major reason for the poor performance of the economy has been the low level of investment. Gross domestic investment was only 11% of GDP in 1990, and private fixed investment was only 4% of GDP. Net direct foreign investment was less than 1% of GDP, despite attractive opportunities in hydrocarbons and mining. Additionally, continued losses by public banks, the weak portfolios of some private banks, and some low-productivity public sector investments indicate that a portion of this low level of investment is not allocated efficiently. There is some evidence of an improvement in the supply response in 1990, including a rapid expansion of agricultural exports, reports of increased interest by foreign investors and a sharp rise in non-tin, private sector mining.

10. In accordance with its strategy to focus public sector intervention towards improving education, health and poverty alleviation, the Government has made a significant shift in its investment program toward the social sectors. Expenditures for health have increased from US$9 million in 1989 to US$20 million in 1990, and a well formulated national health program has been established. Expenditures on education also increased somewhat from US$10 million in 1989 to US$14 million in 1990, but the sector is still lacking a major policy reform to improve the delivery of services. These increases, though small compared to the absolute requirements, are a major step towards fulfilling Bolivia's policy goals as well as developing the strong human resource base necessary for sustained economic development.

Medium-Term Prospects

11. Although Bolivia's adjustment program has successfully created the foundations for sustainable growth, Bolivia is now entering its fifth year of slow growth. GDP rose by only 2.5% a year in the period 1987-90, below the annual 2.8% rise in population; consumption per capita continues to decline; and private investment remains below 5% of GDP (and a portion of that amount is financed by donor funds). Slow growth, in part, has been due to the collapse in tin prices, erratic payments from Argentina for Bolivian gas shipments, and a severe drought. The larger problem, however, is the low level and impaired productivity of investment. Constraints to improved investment performance include: (i) an inadequate legal framework to encourage private investment; (ii) misallocation of capital through the financial system; (iii) inefficient operation of public enterprises; (iv) weak institutions and cumbersome bureaucratic procedures governing trade and company registration; and (v) inadequate levels of infrastructure and social services.

12. The Government's medium-term strategy aims to achieve a GDP growth rate of at least 4% per year, to maintain price stability, and to alleviate poverty (projections data are given in Annex I):

(i) Higher GDP growth will depend largely on an acceleration of private sector economic activity. Private savings must rise strongly, from 3% of GDP in 1990 to over 6% by the year 2000. This, coupled with increased inflows of direct investment, would enable private investment to rise from the very low 4% of GDP in 1990 to over 7% by the year 2000. Key public policies essential to facilitate an increase in the level of private sector investment include: maintenance of an appropriate incentives structure with free determination of interest rates, wage rates and other prices; a low and uniform tariff policy and the absence of quantitative constraints on trade and capital flows; and a substantial increase in infrastructure and other public services.

(ii) Stability will require continued tight fiscal policies and market determination of the exchange rate. The further decline in the deficit of the nonfinancial public sector in 1990 was achieved through a sharp decline in the primary deficit (i.e. excluding interest payments), from 1.3% of GDP in 1989 to near zero in 1990. This is a remarkable achievement for the Government of Bolivia, which had a primary deficit throughout the 1980s. It will be essential to maintain a primary surplus over the next ten years to ensure stability. Given constraints on external lending, any substantial increase in the deficit would have to be financed either by an unsustainable rise in domestic debt or by inflationary rates of money growth. Deficit control will be facilitated by elimination of loss-making public enterprises in the financial and productive sectors and by increased private sector participation in mining and hydrocarbons (which cannot be privatized owing to Constitutional restrictions) and in the provision of some public services.

(iii) Substantial increases in public sector expenditures and a reallocation of expenditures to serve the poorest groups are essential to make any progress in alleviating the worst instances of poverty. Health and education presently account for less than 10% of total public sector investment, and current expenditures in the social sectors are disproportionately directed at curative health care and university level education, as opposed to primary health care and basic education. This imbalance must be corrected if real progress is to be achieved in reducing poverty and developing the human capital essential for economic growth in the long term.

13. The principal dilemma facing the Government which emerges from this analysis is that a decline in the deficit of the public sector must be accompanied by an increase in the supply of essential public goods, both to complement private investment and to alleviate the worst instances of poverty. To some extent, increases in public goods can be financed through eliminating losses (for example by public banks and state enterprises) and by improvements in the efficiency of investment. However, it is likely that the increases in public goods necessary to support acceptable levels of growth will require some increase in expenditures. Higher levels of public expenditures can only be reconciled with continued declines in the deficit by raising tax revenues. Tax collections under the present system are well short of potential, and it is likely that considerable increases in revenues can be achieved through improved administration and control. The Bank and the IMF have worked closely with the Government to improve tax enforcement, and this Credit would support this effort through a study of means of reducing tax evasion and development of an action plan to implement the study's recommendations (see Annex XVI).

14. A major question is whether growth of 4% per year is consistent with the availability of external and internal finance, given Bolivia's large debt burden, low savings rate and worsening terms of trade projected as of 1992. To achieve this average growth rate, investment would have to rise from 11% of GDP in 1990 to 18% in 2000, financed by higher domestic savings, increased private capital inflows, and continued assistance from donors, including new lending and debt relief from bilateral creditors.[1] Domestic savings is expected to rise from 8% of GDP in 1990 to 16% by 2000, encouraged by a stronger fiscal effort and increased confidence in the maintenance of appropriate macroeconomic policies. While domestic savings would rise substantially from present levels, savings would remain below the average of 17% of GDP achieved in the decade of the 1970s. An improved incentives framework should encourage increased inflows of net private capital, from close to zero in 1990 to above 1% of GDP by 2000, which together with an increased private domestic investment effort should result in a stronger supply response[2]. Disbursements from official donors should average 5% of GDP from 1991-2000, a decline from the 7% of GDP received in disbursements over the past two years. The expected decline in debt-creating capital

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[1] Bolivia is not expected to be creditworthy to receive lending from commercial banks over the next decade.

[2] This may be a conservative estimate of the potential for private capital inflows, given the recent passage of laws which provide a more appropriate environment for foreign investment than previously.

inflows is necessary if Bolivia is to reduce its excessive debt burden. In addition, bilateral creditors would provide continued debt relief through the Paris Club, amounting to 1.1% of GDP from 1991-2000. This assumes provision of concessional rescheduling terms comparable to the recent agreement, at least for the next few years. Repayment of all scheduled debt service would be futile for Bolivia and its creditors, as it would make it impossible to finance the investment necessary to produce the output and exports essential to service the debt.

15. This scenario would permit a substantial reduction in dependence on foreign lending and a sharp decline in the debt burden; the current account deficit is projected to fall from 8% of GDP in 1990 to 5% by 2000, and the debt to GDP ratio from 79% in 1990 to 50% in 2000. Consumption per capita is projected to rise by less than 1% per year on average, a relatively slow recovery from present, depressed levels. This is a feasible scenario, consistent with Bolivia's potential and predicated on a considerable adjustment effort. However, it will not be achieved unless the comprehensive structural reforms proposed under this Credit are implemented in the very near future. Further delay and continued economic stagnation will undermine public support and make the sacrifices required for successful adjustment difficult to obtain.

Bank Group Operations and Strategy

16. Total lending from the World Bank Group as of June 30, 1991 stands at US$911.8 million, consisting of 16 loans for US$274.8 million and 41 credits (including IDA-reflow credits) totalling US$637.1 million (see Annex II). The 16 loans are fully disbursed; 21 credits (including two of the three IDA-reflow credits) have also been fully disbursed. The remaining 16 credits have US$244.4 million undisbursed as of June 30, 1991. Bolivia has repaid the Bank US$161.9 million and has a total outstanding IBRD debt of US$124.2 million and IDA debt of US$625.7 million.

17. Although the Bank Group has been involved in Bolivia since 1964, no new loans were made between 1980-1985 due to poor economic management and lack of creditworthiness. Lending operations were resumed in FY86. Total lending between FY86 and FY91 was US$503.5 million, including three policy-based operations (a Financial Sector Adjustment Credit and two Reconstruction Import Credits) and two institutional development operations to strengthen public sector management.

18. The Bank has played and will continue to play an important role in the design and implementation of Bolivia's economic reform program and in the mobilization of needed financial resources to support the program. The PFP, prepared annually by the Government, the Bank, and the IMF, establishes an appropriate policy umbrella for Bank adjustment and investment operations. The Bank's basic strategy has been to support the objectives of the Government's economic adjustment effort by: (i) carrying out analyses of macroeconomic, structural and sectoral reform programs through economic and sector work; (ii) designing and implementing a lending program through both adjustment operations and investment lending to increase economic growth and strengthen the performance of the public sector; (iii) assisting to develop the institutional capacity of the public sector; (iv) improving aid coordination to ensure adequate overall funding for Bolivia's economic

program; and (v) improving the delivery of technical assistance to key institutions.

19. The Bank's assistance to Bolivia focusses on several of the key priorities of the Government's development strategy. For the future, the overall level and pace of Bank assistance for Bolivia will take into account the progress made in the implementation of the PFP. The planned volume of lending for the FY92-94 period is expected to be about two to three operations annually amounting to about US$60-65 million a year.

Macroeconomic Stabilization and Structural Reforms: The Bank is addressing necessary structural reforms in economic policy to increase competition and establish an appropriate incentives framework for private sector development. **Past Operations:** The **Financial Sector Adjustment Credit (FY88)** is helping to strengthen Bolivia's banking system by improving banking regulations and supervision. The **Mining Sector Rehabilitation Operation (FY89)** is promoting new private mining investment, supporting the restructuring of the state mining company (COMIBOL) to become a holding company, strengthening key mining sector institutions, and assisting the Government in dealing with mining environmental issues. **Future Operations:** The center piece of IDA lending operations will be the proposed **Structural Adjustment Credit** described in this document.

Public Sector Administration: Weaknesses in public sector administration remain serious constraints on Bolivian development, and the Bank has an active technical assistance program to improve the efficiency of public sector management. **Past Operations**: The **Public Financial Management Operation I (PFMO - FY88)** and its follow-on project **PFMO II (FY91)** are designed to strengthen financial management through reform of tax administration, restructuring of the central bank, and changes in the financial administration and control system over the public entities. The **Economic Management Strengthening Operation (FY89)** is supporting needed improvements in the management of the public investment program, advancing the process of decentralization, increasing the coverage and quality of statistics, and beginning a pilot program for improving public sector management and eventually reforming the civil service. **Future Operations**: Over the next several years the main focus of Bank efforts in this area will be on the implementation of the recently approved Second Public Financial Management Operation.

Sectoral Policy Reforms and Investments: The supply response to Bolivia's structural reforms will depend on continuation of policy reforms at the sectoral level and on appropriate investments in infrastructure and private production activities. The Bank will continue to focus its support to the Government on operations in agriculture and infrastructure, and on increasing the provision of financial resources to, and strengthening the productive base of, the private sector. **Past Operations**: The **Eastern Lowlands (FY90)** project is supporting the development of commercial export agriculture in eastern Bolivia and developing a plan for the rational and sustainable development of its renewable natural resources. The **Agricultural Technology Development Project (FY91)** aims to improve the research and development capacity in the sector with a view to improving the productivity of farmers in the poverty stricken highland of Altiplano. The **Export Corridors Project (FY89)** operation aims to improve Bolivia's railway and road infrastructure, making them more efficient and reliable for developing exports. The **Major Cities Water and Sewerage Rehabilitation Project (FY91)** aims to improve both the physical and financial management of water/sewerage systems in the major cities of Bolivia. The **Private Enterprise Development Project (FY90)** will help small and medium industrial enterprises improve their access to the formal credit system and strengthen their marketing, accounting and management skills. **Future Operations**: The agricultural sector will be supported by the proposed **Agro-Export Development Project** to promote increased production and exports of non-traditional products. The transport sector will be supported by the proposed **Road Maintenance II** which aims to improve the Government's management of road maintenance activities as well as to further enhance the private sector involvement in road works. In addition, infrastructure investments are essential to enable Bolivia to export its considerable natural gas resources. The proposed **Bolivia-Brazil Gas/Power Pipeline Project** would develop the facilities necessary for the generation of electricity using natural gas and its export to Brazil (enclave IBRD loan).

Poverty Alleviation and Human Resource Development: Improvements in public services provided to the poor are essential to achieve greater social equity and to build the human capital necessary to support economic development. Thus, the Bank will continue to place a high priority in sector work and in lending operations to provision of primary health and education services and to projects targeted on poorer communities. **Past Operations**: The **Integrated Health Development Project (FY90)** supports improvements in the delivery of health services, institutional strengthening, and training. The **Social Investment Fund (FY90)** will assist the Government in financing social development projects, building on the successful experience of the Emergency Social Fund. **Future Operations**: Little work has been done to address the very severe organizational problems affecting education. A reform program for the education sector will be supported by the proposed **Primary Education Project** which will address the issue of improving literacy, provision of education to a higher proportion of the population, and improving efficiency.

Environment: Bolivia faces a number of severe environmental problems that constrain development. **Past Operations**: Several of the above projects contain components to support prudent environmental management, notably the **Eastern Lowlands** project and the **Mining Sector Rehabilitation Operation. Future Operations**: The proposed **Environmental Technical Assistance Project** would assist the Government in : (i) formulating a strategy for addressing environmental problems; (ii) designing a coherent set of policies and instruments consistent with the strategy; and (iii) strengthening institutions to implement policies through appropriate regulations, laws, and incentives. Also, a proposed **Mining and Environment Project** would address the very difficult environmental issues surrounding the development of Bolivia's considerable mineral resources.

20. Economic and Sector Work. The intellectual underpinnings of our dialogue with the Government on policy issues and macroeconomic and sectoral strategies have been established through our economic and sector work (ESW). In an effort to rebuild our country knowledge and investment pipelines, a major ESW program was carried out in FY88 and FY89. Special attention was given to issues of poverty alleviation, women in development, and public investment (with completion of major reports on each issue). An in-depth assessment of the public sector investment program and analysis of the sustainability of fiscal and monetary policy over the medium term was carried out under the Updating Economic Memorandum completed in FY90. Public sector investment and expenditure reviews have been carried out every year since 1987. A poverty report (8643-BO) was distributed to the Board in 1990, which provides an overview of poverty issues and will propose an action plan for poverty alleviation, with special emphasis on the role of women. On the sectoral level, analytical work in the health, education, transport, banking and financial sectors and water supply was completed during the FY87-90 period. These documents formed the basis for agreeing with the Government on a specific strategy to be followed for each sector, and for IDA investment operations.

21. As for the next phase of the ESW program, a general economic review, along with public sector expenditure reviews will continue to be carried out on an annual basis. Over the next two years, the focus will shift towards the productive sectors and further privatization efforts. The main area which requires in-depth investigation is the agricultural sector, where issues related to land tenure, rural credit, export promotion, product development and extension services require a clear strategy for future development. Special focus will also be given to the issue of environmental protection, with particular emphasis on the agricultural and mining sectors.

22. Cooperation with the IMF. The Bank has worked closely with the IMF in the design and execution of adjustment operations, in formulating the lending strategy, and in economic and sector work. Since 1987, the Bank and the IMF have carried out joint annual missions to develop with the Government the Policy Framework Paper. There has also been frequent cross-mission support. For example, Bank and Fund staff recently cooperated in the presentation of a financial reform program which will be supported by this Credit. Considerable effort is made by staff of each institution to comment on the other's work, to use a common database, and to ensure consistent conditionality in lending operations.

23. Aid Coordination and Cofinancing. The Bank has been very active in aid coordination in Bolivia over the last few years, with efforts directed at helping ensure that both the amount and composition of donor assistance are appropriate to Bolivia's circumstances. In particular, annual Consultative Group meetings have become an effective mechanism for donor coordination and consultation, as well as for aid mobilization. The most recent Consultative Group meeting was held in October 1990, and was very successful in generating increased commitments of donor assistance to Bolivia. The meeting focused on continued macroeconomic stability, public investment implementation issues, the next phase of the adjustment process to ensure a return to growth, environmental issues, alternative development, and issues of poverty alleviation and human resource development.

24. A number of investment and adjustment operations have attracted a substantial amount of co-financing (particularly the Financial Sector Adjustment Credit, Emergency Social Fund,and the Social Investment Fund); this trend is expected to continue. In addition, Bank reports, particularly the Country Economic Memoranda and the Public Investment and Expenditure Reviews have facilitated improved aid coordination by providing a policy framework and strategy which can be drawn on by other donors.

25. IFC Operations. IFC has been active in Bolivia every year for the last five years, after six years of inactivity. In FY91, IFC's Board approved four projects: (i) the expansion and restructuring of Puerto Aguirre, a port facility on the Tamengo canal which allows access to the Atlantic Ocean along the Paraguay river; (ii) GENEX S.A., a project to substitute gasoline with compressed natural gas in public transport vehicles; (iii) Minproc Bolivia S.A., a promotional company to do the pilot test work for a project to retreat tailings from the Colquiri mine and (iv) a cross-currency interest rate swap facility to help Banco Industrial S.A. (BISA) hedge against foreign exchange risk and diversify its sources of funding similar to the one approved by the Board in FY90 also for BISA. In FY89, IFC's Board approved a US$10 million investment in COMSUR, Bolivia's largest private mining company. Prior to this, IFC had two projects in Bolivia, a loan to BISA for US$10 million approved in FY88, and another for US$1.2 million to COMCO S.A. (a medium-size mining company) for extracting silver from ores, which was approved in FY87. This year IFC plans to assist in attracting private sector capital to COMIBOL (mines), and providing financial assistance to medium-size enterprises through financial intermediaries. IFC expects to increase substantially its investments in Bolivia over the next three to four years. It is likely to concentrate its investments in mining, energy, and agro-industries.

26. MIGA Operations. Bolivia was one of the first signatories of the MIGA agreement, which its Congress ratified in 1990. The Government has made its capital contribution to MIGA, although there are still no MIGA operations in Bolivia.

Summary

27. Bolivia is now entering its fifth year of economic stabilization without significant growth. The elements required for resumption of real per capita income growth, are first, to maintain economic stability; second, to continue economic restructuring through enacting and implementing legislation to encourage private sector investments, while moving the state out of the productive sectors and eliminating the state's role in direct lending operations through liquidation and privatization; third, to improve the efficiency of state provision of infrastructure; and fourth, to move aggressively to alleviate poverty through better focussed involvement in the health, education and water sectors.

28. Given the recent approval of legislation setting the incentive system for private sector investments, the performance of Bolivia over the next one to two years should be judged on (i) adherence of the Government to the fiscal and monetary targets required to maintain macroeconomic stability (agreed to under the ESAF and PFP); (ii) the pace of public sector reform (i.e. privatization or liquidation of public enterprises and improvements in the management of enterprises remaining in the public sector); (iii) pace of financial sector reform (liquidation of public sector banks and enforcement of

financial sector regulations); and (iv) proper application of the investment, hydrocarbons, and mining laws to entice private sector investments and the SAFCO law to control Government and state enterprise operations.

29. The Bank's activity will focus around the continued assistance for (i) structural reforms, particularly in the banking/financial sector, public sector administration and trade procedures; (ii) improving efficiency of public sector administration; (iii) strong emphasis on improving the education, health and infrastructural sectors; and (iv) development of environmental protection legislation in the agricultural and mining sectors.

II. THE STRUCTURAL ADJUSTMENT PROGRAM

30. The proposed adjustment operation is designed to serve as a bridge from stabilization to sustained growth, and may well be the final adjustment operation necessary for Bolivia. It deals with a large and diverse set of measures, including many related to the financial sector, which remain impediments to efficiency and growth. The goal of the operation would be to increase the level and efficiency of private and public investments through improving incentives for and regulation of private sector economic activity, improving the performance of public sector investment and enterprises, reducing the share of productive activities carried out by the public sector and increasing the supply of necessary infrastructure and social services.

Summary of Issues and Objectives

31. The goal of the operation would be to accelerate recovery through increasing the level and efficiency of investment in the Bolivian economy. The financial sector component would improve the allocation of savings through the financial system by closing public banks that have incurred substantial losses and misallocated scarce investment funds, by improving the allocation of development credit financed by external donors, by strengthening supervision of the banking system and other financial intermediaries, and by removing various impediments to capital market development. The public enterprise component would assist the Government in strengthening major public enterprises that provide key public services, increasing private sector investment in mining and hydrocarbons (which cannot be privatized due to Constitutional restrictions) and privatizing public enterprises operating in other competitive markets. Streamlining of trade and registration procedures would facilitate trade and remove bureaucratic impediments that particularly impair investment by small businesses. The public sector investment component would assist the Government in improving investment project selection. Finally, to support long-term growth and to ensure that essential services to the poor are not curtailed as part of the adjustment effort, the social sector expenditures component would support increased targets for current expenditures on primary health care and basic education.

32. The Government made substantial progress during preparation on the reform program. The recent passage of the investment, hydrocarbons and mining laws was essential to ensure that the reforms proposed in this Credit result in substantial increases in investment and productivity. The investment law establishes an appropriate incentives framework for private investment. The mining law provides legislative sanction for joint ventures between COMIBOL and the private sector, and authorizes an optional tax regime that is consistent with tax policy in the home countries of most multinational

enterprises. The hydrocarbons law provides legislative sanction for joint ventures between YPFB (the State oil and gas company) and the private sector, expands the areas eligible for private sector exploitation and eliminates the restriction on private sector ownership of oil and gas pipelines. The Government also improved the allocation of donor-financed development credit by raising interest rates charged financial intermediaries to market levels, eliminating restrictions on interest rates charged final borrowers and providing access to development credit to non-bank financial institutions. These measures show the Government's willingness to make politically difficult decisions in support of long-term development and increase the credibility of the Government's commitments under the Credit. Preparatory work for the credit was supported by a Project Preparation Facility of US$750,000 approved in September 1990.

Financing Implications of the Adjustment Program

33. Budgetary impact. The policies supported by this Credit would reduce substantially drains on public sector revenues over the long term, by closing or restructuring the state banks, eliminating loss-making public enterprises, improving the efficiency of enterprises remaining in the public sector, and reducing potential Government losses to commercial banks. However, the program will incur substantial short-term costs, particularly the payment of unfunded pension liabilities and severance pay to workers and realization of financial losses incurred by the state banks. At this time, it is not possible to estimate the total cost to the public sector of the financial liquidation of the state banks because: (i) the share of the banks' assets that will be recovered is uncertain; and (ii) the banks' accounts do not show which elements of their balance sheets are claims on or liabilities to other public sector entities. Therefore, the full costs of the liquidation of the state banks will only become known during the liquidation process, although we expect that these costs will be substantial. At this time we can only provide an estimate of the amount the dismissed workers are legally entitled to which would be covered by the counterpart funds for the credit. This figure should be taken as a substantial underestimate of the likely short-term costs of the program. We anticipate that somewhat less than 1500 workers now working for the public sector banks would be dismissed under the program.

Table 1: Severance Costs
(US$ Thousands)

ENFE RESTRUCTURING	10,000
CLOSURE OF BAMIN	2,300
CLOSURE OF BAB	955
RESTRUCTURING OF BANEST	5,400
TOTAL	18,655

Note: Severance costs for the three state banks reflects legal entitlement only, and thus excludes any premium which may be paid for severance.

34. Balance of payments requirements. There is no question that Bolivia needs substantial balance of payments support. The current account deficit is projected to average 8% of GDP over 1991-93 (the period covered by the program), and net reserves are less than 1% of GDP. We anticipate that with this Credit, sufficient external resources will be available over the next

three years to finance the projected deficit and provide for a moderate rise in reserves. These resources will consist largely of assistance from donors and rescheduling by the Paris Club (see Table 2). Bolivia will experience no difficulty in servicing World Bank debt. The total IDA/IBRD debt outstanding is projected to remain at about 11% of total debt, and IDA/IBRD debt service is projected to fall from 6% of exports at this time to 2% by the mid-nineties, due to the increasing share of IDA debt.

Table 2: External Financing Requirements
(US$ millions)

	1989	1990	1991	1992	1993
Total Finance Required:	603	591	648	710	696
Current Account Deficit	393	357	417	452	467
Amortization Owed	210	234	231	258	229
Financed by:					
Official Grants	134	138	160	181	196
Disbursements	397	388	341	331	315
IDA	79	48	60	67	72
(of which this operation)			10	20	10
Other Multilaterals	165	180	157	172	185
(of which IDB parallel financing)			40	50	30
Bilaterals	153	160	125	93	58
Rollover of Bilateral Amortization	69	104	113	130	82
Change in Reserves	140	-99	-75	-50	-30
Other a/	-142	60	109	118	132

a/ Includes errors and omissions, changes in arrears, debt relief from Brazil and private capital.

Experience with Policy-Based Lending

35. The only major adjustment operation since the 1985 stabilization program has been the Financial Sector Adjustment Credit (FSAC - BO-1925), which supported significant improvements in prudential regulations and supervision of the financial system. The Credit achieved considerable success in supporting the implementation of stricter prudential regulations, in building an independent Superintendency of Banks which has improved considerably the supervision and regulation of the banking system and in encouraging a substantial increase in capital on the part of the commercial banks. The progress made under that Credit, particularly the strengthening of supervision, is a prerequisite to the improvements in financial sector operations envisioned under the present operation. Additionally, this Credit would propose major reforms in two areas in which the Government had less success under the FSAC: the reform of state banks and the managing of banking crises. One lesson from the FSAC concerned the strength of the resistance to reform of the state banks from those who had benefitted from implicitly subsidized credit. To ensure the success of the current program, closure of the agriculture and mining bank and cessation of lending by the state bank were met as conditions to Board presentation of this Credit.

III. FINANCIAL SECTOR REFORM

Introduction

36. Financial sector reform is essential to ensure that scarce investment resources are channeled to the most productive uses. The Central Bank already has taken steps to increase the availability of medium- and long-term financing by removing restraints on interest rates on rediscounted credit and auctioning externally financed development credit to financial intermediaries. Interest rates are fully market-determined in Bolivia and financial institutions are in no way forced to lend to particular sectors nor limited from doing so. The Credit would support further measures to eliminate misallocation of credit through the public banks, strengthen supervision of the banking system to improve the soundness of financial intermediaries, and remove impediments to the development of capital markets.

Structure and size of the financial sector.

37. Bolivia's formal financial sector is dominated by the 13 private, domestic commercial banks, which hold over 70% of assets, loans and deposits of the financial system. Other financial institutions include the four foreign banks[3/], three state-owned banks, 12 savings and loans, cooperatives, regional financial funds, public warehouses, finance companies and money exchange brokers. There are also extensive informal markets, but data on such intermediation is not available.

3/ While foreign banks are not subject to special restrictions, most left Bolivia by the late 1980s due to poor profitability, capital losses and an unwillingness to support existing or new country exposure. The remaining foreign banks provide only limited financial services.

Table 3: Financial System Indicators
(%)

	Assets	Loans	Deposits
Shares of Financial Assets a/			
Private Domestic Comm Banks	72.0	77.2	84.5
Private Foreign Comm Banks	1.7	0.7	1.4
State Banks	12.5	9.1	4.1
Total Banks	86.1	87.0	90.1
Other Intermediaries	13.9	13.0	9.9

	$Bs	CMV b/	US$	Demand	Savings	Fixed Term	Other
Shares of Deposits c/	11.7	7.2	80.8	13.1	13.3	73.0	0.6

a/ As of November 30, 1990.
b/ Denominated in bolivianos but indexed against the US$.
c/ Shares of bank deposits as of January 13, 1991.

Source: SBEF.

38. The Bolivian banking system does not appear to be heavily concentrated, at least so far as size of banks is concerned. Assets, deposits and equity of the banking system are well distributed across banks, with each private commercial bank, for example, holding between 3.5% and 17% of total assets. Banks tend to be privately held by a single owner or majority shareholder and tend to be part of financial groups that control companies in one or more sectors.

39. The size of the banking system has grown significantly over the past two years. Deposits in the banking system grew 23% in US$ terms during 1989 and 35% during 1990. The composition of deposits has also changed over this period: the volume of dollar and dollar-indexed deposits increased from 76% of the total at end-88 to 89% at January 13, 1991, and demand and savings deposits taken together increased from 20% of total deposits to 26%. Confidence has risen sufficiently to encourage a return of funds to the banking system after the period of uncertainty following the election in 1989. Even so, the bulk of these funds are deposited at short-term maturities, and bank loans funded by their own resources (that is, excluding development loans funded by international donors) are largely short term.

40. Interest rates have remained high in nominal and real terms since the elimination of interest rate controls in 1985. The interest rate on dollar deposits is now about 14%, and the lending rate averages about 20%. The dollar interest rate is the most relevant indicator of financial conditions, as 88% of deposits are either dollar deposits or are tied to the dollar (see Table 3). The major factors driving the level of interest rates are perceived country risk due to the chaotic economic conditions prior to 1986, the high level of non-performing loans, and banks' high operating costs.

Main Issues Affecting the Financial Sector

41. Misallocation of credit by public banks. Government owned banks have imposed heavy losses and impaired the productivity of investment. The financial and management conditions of the four public banks and funds now in

operation, *Banco Agrícola* (BAB), *Banco Minero* (BAMIN), *Fondo Nacional de Exploración Minera* (FONEM) and *Banco del Estado* (BANEST) are poor. All four institutions have high levels of non-performing assets, have inadequate credit approval procedures and have suffered considerable losses which have been absorbed by the Treasury. Efforts to restructure the banks (supported by IDA's Financial Sector Adjustment Credit, or FSAC) failed, due to the Government's inability to progress from the action plans (required under the FSAC) to implement full-fledged restructuring plans.

42. **BAB** has incurred substantial losses, primarily stemming from the poor performance of its portfolio. As of November 1990, BAB's overdue loans accounted for 67.8% of the total loan portfolio. In addition, an estimated 61% of the performing portfolio has been rescheduled with significant reductions in interest payments. A large number of credits have been overdue for several years and the bulk of BAB's portfolio is composed of a large number of small loans (28,000). Several law firms have been hired to start judicial procedures to recover the overdue portfolio. The bank shows a positive net worth because of a subrogation of the bulk of its debts by the Treasury (the last subrogation amounted to the equivalent of US$51 million).

43. In September 1990 the Government issued Supreme Decree 22602 forgiving interest payments during the period 1985 through September 1990, on loans below US$5,000 which were affected by natural disasters. The BAB has interpreted this Decree very liberally, as entitling any small borrower which attempts to reschedule a loan received after 1985 to the forgiveness of interest payments. It is estimated that BAB will lose the equivalent of US$15 million as a result of this measure. This figure is very high when compared to BAB's total credits since 1985 (US$20 million).

44. BAB's credit weaknesses stem in part from the composition of its staff and its politicized nature. Its credit officers lack essential skills and its financial analysts and accountants are primarily agronomists without financial training. Internal financial controls are also inadequate. The highly politicized nature of BAB activities, its operational weaknesses, and its lack of financial discipline have resulted in a substantial misallocation of capital.

45. BAB continues to have high administrative costs and thus far has not been able to recover overdue loans. It has been financing its expenses from recoveries of previous loans, thus further eroding its capital base. BAB's staff continues to grow (the mission found that 121 employees [more than one-third of BAB's current 301 employees] were hired since 1988);

46. The willingness of BAB to reschedule debts and its propensity to increase its staff suggest that it would be very difficult to turn around the institution because of its inability to withstand political pressures to use it to provide subsidies or employment.

47. **BAMIN** was initially established to provide credit to small and medium size mining companies that lacked the collateral to gain access to commercial bank loans. However, BAMIN's loan portfolio is heavily concentrated in a small number of large borrowers, so that it has not been an effective means of serving this target group. BAMIN's overdue loans are estimated at 49% of the total, and there is evidence that BAMIN's financial statements understate the

problem. From August 1989 to June 1990 BAMIN lent a total of US$11.6 million. If this recent lending matches the profile of BAMIN's previous lending, it will add over US$5 million to losses. BAMIN has also steadily lost money on its many other operations, most of which are incompatible with its status as a bank.

48. While the bank is not engaging in any new lending (due to a lack of funds) it is financing its significant operating expenses with loan recoveries, thus further eroding its capital base. The bank is not servicing its obligations to its creditors, a portion of which has been assumed by the Treasury.

49. BAMIN's management has begun a restructuring plan which involves elimination of some activities, a reprogramming of its loan portfolio and reprogramming of its debts to donors. However, such efforts have yet to pay off. They have received some proposals from debtors but most involve a rescheduling of obligations with substantial forgiveness of interest and capital. On December 5, 1990 the Government issued Supreme Decree 22664 reinstating the public nature of BAMIN (its ownership and Board will again be fully composed of Government officials), instructing BAMIN to contract law firms to start judicial procedures against overdue clients, and authorizing BAMIN to hire an external consulting firm to prepare a diagnosis of the institution and proposals for its restructuring.

50. BAMIN's 1991 budget proposal called for staff increases from its current level of 539 to 622, calling into question the seriousness of the institution in attempting to resolve its financial problems. BAMIN's senior managers are not convinced of the need to close the bank and believe that the bank can be fully privatized. The only function which BAMIN could privatize (and even this is doubtful) is the commercialization of minerals.

51. **FONEM** is another source of public sector losses in mining in its financing of prospecting and high risk exploration. FONEM's rate of loan recovery has been poor owing in part to the high-risk nature of its investments. FONEM really has no viable role in the mining sector other than to subsidize private mining operations. Under IDA's Mining Sector Rehabilitation Project, the Government had agreed to deactivate FONEM once its current program expires. Unfortunately, a more precise timetable was not agreed upon, and so far the Government has resisted liquidation of FONEM. A comprehensive audit of FONEM's accounts is now underway, which will measure the extent of losses from FONEM's activities.

52. FONEM's managers believe that despite their poor track record, their functions are fully justified. FONEM finances its administrative expenses and its small lending program (providing funds only to those projects considered successful) through the 1% earmarked tax on gross mining production and through the small recovery of loans on successful operations. It has not received other Treasury support in the past 18 months. It is only servicing a small proportion of its debt with the Central Bank for the use of credits from bilateral and multilateral creditors (including IDA).

53. **BANEST** suffers from a large volume of non-performing loans, high administrative costs and poor credit analysis and supervision. Most of

BANEST's loan portfolio--approximately US$48 million[4/]--is classified as lost. Despite the development of a restructuring plan and the hiring of a group of specialized consultants under the FSAC, BANEST has not demonstrated improvement in its organizational structure, credit or operating procedures. BANEST has not demonstrated that its lending in any way redresses market failures, and lacks the institutional capacity and financial discipline to effectively lend to its targeted groups. BANEST's continued misallocation of capital is confirmed by the poor quality of its new lending program (which began in November 1989 after a two-year hiatus), including inadequate credit evaluation, inadequate reporting of arrears, and rescheduling of loans.

54. BANEST also performs other functions, including using its large network of branches to take public deposits, serving as a depository and window for both the Treasury and the Central Bank, and providing financial services for provincial and local governments and public enterprises. In many cases, some of these functions could be absorbed by commercial banks. These issues are discussed in Annex VII.

55. Channeling of Development Credit. Development credit refers to loans financed by donor funds or multilateral agencies and channeled through the commercial banking system. In 1989, development credit accounted for one-third of the total increase in credit from the formal financial system. The Government has made substantial progress in improving the allocation of development credit. The Government eliminated restrictions on the interest rate charged to the final borrower, has established an auction system to determine the interest rate charged to commercial banks, and is attempting to reduce directed credit requirements imposed by donors. The Government also has begun a promising effort to increase access to credit by groups not served by commercial banks (for example small farmers and micro-enterprises), by extending eligibility for development credit to non-bank financial intermediaries. Under this program, organizations that work with groups not served by commercial banks would be able to on-lend development credit, at market terms, to these potential borrowers. This initiative is particularly important since these groups will lose whatever subsidies they received from the public banks. Special procedures will be required to ensure sound financial management of the new intermediaries.

56. Further improvements are required in development credit policy to ensure that these loans are directed to productive investments. In 1990 the Government issued two Supreme Decrees authorizing the rescheduling of up to US$42 million in development credit to the agricultural and mining sectors. The wholesale nature of this rescheduling implies a grossly imperfect targeting of subsidies, undermines the repayment discipline of debtors and the need for bankers' scrutiny of debtors' credit risk and loan concentration, and consolidates the public's view of the Government as the residual absorber of all financial risks.

57. Weakness of the Commercial Banks. Despite improvements in supervision, the banking system remains fragile. At the end of November 1990, non-performing loans for private domestic commercial banks represented 11.1%

[4/] This amount is essentially fully provisioned, and represents 55% of the total loan portfolio on a gross basis and 130% of the loan portfolio on a net basis (both adding back provisions).

of total loans and, at the end of October, doubtful or lost (Class 4 or 5) loans represented 2.8% of loans and approximately 24% of equity (adding back provisions). It is likely that these indices understate the default risk of the system. Concerted efforts to accurately classify banks' loan portfolios began over two years ago, and the process of improving reporting systems, training inspectors, and ensuring comprehensive audits is a lengthy one. Further, these average data obscure the particularly difficult position of some banks with a minimal amount of capital, a loan portfolio of questionable quality, and shortages of liquidity. Based on interviews with SBEF analysts and bank officials, it appears that a few of Bolivia's 13 private commercial banks have such poor risk management and asset quality indicators that an accurate representation of their portfolios would require a substantial increase in capital to meet minimum prudential standards.

58. Other indicators demonstrate the high level of risk faced by Bolivian banks. At the end of June, 1990, 80% of total bank deposits from the public were held in accounts with a maximum term of 30 days. The high share of short-term dollar accounts, as well as their concentration increases the risk of substantial deposit losses if confidence is impaired, as was demonstrated by the temporary run in financial markets in 1989. The banking system's heavy concentration of deposits and loans further increases risk. As of end-December 1989, 88% of the stock of deposits of private commercial banks were in accounts that had over US$5,000 and 45% were in accounts over US$50,000. Further, 76% of the stock of loans of private, domestic commercial banks were in amounts over US$25,000 and 54% were in amounts over US$100,000. High deposit concentration raises the vulnerability of banks to withdrawals by a small number of customers, while high loan concentration raises the vulnerability of banks to default by individual debtors.

59. It is important to note that in spite of the difficulties experienced by some banks and the default risk of the system indicated, the banking system has received new infusions of capital during 1990 amounting US$8.7 million (9% of the capital at the end of 1990). Much of this increase was to provide capital to accommodate the increase in public deposits (because of leverage limits). However, in addition the application of prudential regulations was also an important factor in requiring banks to recognize losses and put up additional capital.

60. Need for Continued Improvement in Prudential Regulations and Enforcement. Prudential regulations have improved considerably since late 1988, particularly due to the establishment of a strong and autonomous Superintendency of Banks (SBEF). Mechanisms have been established to limit bank leverage, loan concentration and loans to related parties, as well as to improve the loan classification system, institute and enforce provisioning requirements, and classify bank investments. Stronger supervision has helped to improve the soundness of the financial system. Five banks were sold in Bolivia during 1989, in several cases due to required increases in capital mandated by the SBEF. Efficient allocation of investment funds will require further efforts to formalize prudential regulations in law, increase the frequency of bank inspections, deepen SBEF's analytical capabilities, reduce banks' and the SBEF's reliance on guarantees versus project analysis, and strengthen supervision of non-bank financial intermediaries that take public deposits. Unfortunately, some political decisions have impaired prudential regulations. The increase in the maximum leverage ratio for banks in early

1990 from 15:1 to 20:1 seriously increased the default risk of the banking system and undercut efforts to ensure adequate capitalization of banks.

61. Inadequate Mechanisms for Managing Banking Crises. The FSAC supported efforts by the Central Bank (BCB) to establish guidelines for the rehabilitation or liquidation of banks, and to set up a unit (the *Gerencia de Sistema Financiero*--GSF) to anticipate banking crises and rehabilitate or provide financial assistance to problem banks. While initially successful in establishing a set of rules and an institution with the capacity for managing bank crises, this effort ultimately failed because: (i) the institutional capacity built up in the GSF was lost with high staff turnover; and (ii) the GSF never had the financial resources or political authority to take decisive measures. The failure of the GSF promptly to rehabilitate or liquidate banks in crisis points out the need for more automatic and less arbitrary mechanisms for intervention and the importance of reinforcing these mechanisms through provisions to a revised Banking Law. Also, Government coverage of deposits should be compulsory and should have a definite limit covering only relatively small deposits (i.e. below US$5,000).

62. Impediments to Capital Market Development Bolivia's domestic capital markets remain very small: the stock exchange trades only certificates of deposit issued by the Central Bank, companies finance the bulk of their activities by borrowing directly from banks or through informal intercompany lending that often involves significant transaction costs, and organized private bond or commercial paper markets are almost nonexistent except for limited private placements. Legal and regulatory provisions hindering development of domestic credit and securities markets include: (i) the legal prohibition of sociedades de responsibilidad limitada (representing 95% of all companies) from issuing or trading all forms of securities or from issuing equity; (ii) uncertainties about the nature and application of the financial transactions tax to privately issued securities; (iii) excessive documentation requirements associated with the public issue of securities; (iv) legal problems in re-possessing collateral whereby techniques available to commercial banks are speedier than that available for corporations; and (v) legal and regulatory ambiguities in Bolivia's commercial code concerning the types of institutions that can issue or trade securities on the stock exchange.[5/]

63. The legal impediments to the development of capital and credit markets are exacerbated by defects in Bolivia's commercial registration system and in procedures for re-possessing collateral. These problems are particularly acute for all forms of private non-bank lending and securities transactions secured by collateral other than real property. The defects in the registration systems are important, because they do not permit a lender to know with certainty that he will be the only creditor with a claim on the collateral (e.g. movable property) in the event of a default by the borrower.

64. Bolivia is also characterized by an underdeveloped and inefficient system of contractual savings (insurance, pensions, and social security). The

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[5/] For example, the code does not permit stock market agents to act as dealers (i.e. carry securities for their own account) which has hindered the efficient development of the government securities market since the stock market agents cannot act as underwriters of securities.

only private provider of health, disability or retirement benefits is the insurance industry which is small and is experiencing distress due to decapitalization of many of the companies. The two types of compulsory occupational pension plans (i.e. basic plans that are part of the social security system and complementary plans organized by sector) have financed only government real estate and fixed capital investments, resulting in significant current and expected deficits in the payments owed to retirees. Development of the contractual savings system has been hindered by the general lack of confidence by payees that they will realize the benefits promised (in real terms), exacerbated by inadequate supervision.

65. Compounding these problems are legal barriers that hinder competition within different segments of the contractual savings system. For example, no system of privately offered pensions is legally permitted and no means exists to permit competition in the management of pension fund assets through introduction of such institutions as Administradores de Fondos de Pensiones (AFPs). Transferability between pension plans also has been restricted at the time of unemployment, limiting competition and incentives for efficient management of the complementary pension funds that are not part of the social security system. Finally, asset restrictions (e.g. forced investments in government real-estate projects), government interference in the setting of minimum insurance premiums, inadequate liquidity of technical reserves, and restrictions that make it illegal for Insurance companies to issue debt have limited the effectiveness of insurance companies as alternative private providers of health and retirement benefits.

<u>The Proposed Credit</u>

66. The broad strategy of the financial sector reform program would be to improve the allocation of investment resources by eliminating the public sector's role in allocating loans while increasing competition in the context of effective prudential regulation and supervision of financial intermediaries. The main instruments to achieve these goals would include reform or liquidation of state banks, improvements in the allocation of development credit, institutional and regulatory improvements to strengthen banking supervision, and removal of impediments to the development of capital markets.

67. <u>Reform or Liquidation of State Banks and Funds.</u> Recognizing the importance of using only the private sector as an allocator of credit, the Policy Letter has indicated the Government's commitment to eliminating its role as a direct financial intermediary to private sector borrowers in the Bolivian economy, and its intent to privatize or close and liquidate the Bolivian Agricultural Bank (BAB), Bolivian Mining Bank (BAMIN) and The National Mining Exploration Fund (FONEM). The Government's strategy will be to begin steps to close and liquidate each institution, while leaving open the possibility of selling an institution at any point in the process if sufficient market interest exists. The Government has issued a Supreme Decree providing for the closure and liquidation of each institution. As a result, these institutions have: (i) ceased all lending operations; (ii) established plans for retaining only those employees directly involved in asset recovery or liquidation; and (iii) established programs for the recovery, sale, legal adjudication or liquidation of financial and fixed assets. These institutions will no longer be eligible for subsidies from the Treasury. A liquidator for each institution will be designated, and will be authorized to contract

external consultants to prepare liquidation plans and to initiate liquidation procedures (see Annex VIII).

68. As a condition for second tranche release, BAB, BAMIN and FONEM either will have been sold to the private sector (and all public sector responsibility for the institution eliminated) or closed. If closed, employees not directly involved in asset recuperation or liquidation will have been released, and the Government would be in compliance with the program for the recovery, sale, legal adjudication or liquidation of financial and fixed assets. As a condition for third tranche release, the Government will continue to be in compliance with the program for the recovery, sale, legal adjudication or liquidation of financial and fixed assets.

69. The Bolivian State Bank (BANEST) presents more complicated problems than the other public banks, as it provides a number of important financial services including taking public deposits, providing various services as an agent of the Central Bank, handling the bank accounts of public sector entities, and accepting tax payments.

70. The Government has set out in the Policy Letter its commitment to significantly restructure and restrict the functions of BANEST, and to accelerate the liquidation of BANEST's past due loan portfolio, assets received in lieu of loan payments, and other fixed assets, according to an agreed program. The Government has issued a Supreme Decree significantly restricting BANEST's functions, including cessation of all lending activities. BANEST will not receive any subsidy from the Treasury, and large taxpayers are now permitted to make contributions into commercial banks rather than being restricted to BANEST. The Government has indicated a plan to dismiss employees involved in lending operations (with appropriate compensation) and has initiated a branch-by-branch evaluation of the costs and benefits of providing the services indicated above in each, including an evaluation of offering such services through alternative institutions.

71. Based on the branch-by-branch evaluation of BANEST's functions indicated above, the Government by second tranche release will: (i) close those branches found not cost effective or justifiable; (ii) transfer to the private sector those functions now performed by BANEST which can be handled efficiently by the private sector; and (iii) be in compliance with the plan to recover, sell, adjudicate or liquidate financial and fixed assets. Alternatively, the Government can meet the requirement for second tranche release by selling BANEST in its entirety to the private sector, with no remaining Government participation. By third tranche, the Government will continue to be in compliance with the plan to recover, sell, adjudicate or liquidate financial and fixed assets.

72. The Government has issued a Supreme Decree modifying the objectives of the ***Fondo de Desarrollo Campesino*** (FDC) to ensure that the FDC will not have access to development credit for onlending purposes and will not be eligible as a direct financial intermediary to private sector borrowers. The Policy Letter commits the Government to define the FDC's role in serving the rural poor in the most effective manner possible, consistent with the Government's financial sector policies. The primary function of the FDC will be to provide assistance to poor rural communities, in the form of public services, infrastructure and technical assistance. To the extent that the FDC channels funds to financial intermediaries, the following conditions will apply: (i)

funds will be channeled only through eligible financial intermediaries (approved ICIs); (ii) the interest rate charged the ICI will be no less than the observed auction rate of development credits during the week prior; and (iii) funds will be subject to full recovery by the FDC as supervised by the Superintendency of Banks and Financial Intermediaries. More generally, in the Policy Letter the Government indicates that it will not establish new institutions for lending directly to the private sector.

73. Reforms in the channeling of development credit. The Government has indicated in the Policy Letter its program to prevent the misallocation of external credits for developmental purposes. To ensure that intermediation of development credit reflects market conditions, the Central Bank has established a floor rate on the auctioning of these credits. This rate is no less than the average borrowing rate of the commercial banking system, including public deposits (savings and time) and BCB *CEDES*. Further, in order to ensure financial discipline and full bearing of credit risk by ICIs in development credit lending, the Policy Letter commits the Central Bank to not rescheduling development credits unless an institution is intervened. Finally, to ensure that development credits do not finance poor projects, the Central Bank will require as a condition of eligibility for access to development credit, that ICIs maintain a share of non-performing loans on such credits no more than 50% higher than the average rate of non-performance for the private commercial banking system.

74. In order to widen the scope for supervised financial intermediaries to intermediate development credit and to reach areas and groups not presently served by the commercial banking system (particularly in light of the closure of the public sector banks), the program will support measures by the Government to establish new non-bank financial intermediaries (*Casas Bancarias*). The Government has issued a Supreme Decree authorizing the establishment of such institutions. Such institutions will be subject to the same or stricter prudential regulations than banks and potentially would be eligible to intermediate development credits. The Central Bank has issued a resolution clarifying the eligibility criteria for access of banks and these specific non-banks to intermediate development credit. Under the program, the Central Bank will not consider for ICI certification any non-bank financial institution that does not meet the legal requirements applicable to *Casas Bancarias*. Non-bank institutions presently certified will have until July 1992 to fulfill these requirements. Implementation of the eligibility criteria and sound supervision of ICIs are conditions of second tranche release.

75. Technical assistance would be provided under a separate but related IDB Credit to improve the management of development credit by the Central Bank, to ensure separation of development credit operations from Central Bank accounts, and to streamline credit approval procedures.

76. Improvement in Regulation and Supervision of Financial Intermediaries. A principal goal of the Credit is to ensure that strong, well managed banks can operate freely and that risky, poorly managed banks that do not operate within the required limits are recapitalized by the private sector, are restructured to improve risk management, and, if necessary, are closed and liquidated.

77. The Government has presented to Congress a law for the regulation and supervision of the financial system. Approval by Congress of the Banking Law is a condition of second tranche release, and implementation of the regulations is a condition for second and third tranche release. The law includes: (i) a minimum dollar amount of capital required for operation as a bank, (ii) a 6% minimum capital requirement in relation to assets, (iii) limits on the total amount of credits to individual borrowers, including credits to related parties, (iv) auditing, financial reporting and information disclosure requirements, (v) authority, autonomy and responsibilities of the SBEF, (vi) fines and sanctions for non-conformity with the law, (vii) conditions for bank intervention, and (viii) mechanisms for handling banking crises, including liquidation procedures.

78. The Government has developed an action plan for further progress in the strengthening of regulation and supervision of the banking system, consistent with the draft law. This plan includes: (i) strengthening of the classification system for commercial bank loans and investments, including the assessment of loan collateral; (ii) establishment of an adjustment period for strengthening the capital base of commercial banks to reflect the strengthening of loan classification and provisioning requirements (including 10% provisions for Class 3 loans by third tranche release); and (iii) implementation by the SBEF of a requirement that commercial banks require that recipients of commercial loans above a given amount have audited financial statements. Implementation of the action plan is a condition of second tranche release. Important elements of the action plan and draft law are discussed in Annex V.

79. The Policy Letter commits the Government to the implementation of a program for managing banking crises, which would provide clear rules for actions and minimize discretion. The program, which is described in more detail in Annex VI, would contain the following elements: (i) a preventive surveillance regime for banks that violate certain objective criteria; (ii) intervention of banks that do not comply with a rehabilitation plan agreed to following imposition of a preventive surveillance regime, which have lost more than 50% of their capital or which have committed egregious violations of prudential regulations; (iii) criteria for determining whether to rehabilitate or liquidate intervened banks; (iv) rules for the provision of short-term liquidity support by the Central Bank; and (v) rules for the maximum compensation of depositors.

80. The Credit would finance technical assistance to strengthen enforcement of prudential regulations and the capacity of the SBEF to process and scrutinize financial and accounting information. As indicated in Annex XVII, The program would: (i) support the continued strengthening and implementation of improved prudential regulations with the assistance of a senior international consultant; (ii) finance training of existing and new inspectors and bank analysts; (iii) provide hardware, software and consulting assistance to improve the SBEF's bank accounting and risk-monitoring systems; and (iv) assist in the strengthening of SBEF's capacity to regulate non-bank financial institutions.

81. <u>Increase in Credit Market Information</u>. The credit would support measures to increase the availability of financial information in order to support market transparency and capital market development. The Policy Letter describes the Government's program to increase the availability of credit

market information, in order to facilitate more objective decision-making and market discipline by depositors, investors and borrowers. Further, disclosure helps to deepen the level of financial intermediation. The Government in the Policy Letter indicates its intent to: (i) permit selective disclosure of credit information to institutions other than banks from the SBEF's *Central de Riesgos*, provided that the potential borrower provides explicit written authorization; (ii) to facilitate public disclosure by SBEF of regulatory rulings, (iii) establish requirements that banks publicly disclose the interest rates charged on various categories of loans on a uniform basis (including all fees and commissions) and indicate the effective annual interest rate on deposits. In addition, a provision of the revised Banking Law will require that banks annually publish their loan classifications along with their annual financial reports as public documents.

82. Improvements in the Functioning of the Central Bank. Recognizing the importance of automatic, short-term liquidity support for financial institutions experiencing liquidity problems, the BCB will ensure that resources are provided in accordance with the rules provided in the Banking Law. In order to ensure financial discipline, the Government (including the Central Bank) has agreed in the Policy Letter not to undertake any wholesale refinancing of commercial bank loans (except for liquidity support) nor offer direct financing for, or contributions to, banks' capital (outside of BCB capitalization financing to individual institutions for purposes of merger or sale after intervention). The Central Bank will undertake a program to strengthen the *Gerencia del Sistema Financiero* (GSF) to certify institutions to intermediate development credit and to carry out its responsibilities of management of banks in crises as specified in the Banking Law. Further, the Central Bank will restructure and strengthen the *Gerencia de Desarrollo* to improve administration of the credit auction mechanism and streamline the operating and institutional procedures related to the transfer and supervision of development funds.

83. Capital Market Development. The Policy Letter commits the Government to a program to strengthen capital markets. The Government will undertake the following actions to improve the efficiency, competitiveness, and transparency of Bolivia's capital markets:

(i) amend relevant laws and regulations to permit **sociedades limitadas** to issue and trade all forms of securities (e.g. commercial paper), subject to disclosure requirements issued by **Comision Nacional de Valores** (CNV);

(ii) amend relevant laws and regulations to allow origination and trading of bankers acceptances on the securities exchanges based on storage warrants (i.e. warehouse receipts) issued by licensed warehouses (**Almacenes Generales de Depósito**) and to allow the trading of the warrants by **sociedades anónimas** and **limitadas**;

(iii) amend the relevant laws and regulations to permit brokers to carry securities for their own account, which will permit them to act as underwriters;

(iv) improve procedures for repossession of collateral pledged in lending contracts involving chattel mortgages, permit trading of such contracts and improve the commercial registration system for contracts secured with moveable property and other forms of collateral (see Annex XII).

84. The Government will undertake a study of the contractual savings system to improve its efficiency as a provider of long-term savings (see Annex X). Specific reforms to social security/pensions and insurance will be examined. Some of the more important issues to be investigated include: (i) the extent of minimum retirement and health benefits that should be provided by the social security system; (ii) estimates of the fiscal costs of maintaining the present system compared to privatization of the provision of retirement benefits; (iii) barriers to different forms of private voluntary pension schemes; (iv) barriers to competition in the management of the assets of pensions funds and to the mobility of participants across plans; and (v) necessary changes to permit insurance companies to issue debt and to diversify asset portfolios (including allowing offshore investments), to deregulate insurance premia and to allow insurance companies to act as managers of pension fund assets.

85. Actions also will be taken to improve the supervision of capital market institutions (see Annex XIII) through strengthening or reorganizing the **Superintendencia Nacional de Seguros y Reaseguros** (SNSR), the **Instituto Boliviano de Seguridad Social** (IBSS), and the **Comisión Nacional de Valores** (CNV). Staff will be reduced in the SNSR and IBSS, and examinations undertaken to ensure that remaining staff have appropriate technical skills. External audits of all insurance companies and of the complementary pension funds will be undertaken (see Annex XI). Insurance companies not meeting minimum capital requirements (inclusive of technical reserves) will be subject to bankruptcy proceedings if capital is not increased after a prescribed period of time.

86. The Government will undertake a study of the specific changes in law and regulation necessary to effect the recommendations of the contractual savings study and to improve the supervision of capital market institutions (see Annex IX). Also, changes in the insurance law, the social security law and in the organic law defining the role and functions of the CNV will be considered to ensure sufficient managerial independence for those agencies.

87. Technical assistance will be provided to the Government in support of the program to strengthen capital market development.

IV. PUBLIC ENTERPRISE REFORM

88. The goal of the public enterprise reform component is to raise the efficiency of investment and to avoid potential drains on Treasury revenues, through improving the management of essential public enterprises and eliminating the Government's role in production of goods which can be provided more efficiently by the private sector. Measures to be supported would involve: (i) improvements in the performance, efficiency and financial self-sufficiency of public enterprises which either provide public goods or represent natural monopolies; (ii) reforms to increase private sector participation and investment in public enterprises operating in mining and

hydrocarbons, which are subject to Constitutional restrictions against privatization; and (iii) a broad program aimed at progressively divesting all state-owned companies in competitive markets.

Overview of Public Enterprise Sector

89. The public sector can be grouped into three categories: (i) administrative agencies, including Central Government ministries, decentralized administrative agencies, regional development corporations, municipalities and "prefecturas" - or local governments; (ii) the public banks (discussed above); and (iii) non-financial public enterprises. There are presently 138 non-financial public enterprises. These can be divided between the major enterprises (power, railroads, mining, hydrocarbons, airlines and telecommunications), the smaller enterprises providing public services (i.e. water and electricity) and the roughly 100 enterprises operating in competitive markets, largely manufacturing and agro-industry.

90. Beginning with the 1952 revolution, Bolivia pursued an economic development strategy which relied heavily on state ownership of productive assets. By the mid-80s, this strategy had contributed to a severe economic crisis characterized by massive foreign debt, a huge public sector deficit and hyperinflation. The stabilization program initiated by the new Government in 1985 included a series of measures to reduce public enterprise deficits, tighten financial controls and improve financial self-sufficiency: access to domestic credit by public enterprises was limited to loans from the Central Bank, Government transfers to public enterprises were sharply reduced, price controls were virtually eliminated and prices for key public services were raised using neighboring countries' prices as guidelines. In addition, a new financial reporting and budgeting system was introduced as part of the SAFCO program. Despite these reforms, serious problems continue to impair the performance of public enterprises. Many enterprises were overbuilt in relation to the markets they serve, were politically motivated, and are now operating at less than 20% capacity.

Main Issues Affecting Public Enterprises

91. Financial conditions of public enterprises. Considerable progress already has been made in achieving financial self-sufficiency for public enterprises, which is a key objective of this credit. The aggregate current account of non-financial public enterprises improved from a deficit of Bs 26 million in 1987 to a current surplus of Bs 272 million in 1990 (through November). The overall deficit (current surplus less capital expenditures) dropped from Bs 395 million in 1987 to roughly Bs 90 million annually over the last three years. Central and regional government transfers to non-financial public enterprises were sharply reduced, from an estimated Bs 198 million in 1987 to a budgeted figure of Bs 10 million by 1990[6/] (Bs 8 million, or US$ 2 million, are budgeted for 1991). By comparison, public enterprises are expected to contribute Bs 1.7 billion (US$ 500 million) to the Government, primarily through hydrocarbon royalties from YPFB. Public enterprises' debt (both to the Central Bank and external creditors) has increased from US$468

[6/] Actual transfers from the Central Government to public enterprises in 1990 totalled Bs 1.1 million. Data on actual transfers to public enterprises from the regional development corporations in 1990 are not available.

million at end-1988 to US$576 million at end-1990. Arrears on this debt have remained at roughly US$ 10 million.

92. Efficiency improvements in public enterprises. The Government is taking steps to improve the performance of major public enterprises providing key services, such as power, railroads and telecommunications. The Government is not in a position to privatize these services at this time, due to the lack of institutional resources to effectively regulate the privatized companies. To improve the efficiency of these enterprises, the Government has launched a program to adopt performance contracts ("contratos de rendimiento") for the major public enterprises, including ENDE (electricity generation and transmission), ENFE (rail) and ENTEL (long-distance and international telecom). Initially, six-month trial contracts, covering the period July-December 1990, were signed for ENDE and ENFE. Longer-term contracts have since been drafted for ENDE (5 years), ENFE (1 year) and ENTEL (1 year), with provision for annual review. In all cases, the contracts call for increased managerial autonomy in operational matters (procurement, purchase of foreign exchange, staffing decisions), movement to tariff-setting based on economic costs (in the case of monopoly services), and increased accountability through the introduction of specific performance targets. In the case of ENFE, where fundamental restructuring and down-sizing is required, the contract also calls for the preparation of a comprehensive restructuring program. Highlights of the contracts are as follows:

(a) ENFE: The contract is aimed at transforming ENFE into a competitive, commercially-viable transport company. Key elements include: a 30% reduction in the workforce, provision for the sale of ENFE's unproductive assets, preparation of a medium-term strategic plan (setting out new business strategies for ENFE, services to be cut, etc), introduction of a new costing system to allow costing by product and route, phaseout of non-commercial services (unless compensated by Government) and Government financial support for layoffs and non-commercial activities. Performance targets relate to: staff reduction, labor productivity, operating margin, traffic volume, and on-time service.

(b) ENDE: Given that ENDE is considered to be well-managed and efficient, the contract is aimed primarily at providing ENDE management with greater autonomy on operational matters and incentives for operational efficiency and sound financial performance. Performance targets relate to: utilization of installed capacity, debt coverage, labor productivity, and service interruptions. The contract also includes agreed investment and tariff levels and a procedure for periodic tariff adjustments reflecting changes in the costs of key inputs.

(c) ENTEL (long distance and international telecommunications): While ENTEL is considered to be well-managed, some internal restructuring is deemed necessary to improve its efficiency and performance. The initial (one-year) contract calls for, inter alia: the adoption of a new organizational structure (based on lines of business); the introduction of a new costing system (to enable the development of an appropriate tariff structure) and new internal controls/systems; and the preparation of a 3-year Operating Plan. Quantitative performance targets relate to labor productivity and utilization, and call completion rates. In parallel, a master plan for telecommunications will be prepared that will elaborate sectoral investment requirements and reforms to enable increased competition. In this context, the initial performance contract introduces the "common carrier" principle, whereby end-users would have equal access (at equal tariffs) to ENTEL's long distance and international networks. The internal reorganization/restructuring of ENTEL, together with the development of the master plan for telecommunications and the introduction of competition in the long distance/international service, will be followed by a longer-term performance contract commencing in 1992. In addition to these measures, it is expected that the Government will grant a license later this year to a private company to operate one of the two cellular bands.

93. Increasing private sector investment. The Government has taken steps to increase private sector investment in two sectors - hydrocarbons and mining - where there is considerable growth potential and investor interest, but where outright privatization of existing state-owned assets is precluded by the Constitution. The recently-passed hydrocarbons law permits joint ventures between YPFB and the private sector in exploration and development. Since the passage of this law, YPFB has signed contracts with 8 foreign petroleum firms calling for expenditures of US$189 million by the foreign firms in exploration and development. Negotiations are underway for 7 additional contracts totalling US$613 million. These investments by foreign firms (totalling in excess of US$800 million) represent a significant increase in private sector participation in the economy. In addition, YPFB is expected to sign contracts with several Argentinean and US companies for secondary extraction, and is proceeding with the privatization of its retail distribution system. YPFB may need some assistance in designing these contracts to obtain the most favorable terms possible.

94. The Government has signed a performance contract with YPFB to permit greater autonomy in its operations. The company has claimed that it has not been permitted to retain sufficient internal resources to finance its investment program. To increase the transparency of decisions on retention of resources by YPFB, the performance contract calls for the development of four alternative scenarios with varying levels of exploration and production. Based on these four alternatives, the Government will then decide on the program to be carried out and the corresponding level of resources to be retained by YPFB for its investment program. The contract also calls for an internal reorganization of YPFB into a number of cost centers (exploration, engineering, production, refining, transport, and distribution) and profit centers (sales, service station leasing). Key performance targets include: cost/barrel added to reserves, cost/barrel produced, and employees/barrel produced.

95. COMIBOL (mines) has a long history of poor management, serious overstaffing, and huge losses. The collapse of tin prices in 1985 led to massive layoffs, but tin prices have continued to decline since then and the number of employees remains excessive. Further, COMIBOL has demonstrated that it is unable to manage its properties. Privatization of COMIBOL is not feasible due to Constitutional restrictions. However, it would be possible to close all unprofitable mines and operate remaining mines through joint ventures with the private sector. This would imply a sharp reduction in

COMIBOL employment and eventual transformation of COMIBOL into a holding company with no direct managerial responsibilities. To this end, the Government is preparing a master plan for the restructuring of COMIBOL and disposition of properties, which should be ready in early 1992.

96. Privatization objectives. Over the medium-term, it is the Government's objective to progressively divest all state-owned productive enterprises, with the exception of mining and hydrocarbons (due to Constitutional restrictions on their privatization) and enterprises providing key public services such as electricity, water and telecommunications. This will involve roughly 100 companies, including the 62 companies owned by the regional development corporations, Lloyd Aereo Boliviano (the airline), 23 companies under the Defense Ministry, 2 companies under the Ministry of Industry and Commerce, and 14 hotels. Although reliable data on some of these enterprises are not available, we estimate that they account for roughly US$250 million in total assets (book value).

97. The initial phase of the privatization program will include the national airline, Lloyd Aero Boliviano and companies owned by the regional development corporations. An investment bank has been hired to prepare a valuation and detailed privatization plan for the airline. It is expected that up to 35% of the total shares in the company will be sold to a foreign airline; a sale of more than 35% to a foreign carrier would call into question the airline's landing rights in the US as a national carrier. Most of the remaining shares will be sold domestically, with the Government retaining only a minimal interest in the company. Four of the nine regional corporations (Santa Cruz, Tarija, Cochabamba and Chuquisaca) have expressed strong interest in divesting their holdings. The companies belonging to these 4 regions account for roughly US$110 million in net fixed assets.

98. Legal framework. The Bolivian Constitution appears to require legislation to privatize most state-owned companies (with the exception of sociedades mixtas, which already have some private ownership). Despite some ambiguity in the Constitution, the Government believes that Congressional approval is necessary to avoid any legal challenge to the privatization process. The previous Government's privatization program foundered in part on the absence of an enabling legal framework. Consideration had been given to submitting to Congress a law authorizing the privatization of all enterprises owned by the Government (excluding mining and hydrocarbons). However, the Government is concerned that requesting authority for such a sweeping privatization program at this time would run into considerable political opposition. Instead, the Government intends to request Congressional authorization for the privatization of companies owned by regional development corporations which are committed to privatization. This approach should limit opposition and enable the program to proceed more smoothly.

99. Policy and organizational framework. The absence of a policy framework, implementation arrangements and a full-time technical secretariat for the privatization program has hampered progress. The Government recently prepared implementation procedures for the privatization program. The companies subject to the first phase of the program (those owned by the regional development corporations) have been divided into three groups. For each group, a foreign management consultant firm would be hired to evaluate each company, prepare bidding documents and provide other technical advice on the process. A policy statement has been issued describing the framework and

procedures for privatization, and further staff will be hired to assist in the program.

100. Severance provisions. A clear policy on the form and amounts of compensation to workers dismissed as a result of privatization and public enterprise reforms is necessary. It is expected that the Government would have to pay unfunded pension liabilities and severance pay to some workers. We will propose that the Government set up a fund to cover these expenses. Resources for the fund could be taken from Treasury revenues, the counterpart funds for this Credit, and contributions by other donors.

101. Risks facing the privatization process. A number of obstacles exist to successful privatization:

(a) Many of the enterprises will have to be sold at a fraction of the Government's initial investment, which may present some political problems for officials managing the process. This risk will be minimized by following strict and transparent procedures for the evaluation and sale of enterprises, including the reliance on international consulting firms with no financial interest in the recommendations made.

(b) It is expected that elements of the labor unions will oppose the program. The Government will make further efforts to reduce opposition by providing for the sale of some enterprises, where feasible, to the workforce and/or major suppliers, and for providing adequate severance provisions and transitional arrangements for workers affected by the program.

(c) There is some risk that the privatization process will contribute to the already-excessive centralization of economic power in Bolivia, and the small number of wealthy groups in the country raises the potential of collusion and other unfair bidding practices. The Government will attempt to attract foreign investment in the program to reduce centralization. Also, as mentioned above, the Government will make an effort to offer enterprises to workers groups.

The Proposed Credit

102. Efficiency improvements in public enterprises. The Policy Letter will commit the Government to: (i) the preparation, approval and implementation of a restructuring program for ENFE; (ii) the design of improved procedures for YPFB contracts with private sector investors; and (iii) design of a plan to increase competition in the telecommunications sector. The ENFE restructuring program should include dismissal or retirement of 2000 employees, provision for the inventory and sale of unproductive assets, and elimination of non-commercial activities (including the closure of unprofitable lines). Counterpart funds from the credit will be used to pay severance and other costs related to the retirement of the first 1000 employees (see Annex XIV).

103. Increased private sector investment. The Policy Letter will commit the Government to the design of improved procedures for YPFB contracts with private investors. The program for COMIBOL can be divided into immediate actions necessary to reduce losses and longer-term measures to reorganize

COMIBOL. The Government already has made substantial progress on short-term measures to limit COMIBOL losses, as evidenced by preparation of a plan for the reduction of personnel, cessation of new investments in COMIBOL properties, and progress in the preparation of audit reports for COMIBOL operations. Completion of the longer-term plan for the reorganization of COMIBOL and closure of all unprofitable mines is a condition of second tranche release.

104. Budgetary and financial discipline The Credit will support further measures to ensure budgetary and financial discipline in the public enterprise sector. The Government has prepared an action plan for: (i) the elimination of all transfers to national and regional public enterprises (excluding transfers for some limited public services, except those which the Government has obtained written consent of the Association) and (ii) the elimination of major arrears in the payment of debts among public enterprises. Further, as a condition of third tranche release, the Government will complete the elimination of all transfers to national/regional enterprises (excluding those for agreed public services) and the elimination of arrears in accordance with the agreed plan.

105. Design of the privatization program. To ensure transparency and efficiency in the implementation of the program the Policy Letter will commit the Government to the following policies: (i) enterprises/assets will be priced realistically to reflect market value; (ii) no market protection will be provided to purchasers; (iii) no new investments or Government transfers or credit will be provided for enterprises targeted for privatization; (iv) the sale to other state enterprises or public agencies will be precluded; (v) new owners will have flexibility in making workforce adjustments, but the Government will ensure that workers are treated fairly in the process, including where necessary the payment of severance and pension liabilities; (vi) enterprises to be privatized will be required to be set up as sociedades anónimas, unless the Government finds that the cost of doing so is prohibitive; (vii) funds for the settlement of outstanding liabilities will be allocated in the annual Government budget; and (viii) in the context of the Government's overall policy to reduce the scope of the public sector, no new state-owned companies or joint ventures will be established in the industrial or agricultural sectors.

106. Implementation. The Bank and the Government have agreed on the content of a policy statement and implementation guidelines, the staff necessary to manage the program and a privatization agenda setting out the enterprises to be privatized in the first phase of the program. By second tranche release, the Bank and the Government will agree on the agenda of companies to be privatized prior to third tranche release.

107. Targets for privatization. Conditionality for the program has been designed to focus the Government's efforts towards privatizing a small number of the more important enterprises owned by the regional development corporations, plus continuing the program to sell Lloyd Aereo Boliviano. Targets for the privatization program will be defined in terms of numbers of enterprises, formed into three groups according to the dollar value of fixed assets: LLoyd Aereo Boliviano, large enterprises (the 6 enterprises with fixed assets valued from US$9-30 million) and smaller enterprises (the 7 enterprises with fixed assets valued from US$1-5 million). Note that there are no

enterprises for which we have data with an assets value from US$5-9 million. As a condition of second tranche release, the Government will bring to point of sale (including approval for privatization, completion of valuations and sales documentation, and offering for sale) enterprises sufficient to meet the following targets: (i) Lloyd Aereo Boliviano, 2 large enterprises and 3 smaller enterprises; or (ii) 3 large enterprises and 5 smaller enterprises. As a condition of third tranche release, the Government will bring to point of sale additional enterprises sufficient to meet the following targets: (i) Lloyd Aereo Boliviano, 4 large enterprises and 5 smaller enterprises; or (ii) 5 large enterprises and 6 smaller enterprises. In the case of sociedades anónimas mixtas (which includes Lloyd Aereo Boliviano), the Government may satisfy the criteria either by bringing the existing assets to point of sale or by bringing to point of sale sufficient shares to reduce the public sector's ownership of the company below 50%. This provision is included to ensure that the Government has sufficient flexibility in managing the program.

V. TRADE AND REGISTRATION PROCEDURES

Main issues

108. The Government has abolished all quantitative trade restrictions (with the exception of sugar), has lowered tariffs to a flat rate of 10% (with the exception of the 5% rate on capital goods), and has taken initial steps to streamline export procedures. Further work is planned to increase the efficiency of investment by improving the incentives framework for exporters and reducing firm registration and control procedures:

a. The customs system is inefficient and reportedly corrupt. Smuggling and under-invoicing have reduced customs revenues well below their potential, although the extent of lost revenues is difficult to estimate. The Government is presently receiving technical assistance from the IDB and the Spanish Customs Service to undertake a comprehensive restructuring of customs, which may include privatizing some functions. The program would be codified in a new customs law.

b. The Government has eliminated the export subsidy previously given to exporters of nontraditional products to compensate them for duties on their imports. This subsidy was equivalent to 6% of export receipts, and was excessive in comparison to estimated duties. The subsidy has been replaced by a duty drawback scheme, designed to provide a more accurate level of compensation for import duties. The Government also is working jointly with the private sector to draft an export law which would provide an improved incentive framework for exports.

c. The system of export procedures remains highly cumbersome. Exporters must receive a number of approvals from different offices, including Internal Revenue and other parts of the Ministry of Finance, various offices of the Ministry of Industry, the Ministry of Agriculture, Customs and the Central Bank. All of these steps require time and provide the opportunity for corruption. These requirements particularly discriminate against smaller exporters for whom the per unit cost of administrative procedures is relatively high. The Government recently proposed recommendations for the simplification of export procedures.

d. A cumbersome system of firm registration and control procedures impede the efficient management of private sector firms. Firms are required to register with numerous public sector agencies at different levels of government (municipal, departmental and national), as well as with various business organizations. These registration requirements, along with other control procedures and tax reporting, are estimated to cost small firms about sixty working days a year. The Government has recently established a commission jointly with the private sector, which would work on reducing these administrative requirements. Also, the IDB has included assistance in reducing company registration requirements as a part of their next technical assistance program (see Annex XV).

The Proposed Credit

109. The Policy Letter would commit the Government to the following program: (i) reform of customs based on the IDB-financed program (we will review this program once it is fully designed, expected by end-1991); (ii) adoption of a duty drawback or temporary admissions scheme as a replacement for the existing export subsidy; (iii) design and implementation of streamlined export procedures, possibly into a ventanilla unica; (iv) simplification of firm registration and control procedures.

VI. PUBLIC SECTOR INVESTMENT

Main Issues

110. The quality of the public sector investment program has increased markedly since the early 1980s. Many overly-expensive and inefficient projects have been eliminated from the program, and systems have been introduced for the collection and organization of data on public investment. The Bank has performed annual reviews of the public sector investment program in support of the Consultative Group process. However, despite this improvement, a few projects remain with considerable political support that are too expensive or would involve the state in productive activities better left to the private sector.

The Proposed Credit

111. The Policy Letter would provide assurances that the Government will consult with the World Bank and the donor community concerning the selection of investment projects. For the duration of this Credit, the Government will exchange views with the World Bank on all investments over US$10 million in the following sectors: transportation, agriculture and water and sanitation. These investments would be undertaken only with the agreement of the Bank.

VII. SOCIAL IMPACT OF THE ADJUSTMENT PROGRAM

The Government's Program to Alleviate Poverty

112. Bolivia is an extremely poor country. Although reliable data on the incidence of poverty in Bolivia are difficult to obtain, it is possible to provide some indication of the extent of the problem. GDP per capita in 1990 was US$620, placing Bolivia as one of the poorest countries in Latin America. The skewed distribution of income means that many indicators of welfare are even worse than would be suggested by the level of income. Infant mortality is estimated (depending on the source) at either 102 or 117 per thousand in the first year of life, comparable to some of the poorest countries in Africa. Maternal mortality is 48 per 10,000 live births, more than 10 times higher than other Latin American countries. Functional literacy is estimated as low as 50% of the population. 23% of households have access to sanitation. Malnutrition is widespread.

113. The Government's macroeconomic program has been effective in removing distortions which worsened the distribution of income and in avoiding any further discrimination against lower-income groups. A number of measures taken during the 1985 stabilization/adjustment program reversed policies which had adversely affected the rural poor (for example price controls on agricultural commodities), while the removal of financial controls and achievement of price stability reduced rents formerly available to the upper-income groups. Also, the elimination of subsidized credit under the current adjustment program, including closure of the public banks and market determination of interest rates on donor-financed credit, should improve returns to labor and hence help to mitigate poverty.

114. In addition to pursuing an appropriate macroeconomic policy that avoids discriminating against the poor, the Government is involved in a number of specific initiatives, many supported by the donor community, to alleviate the worst aspects of Bolivian poverty. The highly-successful Emergency Social Fund financed short-term projects to generate employment and cushion the impact of the very severe stabilization/adjustment program initiated in 1985. Its successor institution, the Social Investment Fund, has applied the organizational principles used by the ESF to the construction of infrastructure in the social sectors, and to support programs designed to extend health and education services to poor communities. The Regional Development Fund is channeling resources and providing technical assistance to the poorer regions in support of investment projects. The Fondo de Desarrollo Campesino (Peasant Development Fund) began as a means of providing credit to small farmers. As discussed above, the functions of the Fondo have been redefined to provide infrastructure, technical assistance and social services in the poorer rural areas.

115. A major goal of the Government's development policy is to reallocate resources to the social sectors and the poor. Considerable progress has been made in some areas, particularly a significant rise in investment in the health sector and increases in the provision of basic health services consistent with the targets described above. Efforts to increase expenditures in education have had less success due to the very serious organizational problems afflicting the educational sector. The budget recently passed by Congress provided for a significant increase in the share of current expenditures devoted to the social sectors. It is hoped that the strengthened

Ministry of Health will be able to manage with increased efficiency a larger portion of the budget, and that the priorities in the budget are followed in actual expenditures on education. In general, the Government has achieved substantial progress in the difficult process of efficiently reallocating resources to serve the poor. Nevertheless, Government expenditures, even with existing levels of donor support, remain inadequate to the task of resolving even the most severe examples of deprivation in Bolivia.

Impact of the Credit on Poverty

116. The policies supported by this Credit would increase investment and accelerate growth, which should benefit the poor. Even the short-term impact of the program will not have a substantial negative effect on the most disadvantaged groups in Bolivian society, who are marginal farmers and shepherds. The groups that would be directly and adversely affected are workers in the state banks and public enterprises, and companies that have enjoyed subsidized loans from the public banks. Nevertheless, the reform program would involve significant changes in the relative profitability of formerly subsidized economic activities, will generate some unemployment over the short term, and thus could indirectly penalize the lower strata of Bolivian workers.

117. Thus it is useful to consider activities under the program which would help to offset any deleterious impact on the poor. We propose to support programs that would directly benefit the poor and that would be consistent with ongoing efforts by the public sector. One issue of great importance to the poor and to Bolivian development concerns the extremely low level of expenditures on primary health care and education, versus the relatively much larger amount of funds provided for hospitals and other curative care services, and to higher education. This allocation of funds essentially subsidizes the middle and upper classes at the expense of the poor, is inefficient and leads to waste. A related issue is that educational expenditures are heavily skewed to personnel, with little or nothing devoted to providing books and teaching materials or to maintenance of infrastructure. Further, personnel expenditures are substantially misallocated; there are a significant number of 'ghost' teachers on the payroll, absenteeism is high, and teacher salaries are so low that it is difficult to attract competent people to the profession.

118. The Bank is already addressing these issues. The Social Investment Fund will improve infrastructure in the health and education sectors, and the Integrated Health Development Project will support a program to increase the availability of primary health care. We are now planning an education project that would: (i) increase flexibility in the allocation of teachers to improve efficiency and ensure better service to rural areas, and (ii) increase the share of expenditures devoted to primary education and improve the quality and efficiency at the primary level. The Credit would set initial goals for this program by increasing the share of expenditures devoted to texts and teaching materials used in primary education. Other necessary measures to achieve a more rational allocation of educational expenditures will be discussed in the context of the education project.

The Proposed Credit

119. In the context of the Integrated Health Development Project, we determined the minimum expenditure levels necessary to support expected primary health care programs. We propose to support the requirements of the Health project in this operation. The Policy Letter commits the Government to a program of increases in the share of expenditures devoted to the health sector (from 3% of expenditures in 1989 to 3.8%), the share of health expenditures in the major cities devoted to primary health care (from about 25% in 1989 to 30%), and the personnel allocated to primary health care in the major cities (from 30% in 1989 to 40%). All of these targets would be achieved by 1993. The Policy Letter also would commit the Government to increasing expenditures on texts and teaching materials for primary education, from close to zero in 1989 to 5% of expenditures on primary education in 1992.

VIII. CREDIT PROCEDURES

Credit Arrangements, Disbursements and Cofinancing

120. Implementation. IDA would support the above-mentioned reform through a fast disbursing credit of US$40 million, including the financing of complementary technical assistance. The borrower would be the Government of Bolivia, and the implementing agency the Central Bank. Given the complexity of the program, a very small unit in the Ministry of Planning has been designated to administer the loan and coordinate with affected Government agencies. It will be in charge of: (i) preparing the appropriate information required for certification and supervision of each stage of loan processing, (ii) ensuring that technical assistance funds are channelled in accordance with the budget indicated in the loan documents, (iii) coordinating the multiple elements of the loan, and (iv) ensuring that funds are disbursed according to IDA procedures. The appraisal mission was in January 1991, and a post-appraisal mission took place in March 1991. Negotiations were in May 1991.

121. Disbursements. The proposed Credit would be disbursed in three tranches (excluding the US$3.6 million for the technical assistance component): the first tranche would be US$15 million, the second tranche US$15 million, and the third tranche the remainder of the fast-disbursing component (US$6.4 million). Retroactive financing would be permitted for those eligible imports made before the date of the loan agreement but not before March 20, 1991, up to an amount equal to US$8 million. As there are no policy conditions of effectiveness, the first tranche could be disbursed as soon as Congressional approval of the Credit is received (expected by October 1991) and sufficient import documents are provided. The second tranche is expected to be disbursed by December 1992, and the third tranche by December 1993. The funds for the technical assistance component should also be fully disbursed by end-1993.

122. The bulk of the Credit (US$36.4 million) would apply to 100% of the c.i.f. costs of eligible private and public sector imports. Eligible imports would be all goods except those normally excluded under Bank policy-based lending, such as alcohol, tobacco, and armaments; and goods financed by other Bank loans or IDA credits. The remainder of the credit (US$3.6 million) would be disbursed for technical assistance to the Superintendency, the Central Bank, the Ministry of Planning and the Ministry of Finance, including training, computer equipment and consultants' services (see Annex XVII). A

special account will be set up to facilitate disbursements under the technical assistance program. Disbursement of the technical assistance funds would be independent of tranche release. The closing date of the Credit would be July 1, 1994.

123. Donor coordination. We have cooperated closely with other donors in preparation of the Credit. The preparation mission worked closely with an IMF mission providing technical assistance to the financial sector. More generally, policy recommendations of the two institutions are virtually identical, formed under the umbrella of an agreed Policy Framework Paper. We expect to continue collaborating closely with the IMF, not only in the design of the reform program but also in the assessment of the appropriateness of macroeconomic management. We have also cooperated closely with the Inter-American Development Bank (IDB), presenting joint aide memoires in both the identification and preparation missions for the financial sector component. The German aid agency (GTZ) also participated in the preparation mission and agreed with the policy recommendations. Finally, we will continue to work closely with USAID in their studies of financial sector and the privatization program.

124. Cofinancing. The IDB is considering two parallel financial sector loans, a fast disbursing loan for US$40 million and multisectoral credit operation for US$80 million. These loans would have the same conditionality as that included in the financial sector component of this Credit. The Government of Switzerland is considering cofinancing equivalent to approximately US$7 million, and USAID may finance a portion of the technical assistance component concerned with capital market development. We are exploring further cofinancing possibilities with other bilateral donors.

125. Dialogue with the Government. The Bank and the Government have been involved in an intensive dialogue on adjustment policy since 1985. Proposals in this operation reflect preparation and supervision work in credits involving the financial sector, transportation, agriculture, mining, hydrocarbons, power, health, and education, plus economic and sector work.

Procurement

126. For the fast-disbursing component, all contracts for the procurement of general imports by the public and private sectors to cost the equivalent of US$5.0 million or more shall be awarded through simplified international competitive bidding. For the public sector, contracts costing under the equivalent of US$5.0 million would be procured through the normal procurement procedures of the importing agency. IDA has reviewed the public procurement procedures, which operate through procurement agents, and found them acceptable. For the private sector, procurement would be done through normal commercial practices, provided that contracts have been awarded on the basis of evaluation of quotations obtained from at least two eligible suppliers (except where direct contracting is appropriate under the circumstances specified in IDA procurement guidelines). For the technical assistance component, the procurement of equipment exceeding US$100,000 will be done under international competitive bidding. Equipment valued below US$100,000 but above US$25,000 would be procured through local competitive bidding procedures satisfactory to IDA, up to an aggregate of US$300,000.

Miscellaneous items under US$25,000 (and not exceeding US$150,000 in aggregate) would be purchased following comparison of price quotations obtained from at least three eligible suppliers. Local manufacturers may be granted a margin of preference in accordance with Bank guidelines for contracts awarded following ICB procedures. Prior review by the Bank is required for all ICB contracts. Consultants will be employed in accordance with the principles and procedures set forth in the "Guidelines for the Use of Consultants by World Bank Borrowers and by the World Bank as Executing Agency" published by the Bank in August 1981. For all studies to be financed under the technical assistance component, the final report must be approved by IDA prior to payment.

127. All disbursements under the fast-disbursing component for contracts valued at below US$1.0 million would be made against statement of expenditures to be submitted by the Central Bank, which is expected to undertake the screening process to ascertain that the above conditions have been met and to disburse the Credit on the basis of documented import payments from the commercial banks. Contracts valued at above US$1.0 million would be disbursed against full documentation. Also, statement of expenditures would be allowed under the technical assistance component for contracts valued at below US$25,000. The Central Bank will maintain separate accounts to record and monitor Credit disbursements and repayments. An audit by independent auditors acceptable to IDA of all records and accounts related to expenditures financed under the proposed Credit would be submitted to IDA within ninety days after disbursement of each tranche of the Credit, and the corresponding terms of reference should include a review of the procurement procedures followed. Disbursement of the second and third tranche could not be made until a satisfactory audit report covering the previous tranche had been received.

Credit Conditions

128. The Government has already made substantial progress on the reform program. The following actions were completed prior to presentation of the credit:

(i) issuance of supreme decrees providing for the closure or privatization of BAB, BAMIN, and FONEM, and providing that in the interim these banks will receive no subsidy from the Treasury;

(ii) issuance of a supreme decree requiring BANEST to cease lending operations and limiting BANEST's role to being a financial agent to the Government and provider of selected banking services;

(iii) provision of authority for large taxpayers to make tax payments through the commercial banks;

(iv) submission of action plans for the recovery, sale, legal adjudication and liquidation of financial and fixed assets of BAB, BAMIN, FONEM, and (where relevant) BANEST;

(v) submission of plans for reductions in employment in BAB, BAMIN, FONEM and BANEST;

(vi) designation of professional staff to manage the liquidation of the public banks;

(vii) initiation of a study to determine the potential for using the private sector as a financial agent and the costs and benefits of the provision of banking services by BANEST, on a branch by branch basis;

(viii) issuance of a supreme decree prohibiting the Fondo de Desarrollo Campesino from lending directly to final borrowers;

(ix) issuance of a supreme decree establishing new non-bank financial intermediaries and issuance of a Central Bank resolution providing eligibility criteria for access of banks and non-banks to development credit;

(x) establishment of an auction system for the allocation of development credit to financial intermediaries;

(xi) presentation of the banking law to Congress;

(xii) submission of an action plan for the improvement of supervision and regulation of the banking system;

(xiii) compliance with the program for limiting COMIBOL losses;

(xiv) preparation of an action plan to eliminate all transfers to public enterprises (excluding those for agreed public services) and for the elimination of major arrears in the debts among public enterprises;

(xv) establishment of an inter-ministerial commission to set policies for the privatization program, issuance of a policy statement and implementation guidelines for the privatization program, and approval of a privatization agenda setting out enterprises to be brought to point of sale, sufficient to meet the conditions for second tranche release; and

(xvi) passage of the mining, hydrocarbons and investment laws by Congress.

129. To provide continued support to the structural reform program, the second tranche of US$15 million would be released upon the furnishing of satisfactory evidence to IDA of the following:

(i) continued maintenance of a macroeconomic reform program consistent with the objectives of the program and satisfactory performance of the program described in the Government's Letter of Development Policy (Annex III);

(ii) for BAB, BAMIN and FONEM, either: (a) closure of the institution, dismissal of employees not involved in loan recuperation or liquidation and compliance with the program for the sale, legal adjudication and liquidation of their financial and fixed assets; or (b) sale to the private sector with no remaining Government participation;

(iii) completion of either: (a) closure of branches of BANEST which are not found to be cost effective or justifiable, transfer of its functions which can be handled efficiently by the private sector and compliance with the program for the recovery, sale or liquidation of BANEST's financial and fixed assets; or (b) sale of BANEST to the private sector with no remaining Government participation;

(iv) implementation of eligibility criteria for access of banks and non-banks to development credit and supervision of these intermediaries consistent with sound regulatory practices;

(v) passage of the Banking Law by Congress and implementation of the regulations;

(vi) implementation of the action plan to improve supervision and regulation of the banking system;

(vii) completion of a plan for the reorganization of COMIBOL and closure of unprofitable mines;

(viii) approval for privatization, completion of asset valuations and sales documentation and offer for sale of at least 51% of the voting shares held by the Government have been made in respect of either: (a) Lloyd Aereo Boliviano, 2 large enterprises and 3 small enterprises, or (b) 3 large enterprises and 5 small enterprises; and

(ix) an approved privatization agenda setting out enterprises to be brought to point of sale, sufficient to meet the conditions for disbursement of the third tranche.

130. To provide continued support to the structural adjustment program, the third tranche of US$6.4 million will be released upon the furnishing of satisfactory evidence to IDA of the following:

(i) continued maintenance of macroeconomic policies consistent with the goals of the program and satisfactory performance of the program described in the Government's Letter of Development Policy (Annex III);

(ii) compliance with the program for the sale, legal adjudication and liquidation of the financial and fixed assets of BAB, BAMIN and FONEM;

(iii) compliance with the program for the recovery, sale and liquidation of BANEST's financial and fixed assets;

(iv) continued implementation of the regulations for the Banking Law;

(v) elimination of transfers from the Treasury to public enterprises (except those for which the Government has attained written consent of the Association) and elimination of arrears in the payment of debts among public enterprises;

(vi) implementation of a requirement that commercial banks make provisions in amounts equivalent to 10% of their Class 3 loans;

(vii) approval for privatization, completion of asset valuations and sales documentation and offer for sale of at least 51% of the voting shares held by the Government have been made in respect of either: (a) Lloyd Aero Boliviano, 4 large enterprises and 5 small enterprises; or (b) 5 large enterprises and 6 small enterprises.

Risks

131. The credit would involve a number of risks:

(i) Given the political sensitivity of some of the proposed reforms (particularly closure of the public banks and privatization), there is a risk that the Government may not be able to carry out the reform program with the required speed and thoroughness. The economic team is firmly committed to the program, but several powerful groups have expressed opposition. The economic team has obtained the support of the President for the reform program, which should facilitate implementation. To reduce the risk of policy slippage after approval of the Credit, key requirements that may raise political difficulties have been met as conditions of Board presentation.

(ii) While continued improvement in prudential regulations should increase financial intermediation in the long-term, the short-term effects of measures such as provisioning requirements and minimal capital standards could result in decreases in financial intermediation by some banks if they restrict new lending rather than put in fresh capital. The Government's macroeconomic program includes further declines in credit to the public sector. A reduction in the public sector's claims on resources therefore should encourage a decline in interest rates and facilitate increased private sector lending, thus muting the impact of any short-term reduction in lending by problem banks.

(iii) The Government's lack of administrative resources also may make achievement of the many proposed conditions difficult. The technical assistance component, in conjunction with complementary efforts by other donors, should help to reduce this problem.

(iv) Finally, any failure to maintain macroeconomic stability could endanger the success of the structural reform process. Maintenance of a macroeconomic program acceptable to the Bank is a condition of tranche release.

IX. RECOMMENDATION

132. Subject to the above conditions, the proposed operation would constitute a suitable basis for an IDA credit of SDR 30 million (US$40 million equivalent) to the Republic of Bolivia.

Barber B. Conable
President

Attachments

Washington, D.C.
August 1991

0 May 1991,

KEY INDICATORS TAL

	(Actual)									
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GDP Growth Rate	-1.37	0.93	-4.36	-4.46	-0.60	-0.96	-2.49	2.60	2.96	2.72
GNP Growth Rate	-7.19	1.00	-6.78	-3.79	-0.22	-3.00	-0.96	4.62	3.10	3.17
GDP/Capita Growth Rate	-4.13	-1.86	-7.16	-7.25	-3.41	-3.80	-5.32	-0.20	0.16	-0.06
GNP/Capita Growth Rate	-9.94	-1.79	-9.58	-6.58	-3.03	-5.84	-3.79	1.82	0.30	0.39
Total DOD (in US$) 1/	2181.57	2722.73	2836.52	3254.68	3371.62	3511.18	4068.98	4382.70	4201.68	3420.24
DOD/IGS 2/	195.97	177.41	244.53	281.22	323.96	279.09	357.71	367.18	351.63	261.99
DOD/XGS	208.62	266.52	308.85	362.01	399.87	476.11	567.42	657.07	609.91	384.08
DOD/GDP	43.51	39.19	48.46	55.52	52.95	68.59	104.80	101.69	95.00	75.71
Debt Service (in US$)	290.08	280.56	288.81	290.69	304.71	322.76	224.45	481.57	373.56	374.23
Debt Service/IGS	26.06	18.28	24.90	25.12	29.28	25.65	19.73	40.35	31.26	28.67
Debt Service/XGS	27.74	27.46	31.45	32.33	36.14	43.76	31.30	72.20	54.23	42.02
Debt Service/GDP	5.79	4.04	4.93	4.96	4.78	6.30	5.78	11.17	8.45	8.28
Interest (in US$) 1/	163.76	170.74	180.77	183.86	190.39	174.13	120.90	195.64	165.51	164.77
Interest/IGS	14.71	11.12	15.58	15.89	18.29	13.84	10.63	16.39	13.85	12.62
Interest/XGS	15.66	16.71	19.68	20.45	22.58	23.61	16.86	29.33	24.02	18.50
Interest /GDP	3.27	2.46	3.09	3.14	2.99	3.40	3.11	4.54	3.74	3.65
Consumption/GDP	81.25	88.25	82.19	88.50	89.57	91.54	95.00	95.15	93.39	91.68
Domestic Savings/GDP	18.75	11.75	17.81	11.50	10.43	8.46	5.00	4.85	6.29	8.32
Gross Investment/GDP	14.79	13.88	13.82	8.67	7.25	10.15	7.87	11.06	12.08	11.99
National Savings/GDP	13.10	6.14	10.15	4.92	4.22	0.26	-2.49	-0.74	0.93	3.29
Public Investment/GDP	6.99	7.15	6.86	5.02	4.51	3.54	4.78	6.24	8.08	8.75
Private Investment /GDP	7.36	3.80	6.95	3.58	3.99	3.68	4.67	4.05	4.16	4.05
Ratio of Public/Private Investment	0.95	1.88	0.99	1.40	1.13	0.96	1.02	1.54	1.94	2.16
Export Growth Rate 3/	-6.52	-1.91	-5.30	-8.64	-6.93	-9.44	17.33	-7.16	10.83	27.11
Exports/GDP	18.79	13.13	14.14	12.88	11.30	12.27	15.13	12.04	12.26	16.01
Import Growth Rate 4/	-32.45	48.14	-37.57	1.28	-15.65	48.90	-18.60	2.66	-7.65	-22.11
Imports/GDP	13.53	14.04	9.87	10.05	7.67	13.50	17.36	17.80	17.32	19.26
GDP in US$	5014.11	6947.59	5853.11	5862.41	6368.06	5119.17	3882.53	4309.66	4422.89	4517.79
Exports of G&S	1045.74	1021.57	918.40	899.05	843.18	737.48	717.11	667.01	688.90	890.50
Imports of G&S	1113.20	1534.70	1160.00	1157.35	1040.76	1258.06	1137.50	1193.61	1194.90	1305.47

	(Estimate)		(Projections)								
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP Growth Rate	2.70	3.48	4.00	3.95	3.95	4.20	4.07	4.16	4.27	4.38	4.48
GNP Growth Rate	2.80	3.82	4.25	4.22	4.25	4.36	4.26	4.31	4.38	4.48	4.57
GDP/Capita Growth Rate	-0.08	0.70	1.20	1.15	1.15	1.42	1.27	1.36	1.47	1.58	1.68
GNP/Capita Growth Rate	0.02	1.04	1.45	1.42	1.45	1.58	1.46	1.51	1.58	1.68	1.77
Total DOD (in US$) 1/	3536.74	3760.12	3753.16	3921.75	4077.06	4204.19	4333.06	4455.28	4580.17	4741.80	4913.83
DOD/IGS 2/	261.64	255.75	237.90	235.19	231.60	223.79	214.76	205.22	195.26	186.02	177.18
DOD/XGS	363.51	364.99	341.10	334.16	321.37	303.32	284.79	266.79	249.71	235.25	221.73
DOD/GDP	79.16	74.89	70.28	68.18	66.60	63.78	60.92	57.99	55.13	52.73	50.44
Debt Service (in US$)	404.67	423.38	451.28	417.19	416.32	461.83	459.21	418.53	412.15	386.29	377.20
Debt Service/IGS	29.94	28.80	28.60	25.02	23.65	24.58	22.76	19.28	17.57	15.15	13.60
Debt Service/XGS	41.59	41.10	41.01	35.55	32.82	33.32	30.18	25.06	22.47	19.17	17.02
Debt Service/GDP	9.06	8.43	8.45	7.25	6.80	7.01	6.46	5.45	4.96	4.30	3.87
Interest (in US$) 1/	170.37	192.66	193.36	188.47	174.98	176.05	176.78	180.20	186.09	193.08	202.48
Interest/IGS	12.60	13.10	12.26	11.30	9.94	9.37	8.76	8.30	7.93	7.57	7.30
Interest/XGS	17.51	18.70	17.57	16.06	13.79	12.70	11.62	10.79	10.15	9.58	9.14
Interest /GDP	3.81	3.84	3.62	3.28	2.86	2.67	2.49	2.35	2.24	2.15	2.08
Consumption/GDP	91.60	90.28	89.88	88.91	88.05	87.07	86.13	85.50	84.92	84.56	84.22
Domestic Savings/GDP	8.40	9.72	10.12	11.09	11.95	12.93	13.87	14.50	15.08	15.44	15.78
Gross Investment/GDP	11.45	13.38	14.18	15.06	15.64	16.22	16.84	17.16	17.48	17.71	17.94
National Savings/GDP	3.46	5.07	5.71	6.94	8.09	9.21	10.32	11.07	11.73	12.18	12.60
Public Investment/GDP	7.85	8.34	8.66	9.00	9.26	9.51	9.78	9.86	9.93	9.99	10.04
Private Investment /GDP	4.09	4.55	5.03	5.56	5.89	6.22	6.57	6.81	7.06	7.23	7.41
Ratio of Public/Private Investment	1.92	1.83	1.72	1.62	1.57	1.53	1.49	1.45	1.41	1.38	1.35
Export Growth Rate 3/	15.38	6.13	5.73	5.31	5.03	5.29	5.53	5.60	5.73	5.89	6.05
Exports/GDP	18.09	16.93	16.99	16.84	17.20	17.58	17.99	18.39	18.78	19.17	19.55
Import Growth Rate 4/	11.25	7.57	7.17	4.02	3.80	4.41	4.78	4.62	4.94	5.59	5.65
Imports/GDP	20.70	20.23	20.90	20.76	20.84	20.79	20.87	20.93	21.03	21.24	21.45
GDP in US$	4467.94	5020.81	5340.01	5751.80	6121.96	6592.12	7113.18	7682.95	8307.58	8992.40	9742.79
Exports of G&S	972.93	1030.19	1100.31	1173.62	1268.67	1386.04	1521.50	1669.93	1834.18	2015.62	2216.11
Imports of G&S	1351.75	1470.26	1577.65	1667.50	1760.39	1878.65	2017.58	2171.01	2345.62	2549.08	2773.38

1/ DOD includes only Public and Publicly Guaranteed.
2/ Imports of Goods and Services.
3/ Merchandise Exports.
4/ Merchandise Imports.

Bolivia: Debt Figures
(in Current US$)

10 May 1991

	Actual 1980-84	Actual 1985-89	Estimate 1990	Estimate 1991	Projections 1991-95	Projections 1996-2000	Projections 1991-2000
Principal Repayments							
Multilateral	16.9	76.4	98.8	90.0	100.2	124.5	112.4
of which IBRD	7.6	17.9	8.7	8.1	12.4	14.7	13.5
of which IDA	0.5	1.1	11.5	12.6	8.3	5.8	7.0
Bilateral: Scheduled	40.7	106.2	130.8	138.3	145.1	97.3	121.2
Projected	40.7	34.5	26.6	25.6	57.8	88.4	73.1
Private	55.5	8.5	4.7	2.4	3.5	1.1	2.3
Total: Scheduled	113.1	191.1	234.3	230.7	248.9	222.9	235.9
Projected	113.1	119.4	130.1	118.0	161.6	214.0	187.8
Memo: IMF repurchases	9.2	30.3	42.0	46.0	30.5	28.6	29.5
Interest Payments							
Multilateral	30.2	51.2	77.7	87.9	104.4	149.8	127.1
of which IBRD	14.3	18.6	21.0	19.2	14.1	2.9	8.5
of which IDA	0.6	1.3	2.4	2.7	3.9	7.1	5.5
Bilateral	41.2	102.0	89.6	101.6	78.3	36.1	57.2
Private	106.5	11.0	3.1	3.1	2.4	1.7	2.1
Total	177.9	164.2	170.4	192.7	185.1	187.7	186.4
Memo: IMF interest charge	6.2	8.4	16.0	13.2	7.4	4.2	5.8

Bolivia: Debt Ratios

	1989	1990	1991	2000	1991-95	1996-2000	1991-2000
Interest/Exports	18.50%	17.51%	18.70%	9.14%	15.77%	10.25%	13.01%
Debt/Exports	384.07%	363.51%	364.99%	221.73%	332.98%	251.65%	292.32%
Net Disbursements/Interest	113.65%	90.17%	57.44%	84.09%	47.70%	70.16%	58.93%
Net Transfers/GDP	0.50%	-0.37%	-1.63%	-0.33%	-1.70%	-0.69%	-1.19%

Note: Ratios exclude rescheduled amortization.

PROJECTED FOREIGN EXCHANGE REQUIREMENTS

(US$ millions at Current Prices)

10 May 1991

	(Actual)		(Estimate)		(Projections)		
	1980-84	1985-89	1990	1991	1991-95	1996-2000	1991-2000
Gross Disbursements							
Multilateral	93.1	194.4	227.4	216.6	257.4	298.6	278.0
of which IBRD	29.1	3.2	0.0	0.0	0.0	0.0	0.0
of which IDA	6.7	47.4	48.2	59.5	69.3	64.1	66.7
Bilateral	88.9	151.5	160.5	124.8	79.6	57.1	68.4
Private	102.2	2.9	0.0	0.0	0.1	0.0	0.0
Total ..1/	284.2	348.9	387.9	341.4	337.1	355.7	346.4
Memo: IMF Purchases	28.5	56.6	30.4	65.0	13.0	0.0	6.5
Net Disbursements							
Multilateral	76.2	118.0	128.6	126.6	157.2	174.1	165.6
of which IBRD	21.5	-14.7	-8.7	-8.1	-12.4	-14.7	-13.5
of which IDA	6.3	46.3	36.7	46.9	61.0	58.3	59.7
Bilateral	48.2	45.3	29.7	-13.5	-65.5	-40.2	-52.8
Private	46.8	-5.6	-4.7	-2.4	-3.5	-1.1	-2.3
Total ..1/	171.1	157.7	153.6	110.7	88.2	132.8	110.5
Memo: IMF net purchases	19.3	26.3	-11.6	19.0	-17.5	-28.6	-23.0

1/ Public & publicly guaranteed only.

10 May 1991

Bolivia: Base Case Projections, 1989-2000

	1989	1990	1991	1995	2000	(Averages) 1991-95	1996-2000	1991-2000
Constant Prices								
GDP Growth Rate	2.70%	2.70%	3.48%	4.20%	4.48%	4.03%	4.32%	4.16%
Per Capita Consumption Growth ..1/	-4.00%	-1.76%	-1.48%	0.47%	1.32%	-0.20%	0.89%	0.34%
Investment as %GDP	11.99%	11.45%	13.38%	16.22%	17.94%	14.90%	17.43%	16.16%
Domestic Savings as %GDP	8.32%	9.83%	11.73%	15.48%	17.83%	13.66%	17.15%	15.41%
External Savings as %GDP ...2/	3.67%	1.63%	1.65%	0.74%	0.11%	1.23%	0.28%	0.76%
Current Prices								
Current Acc. Balance as %GDP	-8.70%	-8.00%	-8.32%	-7.01%	-5.34%	-7.89%	-5.85%	-6.87%
Public Debt as %GDP	75.71%	79.16%	74.89%	63.78%	50.44%	68.75%	55.44%	62.09%
GDP in billion US$	4.5	4.5	5.0	6.6	9.7	5.8	8.4	7.1

1/ Simple annual average
2/ Trade balance

Bolivia: Investment Financing, as %GDP

	1989	1990	1991	1995	2000	(Averages) 1991-95	1996-2000	1991-2000
Uses of Funds								
Investment	12.0%	11.5%	13.4%	16.2%	17.9%	14.9%	17.4%	16.2%
Scheduled Debt Service ..1/	10.2%	10.7%	9.7%	8.5%	5.4%	9.0%	6.5%	7.7%
Change in Reserves	-3.1%	2.2%	1.5%	0.3%	0.8%	0.7%	0.5%	0.6%
TOTAL...........	19.0%	24.3%	24.6%	25.0%	24.1%	24.6%	24.5%	24.5%
Sources of Funds								
Domestic Savings	8.3%	8.4%	9.7%	12.9%	15.8%	11.2%	14.9%	13.0%
Project Disbursements	7.2%	7.0%	5.4%	5.4%	3.5%	5.4%	4.3%	4.9%
Capital Inflow ..2/	0.4%	4.9%	5.8%	5.8%	4.8%	6.0%	5.1%	5.5%
Required Rescheduling from Bilateral Creditors..3/	3.1%	4.0%	3.7%	0.8%	0.0%	2.0%	0.1%	1.1%
TOTAL............	19.0%	24.3%	24.6%	25.0%	24.1%	24.6%	24.5%	24.5%

1/ Includes other net factor service payments
2/ Net of capital outflow
3/ Rescheduling necessary to reduce external payments such that projected investment can be financed from domestic and external savings. All rescheduling is expected from bilateral creditors.

10 May 1991

Bolivia: Debt Indicators

	----(Averages)---- 1980-84	1985-89	1989	1990	1991	1995	2000	--------(Averages)-------- 1991-95	1996-2000	1991-2000
Debt Ratios a/										
A. Bank and IDA Ratios										
Share of Total Long-term DOD:										
1.IBRD as % of Total	6.9	5.8	5.8	5.4	4.9	3.1	1.1	4.1	1.8	2.9
2.IDA as % of Total	2.9	4.7	9.5	10.2	10.9	15.9	19.5	13.4	18.3	15.9
3.IBRD+IDA as % of Total	9.9	10.6	15.3	15.6	15.7	18.9	20.7	17.5	20.0	18.8
Share of LT Debt Service:										
1.IBRD as % of Total	7.5	10.9	9.8	7.3	6.4	5.9	2.9	6.1	4.2	5.2
2.IDA as % of Total	0.3	0.7	0.9	3.4	3.6	1.7	4.4	2.8	3.2	3.0
3.IBRD+IDA as % of Total	7.9	11.6	10.7	10.8	10.1	7.6	7.3	8.9	7.4	8.2
B.DOD-to-Exports Ratios a/										
1.Long-Term Debt/Exports	309.2	538.9	384.1	363.5	365.0	303.3	221.7	333.0	251.7	292.3
2.IMF Credit/Exports	12.5	24.3	26.6	26.4	26.8	12.2	1.2	18.7	4.3	11.5
3.Short-Term Debt/Exports	35.8	104.6	85.5	80.2	75.8	56.4	35.2	66.3	42.9	54.6
4.LT+IMF+ST DOD/Exports	357.5	667.8	496.2	470.1	467.6	371.9	258.2	418.0	298.8	358.4
C. Debt Service/Exports b/										
1.Public & Guaranteed LT	31.0	48.7	42.0	41.6	41.1	33.3	17.0	36.8	22.8	29.8
2.Private Non-Guaranteed LT	3.5	5.4	4.0	3.6	3.4	2.8	1.8	3.1	2.2	2.7
3.Total Long-Term Debt Service	34.5	54.1	46.1	45.2	44.5	36.1	18.8	39.9	25.0	32.4
4.IMF Repurchases+Serv. Chgs.	1.7	5.4	2.4	6.0	5.7	2.1	0.9	3.3	1.9	2.6
5.Interest only on ST Debt	12.7	1.7	2.3	2.2	1.7	2.2	2.1	1.9	2.1	2.0
6.Total (LT+IMF+ST Int.)	49.0	61.2	50.7	53.3	52.0	40.3	21.8	45.1	29.0	37.0
E. Interest Burden Ratios c/										
2.Total Interest/Exports	19.0	22.5	18.5	17.5	18.7	12.7	9.1	15.8	10.3	13.0

a/ Long-Term Debt includes only Public and Publicly Guaranteed.
b/ Exports of Goods and Services.
c/ Interest includes only Public and Publicly Guaranteed.

Bolivia: Base Case Balance of Payments Projections
(1988 - 2000)

10 May 1991

	1988	1989	1990	1991	1995	2000	(Averages) 1991-95	1996-2000	1991-2000
Exports of G&NFS	673.2	868.4	955.9	1009.3	1364.0	2189.1	1170.2	1826.5	1498.3
Import of G&NFS	914.8	1034.1	1092.3	1193.1	1580.6	2399.3	1384.6	2032.4	1708.5
Trade Balance	-241.6	-165.7	-136.3	-183.8	-216.5	-210.2	-214.5	-205.9	-210.2
Net Factor Services	-260.0	-249.3	-242.5	-256.3	-276.1	-347.1	-264.6	-314.0	-289.3
Interest Due	-226.4	-235.7	-242.6	-259.1	-249.2	-293.8	-252.0	-272.1	-262.1
Net Private Transfers	12.8	21.9	21.6	22.5	30.8	37.2	26.9	34.4	30.7
Current Account Balance	-488.8	-393.1	-357.2	-417.6	-461.8	-520.1	-452.2	-485.4	-468.8
Capital Account	341.6	380.0	381.3	371.8	417.8	597.7	389.8	524.1	456.9
Net Official Transfers	123.9	133.9	138.4	160.0	222.1	270.0	194.7	250.2	222.5
Private Capital Flow ..1/	30.0	35.0	35.0	50.0	83.2	112.4	70.6	98.1	84.3
Net LT Lending	193.6	187.3	153.6	110.7	72.4	170.3	88.2	132.8	110.5
Other Flows ...2/	-5.8	23.8	54.3	51.1	40.0	45.0	36.2	43.0	39.6
Change in Reserves	29.8	139.8	-98.9	-75.0	-19.0	-77.6	-39.8	-47.5	-43.7
Exceptional Financing ...3/	117.4	-126.7	74.8	120.8	63.1	0.0	102.2	8.9	55.6

1/ Mostly net direct foreign investment
2/ Includes Short-term capital, private non-guaranteed, errors and omissions, and unpaid gas receipts from Argentina.
3/ Includes required rescheduling of amortization from bilateral creditors and changes in arrears.

II. Status of Bank Group Operations

A. STATEMENT OF BANK LOANS AND IDA CREDITS IN BOLIVIA (as of June 30, 1991)

Credit Number	Fiscal Year	Borrower	Purpose	Amount (less cancellations) Bank	IDA	Undis-bursed
16 Loans and 21 Credits fully disbursed				274.78	247.05	
17030	1986	Bolivia	Reconstr. Import Cr.		55.00	0.72
18090	1987	Bolivia	Financial Mgt (PFMO)		11.50	0.73
18180	1987	Bolivia	Power Sector Rehab		6.80	0.55
18280	1987	Bolivia	Reconstr. Import Cr. II		47.10	6.69
18420	1988	Bolivia	La Paz Municipal Devt		15.00	3.82
19770	1989	Bolivia	Econ Mgt Strength Opn		9.70	5.69
20120	1989	Bolivia	Export Corridors		37.00	30.34
20130	1989	Bolivia	Mining Sector		35.00	32.30
20920	1990	Bolivia	Integrated Health Devt		20.00	17.67
21190	1990	Bolivia	Eastern Lowlands		35.00	33.50
21270	1990	Bolivia	Social Invest't Fund		20.00	18.02
21340	1990	Bolivia	Private Enterprise Devt		16.10	16.47
19253 (S)	1991	Bolivia	Financial Sector - C		14.50	13.70
21870	1991	Bolivia	Water Supply & Sewerage		35.00	33.20
22160	1991	Bolivia	Technology Dev't		21.00	19.76
22790	1991	Bolivia	Public Financial Mgt II		11.30	11.20
					390.00	244.36
		TOTAL		274.78	637.05	
		Of which repaid		150.54	11.39	
		Total held by Bank & IDA		124.24	625.66	
		Amount sold		0.05		
		Of which repaid		0.05		
		Total Undisbursed				244.60

B. STATEMENT OF IFC INVESTMENTS (as of June 30, 1991)

	Loan	Equity	Total
	(In millions of U.S. dollars)		
Total gross commitments	26.54	10.60	37.14
Less cancellations, terminations, repayments, and sales	10.26	1.20	11.45
Total commitments now held by IFC	16.29	9.40	25.69
Total undisbursed	0.00	5.90	5.90

Presidencia de la República
MINISTERIO DE PLANEAMIENTO
Y COORDINACION
BOLIVIA

July 19, 1991

Mr. Barber B. Conable
President
International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
USA

Dear Mr. Conable:

The Government of Bolivia hereby requests a credit from the International Development Association to support a structural reform program. The objective of the program is to increase the level and efficiency of investment by improving incentives for and regulation of private sector economic activity, reducing the share of economic activity carried out directly by the public sector and improving the efficiency of public sector investment and enterprises. These reforms are of fundamental importance to the acceleration of growth of the Bolivian economy, within a framework of price stability.

The financial assistance requested will release counterpart funds which will help finance the costs associated with the reform program. These costs include: (i) expenses related to the restructuring or liquidation of state-owned financial institutions; (ii) costs of severance payments and unfunded pension liabilities of public banks and enterprises subject to privatization, liquidation or restructuring; and (iii) short-term costs of technical assistance to improve prudential regulations and supervision of the financial system, until more permanent arrangements can be made to cover such costs.

The Macroeconomic Reform Program

Macroeconomic stability and avoidance of Government interference in private sector economic decisions have been fundamental elements of Bolivia's economic policies since the 1985 stabilization program. The Government remains committed to a sustainable macroeconomic program, which has been supported by an Enhanced Structural Adjustment Facility from the International Monetary Fund. The medium-term goals of the program are to achieve a GDP growth rate (in real terms) of approximately 4% per year, to maintain price stability and to improve the conditions of the poor. Key policies to achieve these goals include: (i) maintenance of macroeconomic stability through market determination of the exchange rate and interest rates, improved tax administration and reductions in current expenditures; (ii) increased incentives for private sector economic activity through continued commitment to a liberal market structure, increases in the supply of infrastructure and other public goods and implementation of the structural

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reforms described below; and (iii) well-targeted social programs to increase services to Bolivia's poorest groups and to raise their productivity.

The success of this program will require a considerable commitment of both foreign and domestic resources to raise the level of investment. Substantial commitments from official donors will be required over the next ten years to finance the investment essential for growth. Continued debt relief also will be required for the next few years, including provision by the Paris Club of concessional rescheduling terms. The Government will provide increased domestic financing of investment through a strong fiscal effort. Given that tax collections remain considerably below their potential, the Government will undertake a study of measures to reduce tax evasion and implement an action plan to reduce tax evasion based on the study's recommendations. At the same time, establishment of an appropriate framework to encourage increased private domestic savings and capital inflows. The proposed structural adjustment program is essential to achieve these goals.

The adjustment program would address key bottlenecks to growth, through: (i) financial sector reform - closure or restructuring of public banks (in accordance with paragraph 6 below), improvements in the supervision and regulation of financial intermediaries, improvements in the allocation of development credit and removal of some of the more important impediments to capital market development; (ii) public enterprise reform - improvement of the efficiency of enterprises that provide public goods or operate as natural monopolies and sale or liquidation of productive enterprises; (iii) legislation to improve the climate for private sector investment; (iv) improvements in the selection of public sector investment projects; (v) improvements in trade and registration procedures; and (vi) efforts to increase health and education expenditures that benefit the poor.

II. Financial Sector Reform

Public Banks. The Government is committed to eliminating its role as a direct financial intermediary to private sector borrowers in the Bolivian economy. The Government will therefore not support or establish institutions to lend directly to the nonfinancial private sector. To this end, it has issued decrees to privatize or close and liquidate the Bolivian Agricultural Bank (BAB), Bolivian Mining Bank (BAMIN) and the National Mining Exploration Fund (FONEM). As a result, these institutions have: (i) ceased their lending operations; (ii) established plans for retaining only those employees directly involved in loan or asset recovery or in liquidation; (iii) established plans for loan sales, recovery or liquidation, and sale of fixed assets, recovery of permanent investments, and reconciliation of assets and liabilities with the Central Bank; and (iv) established measures to transfer to the Treasury of any funds recovered after paying debts. Professional staff responsible for implementing the above programs have been designated, and will be responsible

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for contracting external consultants either to sell the institutions or prepare liquidation plans and to initiate liquidation procedures.

By the end of 1992, BAB, BAMIN and FONEM either will have been completely sold to the private sector or closed. For any institution not sold to the private sector, by the end of 1992 personnel will have been reduced to only those employees directly involved in loan or asset recuperation or liquidation and those employees released will receive due compensation. From 1991-93, the Government will implement the plan for the sale, legal adjudication and liquidation of financial and fixed assets held by these institutions.

The Government also is aware of the difficulties experienced by the Bolivian State Bank (BANEST), and is investigating the possibility of selling BANEST to the private sector. In the interim, the Government has issued a Supreme Decree significantly redefining BANEST's functions. BANEST may continue to act as a financial agent for the Government, and may provide selected banking services in some locations where commercial banks are not located, including: (i) serving as a window for the Central Bank, (ii) providing fiscal services, including receipt and transfer of taxes and duties and payment of Government salaries and benefits, (iii) receiving deposits from the general public, and (iv) making funds transfers and selected other financial services.

BANEST has ceased lending and has developed a plan to release employees involved in lending operations, with due compensation. The Government has initiated an evaluation of the costs and benefits of BANEST's role as a financial agent and the provision of the banking services indicated above. This evaluation will consider: (i) the potential for using the private sector as a financial agent, rather than BANEST; and (ii) the costs and benefits of providing the banking services indicated above through each of BANEST's branches, including an evaluation of offering services through alternative institutions. By December 1992, the Government will have transferred to the private sector all BANEST functions which the evaluation determines that the private sector can undertake more efficiently than BANEST. The Supreme Decree provides that BANEST will not be provided any subsidy from the Treasury. The Government has accelerated the liquidation of BANEST's past due loan portfolio, assets received in lieu of loan payments, and other fixed assets, in accordance with an agreed plan. Further, the Government has provided that large taxpayers may deposit their tax payments in commercial banks, thus eliminating the restriction of those payments to BANEST.

Any sale of BANEST or any of its branches to the private sector will be completed by December 1992. By December 1992, each and every branch

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will be closed, unless the Government finds that its operation is cost-effective and justifiable (in accordance with the study indicated in paragraph 9 above). For branches of BANEST that are closed, personnel will be reduced to only those involved in asset recuperation or liquidation. Further, from 1991-93, the Government will implement the plan for the recovery, sale or liquidation of financial and fixed assets of BANEST.

The Government has issued a Supreme Decree modifying the objectives of the **Fondo de Desarrollo Campesino** (FDC) to ensure that the FDC will not have access to development credit for onlending purposes and will not be eligible as a *direct* financial intermediary to private sector borrowers. By the end of 1992, the Government will define the FDC's role in serving the rural poor in the most effective manner possible, consistent with the Government's financial sector policies. The primary function of the FDC will be to provide funds for the construction of infrastructure and provision of social services and technical assistance to small agricultural producers. To the extent that the FDC channels funds to financial intermediaries, the following conditions will apply: (i) funds will be channeled only through eligible financial intermediaries (approved ICIs); (ii) the interest rate charged the ICI will be no less than the observed auction rate of development credits during the week prior, and (iii) funds will be subject to full recovery by the FDC as supervised by the Superintendency of Banks and Financial Entities (SBEF).

Development Credit. The Government is dedicated to ensure the optimal allocation of external credits for developmental purposes. To facilitate the allocation of these credits to banks according to market conditions, the Government has implemented a system of auctioning funds to qualifying institutions (ICIs) and has removed restrictions on the interest rate charged to final borrowers on development credits. To further ensure that intermediation of development credit reflects market conditions, the Central Bank has established a floor rate on the auctioning of these credits. This rate shall be no less than the average borrowing rate of the banking system, including public deposits (savings and time) and BCB CEDES. Further, in order to ensure financial discipline and full bearing of credit risk by ICIs in development credit lending, the Central Bank will not reschedule development credits (unless an institution is intervened). This restriction will not preclude lending to financial institutions by the Central Bank under normal liquidity support operations. Finally, to ensure the quality of final projects financed by development credit, the Central Bank requires as a condition of annual ICI re-certification that each institution maintains a share of non-performing loans on such credits no more than 50% higher than the average rate of non-performance for the private commercial banking system.

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The Government has issued a Supreme Decree authorizing the establishment of new non-bank financial intermediaries (banking houses). The Central Bank has issued a resolution providing eligibility criteria for access of banks and banking houses to development credit. Non-bank financial institutions which do not meet those legal and normative requirements applicable to banking houses (as certified by the Superintendency of Banks and Financial Entities (SBEF)) will not be eligible to receive development credits from the Central Bank. Institutions presently eligible for access to development credit will have until July of 1992 to fulfill these legal requirements. The Government will ensure that eligibility criteria for access to development credit are enforced and that ICIs are supervised in a manner consistent with sound regulatory practices.

Improvement in Regulation and Supervision of Financial Intermediaries. Significant progress has been made in the supervision and regulation of financial intermediaries since the establishment in November 1987 of an independent SBEF. Prudential regulations have been improved and the institutional capacity of the SBEF has increased significantly. The Government supports the further institutional strengthening of the SBEF.

Within the next few weeks, the Government will present to Congress a draft law for the regulation and supervision of the financial system. The law would include: (i) a minimum SDR amount of capital required for operation as a bank; (ii) a 6% minimum capital requirement in relation to assets; (iii) credit limits, including credits to related parties; (iv) auditing, financial reporting and information disclosure requirements; (v) authority, autonomy and responsibilities of the SBEF; (vi) fines and sanctions for non-conformity with the law; (vii) conditions for bank intervention; and (viii) mechanisms for handling bank crises, including liquidation procedures. By December 1992, the Government will have issued regulations implementing the banking law and have begun to enforce these regulations.

The Government will continue to implement the agreed action plan to improve regulation and supervision of the financial system according to the provisions indicated in the law described above. This plan includes: (i) strengthening the classification system for commercial bank loans and investments, including the assessment of loan collateral; (ii) establishment of an adjustment period for strengthening the capital base of commercial banks to reflect the stricter loan classification system and provisioning requirements (including 10% provisions for Class 3 loans by end-1993); and (iii) enforcement by the SBEF of regulations ensuring that commercial banks require that businesses receiving loans above the amount established in the tax law (Law 843) submit financial statements prepared by external auditors.

The Government will initiate a program for the management of bank crises, which will contain the following elements: (i) a preventive

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surveillance regime for banks that violate certain objective criteria; (ii) intervention of banks that do not comply with an agreed rehabilitation plan after being subject to preventive surveillance, which have lost more than 50% of their capital or which have (in the opinion of the SBEF and the Central Bank) committed egregious violations of prudential regulations; (iii) criteria for determining whether to rehabilitate or liquidate intervened banks; (iv) rules for the provision of short-term liquidity support by the Central Bank; and (v) a commitment not to insure commercial bank and banking house deposits in excess of US$5,000.

Increase in Credit Market Information. The Government will encourage selective disclosure of credit market information, in order to deepen the level of financial intermediation and to facilitate more objective decision-making and market discipline by depositors, investors and borrowers. The Government will: (i) permit selective disclosure by the Central de Riesgos of the Superintendency of Banks of credit information to institutions and individuals other than banks, provided that the potential borrower provides explicit written authorization; (ii) publish rulings by tax authorities on issues related to financial markets, including a clarification of the application of the transactions tax across financial instruments or institutions; (iii) require disclosure by banks and by banking houses on a monthly basis of aggregate loans by classification, as well as the associated guarantees and provisions for each category; (iv) issue an SBEF circular requiring banks to disclose to their customers the effective annual interest rate on deposits and loans, including all fees and commissions on a uniform basis.

Improvements in the Functioning of the Central Bank. Recognizing the importance of automatic, short-term liquidity support for financial institutions experiencing liquidity problems, the BCB will ensure that resources are provided in accordance with the rules set forth in the law discussed above. The Government (including the Central Bank) will not undertake any wholesale refinancing of commercial bank loans (except for liquidity support) nor offer direct financing for, or contributions to, banks' capital (outside of BCB capitalization financing to individual institutions for purposes of merger or sale after intervention). The Central Bank will undertake a program to strengthen the Gerencia del Sistema Financiero (GSF) to improve its capacity to administer eligibility criteria for the intermediation of development credit and to manage banks in crisis. Furthermore, the Central Bank will restructure and strengthen the Gerencia de Desarrollo in order to improve its administration of the credit auction mechanism and streamline the operating and institutional procedures related to the transfer and supervision of development credit resources.

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Strengthening of Capital Markets. The Government will undertake the following actions to improve the competitiveness, efficiency, and transparency of capital markets:

(i) amend relevant laws and regulations to permit **sociedades limitadas** to issue and trade all forms of securities (e.g. commercial paper) subject to disclosure requirements, registration and authorization by the **Comision Nacional de Valores** (CNV), and issue CNV circulars to regulate private institutions rating these securities issues;

(ii) amend relevant laws and regulations to allow origination and trading of bankers acceptances on the securities exchanges based on storage warrants (i.e. warehouse receipts) issued by licensed warehouses (**Almacenes Generales de Deposito**) and to allow the trading of the warrants by **sociedades anonimas** and **limitadas**;

(iii) amend relevant laws and regulations to permit brokers to carry securities for their own account, which will permit them to act as underwriters;

(iv) improve procedures for repossession of collateral pledged in lending contracts involving chattel mortgages, permit trading of such contracts and improve the commercial registration system for contracts secured with moveable property and other forms of collateral.

The Government will undertake a study of the contractual savings system to improve its efficiency as a provider of long-term savings. Specific reforms to social security/pensions and insurance will be examined. Some of the more important issues to be investigated include: (i) the extent of minimum retirement and health benefits that should be provided by the social security system; (ii) estimates of the fiscal costs of maintaining the present system compared to privatization of the provision of retirement benefits; (iii) barriers to different forms of private voluntary pension schemes; (iv) barriers to competition in the management of the assets of pensions funds and to the mobility of participants across plans; and (v) necessary changes to permit insurance companies to issue debt and to diversify asset portfolios (including offshore investments), to deregulate insurance premia and to allow insurance companies to act as managers of pension fund assets.

Actions also will be taken to improve the supervision of capital market institutions through strengthening or reorganizing the **Superintendencia Nacional de Seguros y Reaseguros** (SNSR), the **Instituto Boliviano de Seguridad Social** (IBSS), and the CNV. Staff will be reduced in the SNSR and IBSS, and

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examinations undertaken to ensure that remaining staff have appropriate technical skills. External audits of all insurance companies and of the complementary pension funds will be undertaken. Insurance companies not meeting minimum capital requirements (inclusive of technical reserves) will be subject to bankruptcy proceedings if capital is not increased after a prescribed period of time.

The Government will undertake a study of the specific changes in law and regulation necessary to effect the recommendations of the contractual savings study and to improve the supervision of capital market institutions. Also, changes in the insurance law, the social security law and in the organic law defining the role and functions of the CNV will be considered to ensure sufficient managerial independence for those agencies.

Public Enterprise Reform

The 1985 adjustment program tightened financial controls and reduced deficits in state-owned companies, but public enterprises remain important in many sectors of the economy. Further reforms are now required to improve the productivity of investment by increasing the role of the private sector in the economy, improving the efficiency of the major public enterprises and redirecting public sector efforts towards the provision of basic infrastructure and services.

The Government has begun a program to improve the performance, efficiency and financial self-sufficiency of public enterprises which will remain in the public sector. Performance contracts have been signed with three major public enterprises, including: ENDE (electricity generation and transmission); ENFE (rail); and ENTEL (long distance and international telecommunications). A performance contract will be signed with YPFB (hydrocarbons) in the near future. The contracts set out the performance targets and incentives for enterprise management, provide for increased managerial autonomy and accountability, and facilitate increased private sector participation in the activities controlled by the enterprises. In some cases, the contracts call for further restructuring measures during the period of the contract. In the case of ENFE, a restructuring plan will provide for severance or retirement payments for released employees, provision for the inventory and sale of unproductive assets and elimination of non-commercial activities (including the closure of unprofitable lines). Counterpart funds from the Credit will be used to pay severance payments. In the case of ENTEL, a plan for opening up the telecommunications sector to increased competition will be prepared and implemented by mid-1992.

In the mining and hydrocarbons sectors, where constitutional restrictions prevent outright privatization, new laws have been enacted to

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increase private sector participation and investment through joint ventures. In hydrocarbons, contracts have been signed with eight foreign firms involving US$183 million in expenditures on exploration and development, and negotiations are underway on contracts worth an additional US$680 million. The Government will request assistance from donors in reviewing this program to see if improvements are desirable in the form of future contracts. In the mining sector, the Government has entered into leasing agreements with foreign firms for the exploitation of some properties. The Government is implementing a program to limit COMIBOL's losses, including reductions in personnel, cessation of investment in COMIBOL properties, preparation of an analysis of the costs and incomes from COMIBOL mines (including a determination of which mines incur losses and should be closed), and completion of audit reports of COMIBOL operations. By December 31, 1992, the Government will complete the long-term study for the reorganization of COMIBOL and close all unprofitable mines.

In parallel with these measures, strict budgetary and financial discipline will continue to be exercised. The Government has prepared a plan to eliminate all transfers to national and regional enterprises (beyond those required to provide legitimate public services - such as water, waste disposal and electricity) and to eliminate arrears between public enterprises. In accordance with this plan, all budgetary transfers (excluding those for agreed public services) and arrears will be eliminated by December 31, 1993.

The Government has launched a broad privatization program with the objective of divesting, over the medium term, all public enterprises operating in competitive markets (with the exception of the mining and hydrocarbons sectors where there are Constitutional restrictions against outright sale of Government assets). Steps have been taken to implement the privatization program, including: (i) establishment of an inter-ministerial committee, assisted by a small technical secretariat, to oversee the program; (ii) design of a proposal for the implementation of the program through contracting with external firms; (iii) issuance of a policy statement setting out the broad objectives and agenda for the initial phase of the program; and (iv) issuance of guidelines setting out the procedures to be followed in implementing the program.

Targets for the privatization program will be defined in terms of numbers of enterprises, formed into three groups according to the dollar value of fixed assets: Lloyd Aereo Boliviano, large enterprises (the 6 enterprises with fixed assets valued above US$9 million) and smaller enterprises (the 7 enterprises with fixed assets valued from US$1-5 million). By December 31, 1992, the Government will bring enterprises to point of sale (including approval for privatization, completion of valuations and sales documentation, and offering the companies for sale) sufficient to meet the following targets: (i) Lloyd Aereo Boliviano, 2 large enterprises and 3

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smaller enterprises; or (ii) 3 large enterprises and 5 smaller enterprises. By December 31, 1993, the Government will bring additional enterprises to point of sale sufficient to meet the following targets: (i) Lloyd Aereo Boliviano, 4 large enterprises and 5 smaller enterprises; or (ii) 5 large enterprises and 6 smaller enterprises.

To ensure transparency and efficiency, the privatization program will be implemented on the basis of the following principles: (i) enterprises will be priced realistically to reflect market value; (ii) no market protection will be provided to purchasers; (iii) no new investments, Government transfers or credit will be approved or provided for enterprises targeted for privatization; (iv) the sale to other state enterprises or public agencies will be precluded; (v) new owners will have flexibility in making workforce adjustments, but the Government will ensure that employees are treated fairly in the process (including appropriate transition arrangements and payment of severance and pension liabilities); (vi) funds for the settlement of any outstanding liabilities will be allocated in the annual Government budget; (vii) the Government will require that privatized enterprises be established as **sociedades anonimas**, unless the Government finds that it is prohibitively expensive to do so; and (vii) in the context of the overall Government policy to reduce the scope of the public sector, no new State-owned company or joint venture between the Government and the private sector will be established in the industrial or agriculture sectors.

<u>Trade and Registration Procedures</u>

The Government is committed to improving and streamlining procedures under which private sector firms conduct trade and operate in the domestic market. Several measures have been initiated with this objective in mind. Supreme Decree 22407 provides for some simplification of export procedures, and the Ministry of Finance recently completed recommendations for further simplification. A joint commission of the Ministry of Industry, Commerce and Tourism and representatives of the Association of Small Entrepreneurs (FEBOPI) has been constituted in order to diagnose and to gradually reduce registration and operating procedures imposed by public institutions at various levels, particularly affecting small firms. In order to compensate exporters for duties paid on their inputs, the Government has replaced the *Certificado de Reintegro Arancelario* (CRA), which implied a substantial subsidy, with a system of largely automatic duty drawbacks, and has introduced a system of temporary admission. The Government has further designed a project with support from the IDB and the Spanish Customs Service to improve the efficiency of the customs service with the intention of facilitating trade and raising Government revenues.

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Building on these initial measures, the Government will undertake the following additional actions to improve and streamline procedures under which private sector firms conduct trade and operate in the domestic market. A streamlined system of export procedures will be designed (in conjunction with the private sector), including the set up of a ventanilla unica. A proposal will be developed for streamlining registration and operating procedures for firms, based on the work of the newly established commission and other available diagnostic studies. The Government will implement the proposed customs reform program, which will include: (i) legal modifications (including a new Customs Code), revised and more easily controllable customs procedures and administration, and incentives for prosecuting cases of corruption and fraud; (ii) a new personnel strategy, including establishment of a customs service career and provision of training, a revised salary scale, and a new disciplinary code; (iii) privatization of some customs operations, including warehousing, buildings and the processing of documents; (iv) computerization of customs procedures; and (v) provision of adequate infrastructure.

Public Sector Investment

The quality of public sector investment has increased markedly since the early 1980s, and effective systems for the collection and organization of data on public sector investment have been introduced. To further improve project selection, the Government will work closely with the World Bank and the donor community in strengthening mechanisms for the evaluation of investment projects. From now until December 31, 1993, the Government will exchange views with the World Bank on all investments over US$10 million in the following sectors: transportation, agriculture, and water and sanitation. These investments will be undertaken only with the agreement of both the Government and The World Bank.

Legislative Proposals

Substantial progress has been made in establishing an appropriate framework for private investment. The investment law guarantees stable rules of the game for private investment, ensures equal treatment of domestic and foreign investors, prohibits restrictions on profit repatriation and simplifies procedures for registration of foreign investors. The hydrocarbons law provides legislative sanction for joint ventures between YPFB and the private sector, expands the areas eligible for private sector exploitation and removes restrictions on private sector ownership of oil and gas pipelines. The mining law provides legislative sanction for joint ventures between COMIBOL and the private sector and authorizes a tax regime that is consistent with tax policy in the home countries of most multinational enterprises (taxes

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paid on the previous *regalia* system cannot be deducted from companies' tax liability in home countries).

Health and Education Expenditures

The Government is committed to improving the welfare of the poor and to developing the human capital essential for economic growth. The potential impact of the adjustment program on some workers highlights the necessity of moving forward with programs to improve public services. One issue of great importance to the poor and to Bolivian development concerns the extremely low level of expenditures on primary health care and basic education, and in some cases the inefficient management of resources devoted to health and education. The Government's program described in this document should increase the supply of social services, as the savings expected through the reduction of Government interventions in productive sectors and greater efficiency in public sector operations will be reallocated to the social sectors. Further, the Government is now implementing a program to raise the share of current expenditures devoted to the health sector (from 3% of expenditures in 1989 to 3.8% in 1993), the share of current expenditures on health in the major cities devoted to primary health care (from about 25% in 1989 to 30% in 1993) and the personnel allocated to primary health care in the major cities (from 30% in 1989 to 40% in 1993). The Government also is developing a reform of the educational system to emphasize primary education, educational services in rural areas and education of women. As a part of this program, the Government will raise expenditures on texts and teaching materials for primary education, from close to zero in 1989 to 5% of current expenditures on primary education in 1992.

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Implementation of the Reform Program

The Government has established a coordinating committee headed by the Minister of Planning and Coordination and including the Minister of Finance, the President of the Central Bank, and the Superintendent of Banks to determine policies under the Structural Adjustment Program. A small unit reporting to the Minister of Planning and Coordination has been designated to administer the loan and coordinate with affected Government agencies. The unit will be in charge of: (i) preparing the appropriate information required for certification and supervision of each stage of loan processing, (ii) ensuring that technical assistance funds are channelled in accordance with the budget indicated in the loan documents, and (iii) ensuring that funds are disbursed according to IDA procedures.

Enrique Garcia Rodriguez
Minister of Planning and Coordination
of the Republic of Bolivia

Issues and Objectives	Prior Actions/Commitments	Second Tranche	Third Tranche
I. FRAMEWORK FOR STRUCTURAL ADJUSTMENT AND MACROECONOMIC MANAGEMENT			
Definition of a structural adjustment program designed to increase the level and efficiency of investment in the Bolivian economy.	Letter of Development Policy containing the policies to be implemented under the program, including improvements in the supervision and regulation of the financial system, improvements in the allocation of resources by the financial system and capital markets, reductions in the share of production carried out by the public sector, improvements in the performance of public sector investment and enterprises, reductions in the burden of administrative requirements and increases in the level of resources devoted to social services.	Maintenance of a macroeconomic framework consistent with the objectives of the program. Compliance with the policy objectives and programs included in the Structural Adjustment Program described in the Letter of Development Policy. Submission of an audit report on the disbursements made under the first tranche.	Maintenance of a macroeconomic framework consistent with the objectives of the program. Compliance with the policy objectives and programs included in the Structural Adjustment Program described in the Letter of Development Policy. Submission of an audit report on the disbursements made under the second tranche.
II. FINANCIAL SECTOR COMPONENT **A. PUBLIC BANKS**			
Improvement of allocation of resources through closure and/or restructuring of public banks and elimination of Government role in lending directly to the nonfinancial private sector.	Issuance of a Supreme Decree for the closure of BAB, BAMIN and FONEM. These institutions have ceased lending operations, established plans for retaining only those personnel directly involved in loan or asset recovery or in liquidation, and established a program for the recovery, sale, adjudication or liquidation of financial and fixed assets.	For each institution, either: (i) closure of the institution, release of employees not involved in loan recuperation or liquidation and compliance with the program for the recovery, sale, adjudication and liquidation of financial and fixed assets; (ii) sale to the private sector with no remaining Government participation.	Compliance with the program for the recovery, sale, adjudication and liquidation of financial and fixed assets of these institutions.
	Issuance of a Supreme Decree restricting BANEST's functions. BANEST has ceased lending, developed a plan to release employees involved in lending operations, established a program for the recovery, sale, adjudication or liquidation of financial and fixed assets, and will no longer receive any subsidy from the Treasury. Large taxpayers are now permitted to make tax payments through commercial banks. The Government has initiated an evaluation of BANEST's role as a financial agent and provider of banking services, to determine: (i) the potential for using the private sector as a financial agent for the Government; and (ii) the costs and benefits of providing banking services through BANEST's branches, including an evaluation of institutions.	Completion of either: (i) closure or sale to the private sector of branches found to be not cost effective or justifiable, transfer of those functions which can be more efficiently handled by the private sector, and compliance with the program for the recovery, sale, adjudication and liquidation of financial and fixed assets; or (ii) sale of BANEST to the private sector, with no remaining Government participation.	Compliance with the program for the recovery, sale, adjudication and liquidation of financial and fixed assets of BANEST.

Issues and Objectives	Prior Actions/Commitments	Second Tranche	Third Tranche
	Issuance of a Supreme Decree to ensure that the Fondo Desarrollo Campesino will not have access to development credit for onlending purposes and will not be eligible as a direct financial intermediary to private sector borrowers. The Letter of Development Policy commits the Government to defining the role of the FDC in providing services to the rural poor.		
B. DEVELOPMENT CREDIT			
Improvements in the allocation of development credit through expansion in the scope of eligible intermediaries, changes in the terms to reflect market conditions and improvements in the incentives for repayment of development credit by intermediaries and final borrowers.	Issuance of a Supreme Decree for the establishment of new non-bank financial intermediaries.	Evidence of implementation of eligibility criteria for access of banks and non-banks to development credit and supervision of these intermediaries consistent with sound regulatory practices.	
	Issuance of a Central Bank resolution providing sound eligibility criteria for access of banks and non-bank financial intermediaries to development credit. The Letter of Development Policy commits the Central Bank to requiring that each institution maintain a share of non-performing loans on development credits no more than 50% higher than the average rate of non-performance for the private commercial banking system.		
	Maintenance of market-determined interest rates through an auction system with a floor rate no less than the average of the borrowing rate of the private banking system (savings and time deposits) and BCB CEDES.		
	The Letter of Development Policy commits the Central Bank to not reschedule development credit (unless an institution is intervened).		
C. IMPROVEMENTS IN REGULATION AND SUPERVISION OF FINANCIAL INTERMEDIARIES			
Improvements in the financial condition of banks and other financial interemediaries.	Prudential regulations and capacity of the Superintendency of Banks significantly strengthened.		
	Presentation of a law to Congress for the sound regulation and supervision of the financial system, including (among other provisions) a 6% capital-asset limit, explicit provisions for handling bank crises, establishment of the authority and autonomy of the Superintendency of Banks and codification of certain prudential regulations.	Enactment of the law by Congress and implementation of the regulations.	Continued implementation of the regulations

Issues and Objectives	Prior Actions/Commitments	Second Tranche	Third Tranche
	Development of an action plan to improve supervision and regulation, including: (i) establishment of an adjustment period for the strengthening of the capital base of commercial banks according to strengthened prudential regulations; (ii) a requirement that recipients of commercial loans above a given amount have audited financial statements; and (iii) modification of the classification system for bank loans and investments, including the assessment of loan collateral, in order to reduce discretion.	Implementation of the action plan.	Imposition of a 10% provisioning requirement for Class 3 loans under the new criteria.
Improve the efficiency of financial markets through increasing access to credit market information.	The Letter of Development Policy commits the Government to a program of encouraging selective disclosure of credit information from SBEF's Central de Riesgos, whose clients provide explicit authority, public disclosure of regulatory rulings, requirements that banks publish their loan classifications and requirements that banks disclose interest rates charged on a uniform basis.		
	The Letter of Development Policy commits the Government to establish a program for the management of bank crises.		
D. IMPROVEMENT IN FUNCTIONING OF THE CENTRAL BANK			
Increase the ability of the Central Bank to manage efficiently the financial system.	The Letter of Development Policy commits the Government to establish an automatic mechanism for liquidity support for commercial banks, to not undertake any wholesale refinancing of or contribution to banks' capital, and to not insure bank deposits in excess of US$5,000.		
	Initiation of a proram to improve the functioning of the Gerencia del Sistema Financiero in order to ensure correct certification of ICIs and to strengthen management of bank crises.		
	Initiation of a program to strengthen the Gerencia de Desarrollo to improve administration of the auction system and to streamline operating procedures for development credit.		

Issues and Objectives	Prior Actions/Commitments	Second Tranche	Third Tranche
E. CAPITAL MARKETS DEVELOPMENT			
Increase the efficiency of the allocation of capital through improvements in the legal framework for and supervision of insurance, pensions and the securities market.	Improvements in capital market regulation to permit stock brokers to undertake repurchase agreements, improve disclosure requirements and permit banks to issue subordinated mandatorily convertible debentures. The Letter of Development Policy commits the Government to amend relevant laws to: (i) permit sociedades limitadas to issue and trade securities subject to disclosure guidelines; (ii) permit origination and trading of bankers acceptances on the Bolsa; (iii) allow borrowing and lending of storage warrants; and (iv) permit brokers to carry securities for their own account. The Letter of Development Policy commits the Government to improve procedures for the repossession of collateral pledged in lending contracts, permit trading of such contracts and improve the commercial registration system for contracts secured with moveable property and other forms of collateral. The Letter of Development Policy commits the Government to strengthen or reorganize the institutions supervising the capital markets, to require external audits of insurance companies and complementary pension funds and to close insurance companies unable to meet minimum capital requirements within a fixed time period. The Letter of Development Policy commits the Government to undertake a study of the contractual savings system and to study the changes in law and regulation necessary to effect the recommendations of the study and to improve supervision of capital markets.		

Issues and Objectives	Prior Actions/Commitments		
III. PUBLIC ENTERPRISE REFORM			
A. STRENGTHENING OF PUBLIC ENTERPRISES			
Improve the performance, efficiency and financial self-sufficiency of major public enterprises.	Six-month performance contracts signed for ENDE (electricity) and ENFE (rail). Draft medium-term performance contracts prepared for ENDE, ENFE, ENTEL (long-distance and international telecommunications) and YPFB (hydrocarbons).		
	The Letter of Development Policy commits the Government to completion of the following improvements in the management of major public enterprises: (i) implementation of the ENFE restructuring program; (ii) design of improved procedures for YPFB contracts with private investors; and (iii) design of a plan for opening up the telecommunications sector to increased competition.		
	Progress made in the agreed program to limit COMIBOL losses, including reductions in personnel, cessation of investment in COMIBOL properties, preparation of an analysis of the costs and incomes from COMIBOL mines, and completion of audit reports of COMIBOL operations.	Completion of the long-term reorganization plan for COMIBOL and closure of all unprofitable mines.	
Improve financial discipline of public enterprises.	Transfers to public enterprises have been reduced sharply since 1986. Preparation of an action plan for: (i) elimination of all transfers to public enterprises (excluding those for agreed public services); and (ii) elimination of major arrears in the payment of debts among public enterprises.		Elimination of all transfers to public enterprises (excluding those for agreed public services) and of arrears in the payment of debts among public enterprises.

Issues and Objectives	Prior Actions/Commitments	Second Tranche	Third Tranche
B. PRIVATIZATION			
Reduce financial/managerial burden on Government and improve the efficiency of production.	Investment bank hired to assist with the privatization of LAB (airline). Establishment of inter-ministerial commission to set policies and hiring of sufficient technical staff to manage the privatization program. Issuance of a policy statement and implementation guidelines for the privatization program.	The Government will bring enterprises to point of sale, including approval for privatization, completion of valuation and sales documents and offered for sale, sufficient to achieve the following targets: (i) Lloyd Aereo Boliviano, 2 large enterprises and 3 smaller enterprises; or (ii) 3 large enterprises and 5 smaller enterprises. Approval of a privatization agenda setting out enterprises to be closed or brought to point of sale, sufficient to meet the conditions for third tranche release.	The Government will bring additional enterprises to point of sale, including approval for privatization, completion of valuation and sales documents and offered for sale, sufficient to achieve the following targets: (i) Lloyd Aereo Bolivian 4 large enterprises and 5 smaller enterpris or (ii) 5 large enterprises and 6 smaller enterprises.
	Approval of a privatization agenda setting out enterprises to be brought to point of sale, sufficient to meet the conditions for second tranche release. The Letter of Development Policy commits the Government to the following: (i) the medium-term objective of selling or liquidating all public enterprises operating in competitive markets (excluding the mining and hydrocarbons sectors, where constitutional restrictions preclude divestiture of state assets); (ii) no market protection for new owners; (iii) pricing of enterprises realistically to reflect market value; (iv) no new investments, Government transfers or credit for enterprises targeted for sale or liquidation; (v) flexibility for new owners in the level and mix of employees; (vi) payment of the short-term costs of the program; (vii) no sale of enterprises to public sector institutions; (viii) no new public enterprises or joint ventures between the Government and the private sector to be established in the productive sectors (excluding mining and hydrocarbons); and (ix) privatized enterprises will be required to be established as sociedades anonimas mixtas, unless the Government finds that the cost of doing so is prohibitively expensive.		

Issues and Objectives	Prior Actions/Commitments	Second Tranche	Third Tranche
IV. TRADE AND REGISTRATION PROCEDURES			
Improve efficiency of institutions and rules governing trade to raise Government revenues and facilitate commerce. Streamline firm registration and control procedures to increase productivity.	The Letter of Development Policy commits the Government to an action program to reform trade and registration procedures, including: (i) implementation of the customs reform begun with support from the IDB, which would include a new customs law, privatization of certain customs functions, a new personnel strategy and computerization of customs procedures; (ii) implementation of a duty drawback system; (iii) simplification of export procedures, possibly through a ventanilla unica; and (iv) simplification of firm registration and control mechanisms.		
V. PUBLIC SECTOR INVESTMENT PROGRAM			
Improve selection of public sector investment projects.	The Letter of Development Policy commits the Government to seeking agreement of the Bank to undertake any public sector investment over US$10 million in the following sectors: water and sanitation, transport and agriculture.		
VI. LEGISLATION			
Improve incentives framework for private investment.	Congress has passed the investment, mining and hydrocarbons laws.		
VII. HEALTH AND EDUCATION EXPENDITURES			
Improve allocation of social sector expenditures through increasing share of current expenditures on primary health care and improving distribution of expenditures on primary education.	The Letter of Development Policy commits the Government to: (i) an increase in the share of expenditures devoted to the health sector to 3.8% by 1993; (ii) an increase in the share of health expenditures in the major cities devoted to primary health care to 30% by 1993; (iii) an increase in the share of personnel allocated to primary health care in the major cities to 40% by 1993; and (iv) an increase in expenditures on texts and teaching materials to 5% of expenditures on primary education by 1992.		
VIII. FISCAL POLICY			
Finance the increase in public goods essential to development by increasing tax revenues.	The Letter of Development Policy commits the Government to undertake a study of the extent of and measures to reduce tax evasion, and to implement an action plan to reduce evasion based on the study's results.		

Changes in Prudential Regulation and Supervision

1. The Government is committed to improving the regulatory framework for financial intermediaries through the submission and implementation of a revised Banking Law. Further, it is committed to continued improvements in the enforcement of prudential regulations by the Superintendent of Banks and Financial Institutions (SBEF) and in increases in disclosure of credit and financial information. Finally, the Government is committed to improved mechanisms for managing bank crises as reflected in the Banking Law and in the strengthening of the *Gerencia del Sistema Financiero* (GSF) of the Central Bank. Strengthening of the SBEF and the GSF will also be undertaken with the assistance of funds for technical assistance provided in this operation.

I. Components of a Revised Banking Law

2. The following components should be included in the revised Banking Law:[1]

A. Coverage

- *This law will cover any public, private or mixed institution that operates in the offering or receipt of financial resources as defined for the following cases: banks, casas bancarias, sociedades financieras, leasing companies and almacenes generales de deposito.[2] Any individuals connected with such activities are subject to this law.*

B. Bank Capital Requirements and Prudential Regulations

- A minimum amount of capital of SDR 2.9 million will be required for existing or new commercial banks (with a one-year adjustment period for existing institutions with insufficient capital).*

- A minimum amount of capital in relation to assets of 6% will be required. This will replace current leverage limits calculated by discrete liabilities in relation to capital.*

- Banks will not have restrictions on the maturity of their instruments. *Restrictions on subsidiary holdings by banks should be mandated in the law. Restrictions should also be mandated indicating the wall of control and*

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[1] The provisions indicated reflect major components of the projected Banking Law as of December 1990 as well as those recommendations made by the Bank in its January 1991 mission. Recommended reforms added since the January mission have been indicated in italics. Those elements which are starred (*) will be required under the credit as part of the legislation.

[2] *The Bank recommends that the coverage be delimited by specific definitions of the exact activities of each of the mentioned institutions. Specific reference can be made to other financial institutions (eg. savings cooperatives) that have their own legal framework but explain how the SBEF may or may not hold jurisdiction over them.*

information that would be required between different operations of such institutions (e.g. between lending and underwriting) so that conflicts of interest are avoided and depositors' funds are not at risk.

- Banks cannot engage in certain operations such as: (i) using its own shares as collateral for operations, (ii) concede credits with the object that they would be, directly or indirectly to acquire the shares of the bank, (iii) provide loans to parties related to the bank in a way more favorable than that which would be provided to third parties, (iv) lend to bank administrators or employees or parties related to these individuals unless guaranteed by the employees' salaries, (v) authorize lending for political activities, (vi) use the fixed assets of the bank as security, and (vii) invest directly or indirectly in the equity of another bank.*

- A bank cannot maintain credits to a single borrower or group in an amount exceeding 20% of equity except in certain cases where authorized by the SBEF.*

- A bank cannot lend to a single borrower or group in an amount exceeding 1% of equity if the collateral guaranteeing such a credit amounts to less than 50% of the amount of the credit.*

- The total amount of credits to individuals or groups related to the bank (as defined in the law) cannot exceed the total equity of the Bank.*

- Dividends cannot be distributed unless a bank's equity capital is within legal prudential limits.*

- Assets received in lieu of loan payments must be disposed of within one year for goods and chattels and two years for real estate. Otherwise, such assets must be provisioned 20% per year for each year after.

C. Operations of Other Financial Institutions[3]

- Investment Finance Companies (*Sociedades de Inversion Financamiento*) will only be able to fund themselves with deposits or other instruments having a minimum maturity of one year, have a minimum equity to asset ratio of 10%, yet could invest in the shares of companies.

- *Casas Bancarias* are quasi-bank entities that will participate in a series of banking actives but cannot hold sight deposits or undertake other activities prohibited by the SBEF.

- Leasing Companies *which are majority held by banks or other financial institutions* will be subject to select restrictions, have a minimum capital requirement of SDR 700,000, and a minimum equity to asset ratio of 6%.

[3] *The Bank recommends that the law ensure that each non-bank financial institution have mandated: (i) minimum initial capital requirements, (ii) minimum capital-asset requirements, (iii) limits on its holding of subsidiary investments or fixed assets (if any), and (iv) limits on the term structure of its liabilities (if any).*

D. Bank Secrecy - Information Disclosure

- Information about deposits, loans or other bank transactions are subject to bank secrecy provisions. These limit the disclosure of information provided by individuals to financial institutions and from financial institutions to regulatory authorities. Credit information about individual depositors and borrowers will be subject to disclosure by explicit written authorization of the client.

- The SBEF will be obligated every 6 months to publicly indicate the quality of the loan portfolio and other assets by bank. The amount of provisions and collateral for each asset classification will also be required (Beginning 1/1/93).*

E. Role, Appointment and Financing of the SBEF

- Fraudulent management of a bank is subject to the penalties indicated in the penal code.

- The SBEF has the responsibility for ensuring compliance with this law.

- The SBEF cannot authorize the deferral of losses on the part of financial institutions (as had been previously the case for external debts). The SBEF also does not have the authority to condone an institution from providing full provisions for loans or other assets.

- The jurisdiction of the SBEF in the application of the present law cannot be delegated. SBEF has authority under the law over multiple institutions.

- The Superintendent should be named by the President for a six-year term. He or she cannot be removed for acts committed in exercise of his or her functions unless removed according to constitutional guidelines. The Superintendent can name his or her own staff including Intendents.*

- The SBEF will be financed by the BCB and institutions under its jurisdiction in an amount not more than 1/1000 of the total assets and contingencies of such entities.*

- The SBEF has the authority to effect the control of banks and other financial entities through this law and, in this way, can supervise the system including inspections without prior notice. Institutions covered in the legislation must provide to the SBEF whatever information necessary for the SBEF to complete the tasks assigned to it.*

F. Audit and Financial Disclosure

- Financial institutions are required to submit to external auditors according to the directive of the SBEF.

- Auditors and other bank evaluators will be registered by the SBEF.

- Financial institutions will be required to publish their financial statements annually (December 31) in the public press as well as the opinion of external auditors.*

G. Sanctions

- The rules of the law can be sanctioned by multiple measures including: fines to the institution, fines to directors and members of management, prohibition of dividend distribution, suspension of the possibility of conducting specific operations, suspension of directors or management, and cancellation of the license to operate.

- *The SBEF will have specific authority to issue punitive fines for improper classification of loans or other assets.**

H. Special Supervision, Transitory Intervention, Preventive Measures, Mergers, Transformation, Liquidation and Insurance of Deposits (See Annex on Mechanisms for Handling Financial Institution Crises)

II. Changes in Prudential Regulations

3. The following recommended changes to prudential regulations and their enforcement will be examined to determine compliance with the conditions of the Credit. Mechanisms for monitoring compliance with this provision will be indicated prior to negotiations.

A. Loan Portfolio Classification.

4. Every quarter, each commercial bank should be required by SBEF to review the quality of at least 70% of its loan portfolio and classify each loan according to criteria specified by the SBEF (or more strict criteria). Loans should be classified based both objectively on performance and subjectively on the debtor's financial position and the debtor's project's financial position, cash flow and underlying collateral. The SBEF should apply a schedule of fines for loans found upon inspection to have been improperly classified.

(1) Commercial Loans

5. Commercial loans should be classified according to five sets of criteria: (i) the degree to which the borrower is in arrears; (ii) the comprehensiveness of documentation supporting the credit; (iii) the degree to which the loan has been rescheduled, including interest capitalization or replaced by a credit that changes the original terms or collateral; (iv) the debtor's financial position, and the cash flow position and expected future performance of the project financed; and (v) the quality and liquidity of loan collateral. The application of the criteria should be that any of the conditions is sufficient to draw a loan into the subsequent category.

6. Such loans should be classified as follows[4]:

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[4] The recommended loan classification system represents a modification of the existing framework and, as such, contains many elements of the existing one. Recommended provisioning requirements are indicated in Section B.

Normal Loans (Class 1) would be those that have all of the following characteristics:

PAYMENT STATUS	1)	Current in payment.
DOCUMENTATION	2)	Have full credit information.
RESCHEDULING	3)	No rescheduling of the loan has occurred.
FIN POSITION	4)	The financial position of the borrower and project is in no way impaired.
COLLATERAL	5)	The value of the loan collateral is in no way impaired.

Specially Mentioned Loans (Class 2) would be those that exhibit any of the following characteristics:

PAYMENT STATUS	1)	May be behind in payment in an amount up to 30% of the accumulated accrued interest (has paid up at least 70% of the accumulated accrued interest)[5].
DOCUMENTATION	2)	May be lacking certain documentation in the credit folder yet such absence does not impair the capacity to assess the financial position of the borrower or project or the value of collateral[6].
RESCHEDULING	3)	May have rescheduled the principal of the loan or have established a new loan but at least 70% of accumulated outstanding interest has been paid in full[7].

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[5] The Bank accepts the current standard in Bolivia whereby loan payments are applied first to interest and then to principal. While this is contrary to a more common convention where the opposite is the case, such a method avoids a rapid amortization (and thus reduction in new interest payments) in an inflationary environment. However, such a method can result in a relative overstatement of interest income on loans where principal payments have not been made.

[6] The precise documentation requirements for rendering a judgement should be explicitly defined by the SBEF.

[7] An exception to this rule can be working capital loans whereby the client has: (i) increased the value of collateral for the loan to support the increase the loan amount and, (ii) has demonstrated that the increase in the amount of working capital support can be repaid with the projected receipts of the firm during the period agreed to. Such loans can be classified as Class 1. Other exceptions whereby a loan rescheduling or a new loan is established will also be acceptable provided that the two conditions for working capital loans are met. In each case however, the onus of *responsibility will be for the financial institution to provide* ***specific evidence*** *for the application of such an exception.*

FIN POSITION 4) Evidence may suggest that certain factors affect the financial position of the borrower and project but that such conditions are noted as transitory and will not affect the recovery of the loan under its original conditions.

COLLATERAL 5) Evidence may suggest that certain factors could in the future could affect the loan collateral but that such conditions have not affected either the value of the collateral or the ability of the lender to seize it in the short-term[8].

Potentially Problematic - Substandard - Deficient Loans (Class 3) would be those that exhibit any of the following characteristics:

PAYMENT STATUS 1) May be behind in payment in an amount over 30% of the accumulated accrued interest, but the total accumulated interest arrears are less than 90 days. A borrower that is behind in interest payments in an amount equal to less than 90 days accumulated interest but who has also not serviced principal in 180 days would also be classified in this category.

DOCUMENTATION 2) (Same as Class 2) May be lacking certain documentation in the credit folder yet such absence does not impair the capacity to assess the financial position of the borrower or project or the value of the collateral[6].

RESCHEDULING 3) May have either rescheduled the loan or received a new loan (and thus implicitly capitalize interest) and less than 70% of accumulated outstanding interest was paid in full[7]. As is currently the case, financial institutions will be prohibited from providing funds to a borrower from another institution so that he or she can repay loan interest past due more than 90 days.

FIN POSITION 4) Evidence may suggest that there is a well-defined credit weakness or weakness in the sector of the debtor firm such that the cash flow of the borrower is insufficient to promptly service the debt[9]. Such weaknesses suggest that there is a 10% chance of non-recovery of the outstanding loan balance or virtual certainty of recovery of 90% of the outstanding balance.

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[8] Collateral Valuation and Provisioning will be specified in Section B.

[9] Weights and quantitative criteria should be developed by the SBEF and applied to the criteria indicated in Circular 56/88. Such weights and criteria should clarify how such a judgement between classifications should be made. It is also important that the capital position of the borrower be considered in evaluating its capacity to overcome financial difficulties.

COLLATERAL 5) Evidence may suggest that the value or liquidity of the collateral have been impaired[10].

Doubtful Loans (Class 4) would be those that exhibit any of the following characteristics:

PAYMENT STATUS 1) May be behind in payment in an amount over 30% of accumulated accrued interest or total arrears is more than 90 days.

DOCUMENTATION 2) May lack documentation which impairs the capacity to assess the financial position of the borrower or project or the value of the collateral[6].

RESCHEDULING 3) (Same as Class 3) May have rescheduled the loan or received a new loan (including capitalization of interest)[7].

FIN POSITION 4) Evidence may suggest that there is a 50% chance of non-recovery of the loan due to weaknesses in the borrower or project or certainty of non-recovery of 50% of the outstanding loan amount. Such loans suggest a possibility of loss based on the cash flow of the financial position of the borrower and the cash flows and financial position of the project financed[9]. Such a loss however, is not a certainty -- possible mechanisms exist such as purchase of the borrower company or legal action.

COLLATERAL 5) (Same as Class 3) Evidence may suggest that the value or liquidity of the collateral have been impaired[10].

Lost Loans (Class 5) would be those that exhibit any of the following characteristics:

PAYMENT STATUS 1) (Same as Class 4) May be behind in payment in an amount over 30% of accumulated accrued interest or total arrears is more than 90 days.

DOCUMENTATION 2) (Same as Class 4) May lack documentation which impairs the capacity to assess the financial position of the borrower or project or the value of the collateral[6].

RESCHEDULING 3) (Same as Class 3) May have rescheduled the loan or received a new loan (including capitalization of interest)[7].

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[10] Because the provision is calculated after deducting the value of the collateral, any impairment should not in itself directly affect the distribution of a loan between categories 3, 4 or 5. The valuation of collateral will depend on the capacity of the lender to quickly seize and liquidate such assets in addition to their net worth (Refer to the explanation in section B).

FIN POSITION	4) Evidence may suggest that the debtor is insolvent -- the borrower's financial position and the project financed is insufficient to service the outstanding debt. In this case, there is virtual certainty (100%) of non-recovery of the loan.
COLLATERAL	5) (Same as Class 3) Evidence may suggest that the value or liquidity of the collateral have been impaired[10].

(2) Mortgage Loans

7. Collateralized housing loans generally have predictable collateral and should therefore be classified more automatically according to the number of monthly payments past due.

Normal Loans (Class 1) would be those that have all of the following characteristics:

PAYMENT STATUS	1) Current in payment.
DOCUMENTATION	2) Have full credit information.
RESCHEDULING	3) No rescheduling of the loan has occurred.
FIN POSITION	4) The financial position of the borrower is in no way impaired.
COLLATERAL	5) The value of the loan collateral is in no way impaired.

Specially Mentioned Loans (Class 2) would be those that exhibit any of the following characteristics:

PAYMENT STATUS	1) May be up to 30 days past due in interest or principal.
DOCUMENTATION	2) May be lacking certain documentation in the credit folder yet such absence does not impair the capacity to assess the financial position of the borrower or the value of the collateral[4].
RESCHEDULING	3) May have either rescheduled the loan or received a new loan, each of which exceed the former outstanding loan amount (and thus implicitly capitalizes interest). However, any increase in the loan amount is compensated by an increase in the loan collateral and any deficiencies in the value of the loan collateral

in the former loan must be also been fully rectified[11].

FIN POSITION 4) Evidence may suggest that certain factors could affect the financial position of the borrower but that such conditions are noted as transitory and will not affect the recovery of the loan under its original conditions.

COLLATERAL 5) Evidence may suggest that certain factors could affect the loan collateral but that such conditions have not affected either the value of the collateral or the ability of the lender to seize it in the short-term[10].

Potentially Problematic - Substandard - Deficient Loans (Class 3) would be those that exhibit any of the following characteristics:

PAYMENT STATUS 1) May be 30-90 days past due in interest or principal.

DOCUMENTATION 2) (Same as Class 2) May be lacking certain documentation in the credit folder yet such absence does not impair the capacity to assess the financial position of the borrower or the value of the collateral[6].

RESCHEDULING 3) (Same as Class 2) May have either rescheduled the loan or received a new loan, each of which exceed the former outstanding loan amount (and thus implicitly capitalizes interest). Any increase in the loan amount is compensated by an increase in the loan collateral and any deficiency in the value of the loan collateral in the former loan has also been fully rectified[11].

FIN POSITION 4) Evidence may suggest that there may be a weakness in the financial position of the borrower such that there is a 10% chance of non-recovery of the outstanding loan balance.

COLLATERAL 5) Evidence may suggest that the value or liquidity of the collateral have been impaired[10].

Doubtful Loans (Class 4) would be those that exhibit any of the following characteristics:

PAYMENT STATUS 1) May be behind in payment of interest or principal in an amount of 90-180 days.

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[11] An exception to this rule can be where a loan rescheduling or a new loan is established such that the value and liquidity reflects the new outstanding loan amount. In such case, *it will be the responsibility of the financial institution to provide specific evidence for the application of such exception.*

DOCUMENTATION 2) May lack documentation which impair the capacity to assess the financial position of the borrower or project or the value of the collateral.

RESCHEDULING 3) (Same as Class 3) May have rescheduled the loan or received a new loan (including capitalization of interest)[11].

FIN POSITION 4) Evidence may suggest that there is a 50% chance of non-recovery of the loan due to weaknesses in the financial position of the borrower.

COLLATERAL 5) (Same as Class 3) Evidence may suggest that the value or liquidity of the collateral ~~have~~ been impaired[10].

Lost Loans (Class 5) would be those that exhibit any of the following characteristics:

PAYMENT STATUS 1) May be behind in payment of interest or principal in an amount of exceeding 180 days.

DOCUMENTATION 2) (Same as Class 4) May lack documentation which impairs the capacity to assess the financial position of the borrower or project or the value of the collateral.

RESCHEDULING 3) (Same as Class 3) May have rescheduled the loan or received a new loan (including capitalization of interest)[9].

FIN POSITION 4) Evidence may suggest that the borrower is insolvent. There is in this case virtual certainty (100%) of non-recovery of the loan.

COLLATERAL 5) (Same as Class 3) Evidence may suggest that the value or liquidity of the collateral have been impaired[10].

(3) Consumer Loans

8. Because consumer loans are generally small and time-consuming to monitor, they are best placed into categories automatically according to the number of monthly payments past due (indicated below). Consumer loans should be evaluated in a way similar to mortgage loans (per the classification system indicated in the section above) yet such loans should place less importance on the financial position of the borrower and should apply criteria for payment status as follows:

Class 1: Payments up to 30 days past due.
Class 2: Payments 30-60 days past due.
Class 3: Payments 60-90 days past due.
Class 4: Payments 90-180 days past due.
Class 5: Payments over 180 days past due.

(4) Agricultural Credits

9. The nature of agricultural lending, including Bolivian laws regarding collateral likely require modifications to the classification system developed for commercial loans in section (1) above. Such a system should reflect proper management of the risks in lending for crop production and valuation of collateral based on realizable values.

(5) Overdrafts/Current Account Lines of Credit

10. Overdrafts or other current accounts and credit extensions should be considered non-performing when: (i) advances exceed the customer's borrowing line for 90 consecutive days or more; (ii) the customer's borrowing line has expired for 90 days or more; (iii) interest is due and unpaid for 90 days or more; (iv) the account has been inactive for 90 days or more and deposits are insufficient to cover the interest capitalized during the period; (v) there is an overdraft outstanding for 90 days without any authorized limit; or (vi) the authorized limit has been canceled, or the customer is under foreclosure proceedings. When such credits are non-performing for 90 days, they should be classified as deficient, doubtful or lost depending upon the documentation in the credit folder, financial position of the borrower and value of collateral as indicated in section A above.

B. Collateral Valuation and Provisioning

11. Collateral Valuation. The value of collateral is an important element of lending in Bolivia and deserves special scrutiny. The value involves two elements: (i) the estimated liquidation value of such an asset, and (ii) the costs involved in the seizure and liquidation of such an asset. The estimated liquidation value of an asset requires a keen understanding of the market for such asset, including its exact condition. The value of the collateral should also reflect any depreciation in its Boliviano value relative to the US dollar value which may have been established in the loan contract. The costs of seizure and liquidation should include: (a) the probability of asset seizure, (b) legal costs associated with such seizure, (c) depreciation of the asset during the time it takes to seize and sell it, (d) depreciation of the asset due to US$/boliviano variations, (e) costs of storage and sale, and (f) any other transaction costs.

12. Valuation of personal guarantees[12] should be undertaken by examining the financial position of the guarantor as well as other obligations in which the guarantor is liable (with the assistance of the *Central de Riesgos*).

13. The Bank supports measures to increase the reliance on financial indicators of commercial borrowers and projects both on the part of financial institutions as well as on the part of inspectors at the SBEF. These measures should be supported by a requirement that commercial loans over a given amount (eg. US$ 100,000) have audited financial statements of the borrower and that such statements are routinely required and reviewed by SBEF inspectors. In

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[12] The Bank supports the current limit of such personal guarantees to US$ 20,000 or its equivalent.

this way, lending decisions will begin to more reflect borrower and project viability than mere collateral.

14. Although the Bank has supported measures so that financial institutions and the SBEF rely more on indicators of the financial health of borrowers and related projects than on collateral, it nonetheless also believes that continued improvement is needed in the capacity of inspectors to value collateral. Such improvement is also needed on the part of the credit officers of financial institutions. The Bank recommends that the SBEF conduct a study to determine the average transaction costs involved in collateral seizure and liquidation and, at a minimum, uniformly discount the value of collateral using such a factor in its calculations. This will result in more effective risk coverage by collateral.

15. Provisioning. The principle behind adequate provisioning is that full provisions should be established for the expected loss for each loan category[13]. Recommended specific provisions are: Normal Loans (nothing), Specially Mentioned Loans (1%)[14], Potentially Problematic - Substandard - Deficient Credit Loans - Potentially Problematic Loans (10%)[15], Doubtful loans (50%) and Lost Loans (100%). For those loans not specifically reviewed (up to 30% of the portfolio), the provision should consist of the weighted average of provisions for the rest of the portfolio.

16. The Bank has not recommended a generic loan-loss provision because it believes that such a provision can serve as a disincentive (or extra capital requirement) for institutions that have only small amounts of poor quality loans. In addition, because in Bolivia the generic provision is added back to equity in determining compliance with leverage and other prudential requirements, such a provision serves to reduce income (and thus dividend distribution), but does not result in the required capital in relation to prudential risks.

17. The system to control provisions is that financial institutions should indicate the provisions established in accordance with their portfolio quality assessment and SBEF inspectors evaluate the sufficiency of such provisions. External auditors should also review the sufficiency of provisions in accordance with their independent evaluation of portfolio

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[13] The formula for reaching such a provision would be: [(Probability of Default) x (Outstanding Loan Balance)] - (Immediate liquidation value of collateral) + (legal and administrative costs of seizing the collateral) + (estimated asset depreciation during period of seizure and liquidation).

[14] This is a recommended provision but has not been made a loan condition.

[15] The Bank has recommended a transition period in which to implement this provision so that it is reached by the end of 1993. It is expected that the transition period will reflect both the increase in the provision as well as the strengthening of the criteria. A further increase of the provision to 20% as well as the expected probability of loss would further strengthen the classification system and is recommended in the medium-term of the adjustment program (although not required under the credit).

quality. Penalties should be imposed if large discrepancies exist between the institutions' assessment of required provisions and SBEF's.

18. The Bank also supports the current norm whereby any loan to a related party (i.e. individuals or groups with controlling shareholding interest in a bank, or directors, as defined in Supreme Decree 21660) that are classified in categories 4 or 5 should be immediately rectified either by payments or additional collateral. As is currently the case, related parties such as directors should be temporarily suspended from their functions until such accounts have been paid in full.

C. Classification of Other Investments and Off-Balance Sheet Commitments

19. Improved mechanisms are needed for evaluating, valuing and provisioning for financial investments and contingent credit obligations. In particular, losses in the difference between historic and market values of debt (including BCB CEDES) or equity should be appropriately provisioned. Further, while the SBEF has developed a strong accounts manual which includes many off-balance sheet commitments as contingents, nonetheless, further off-balance sheet assessment, classification and provisioning is needed.

20. Improved mechanisms are also needed for evaluating, valuing and provisioning for fixed assets (especially buildings and real estate owned by a financial institution). Parameters are needed to establish market values of such buildings, requirements and limits for periodic revaluation, and limits in the realization of revaluation gains and losses due to market fluctuations.

D. Interest Accrual Policies

21. All loans non-performing for at least 90 days should be placed on non-accrual, and all previously accrued but uncollected interest reversed from income[16]. As indicated earlier, payments are applied first to principal and then to interest and can be justified. In no case should loans in Class 4 or Class 5 continue to accrue interest, regardless of the amount of time the loan has been non-performing. Non-performing loans should be restored to an accrual basis only upon the full settlement of all delinquent principal and interest.

E. Write-Off Procedures.

22. At a minimum, once 12 months has past since a loan has been fully provisioned, the loan should be written off the balance sheet entirely and pass to an off-balance sheet account. Such a transfer would in no way impair the legal right the lender has to the payments or collateral of the borrower.

F. Loan Concentration and Lending to Related Parties

23. Mechanisms to limit risk concentration or lending to related parties are spelled out in the draft Banking Law and indicated in section I above.

[16] This procedure is currently followed.

G. Bank Management and Internal Controls

24. Internal bank management procedures and control mechanisms are as important as the financial statements themselves in determining the condition and risks of banks. Furthermore, the viability of a bank in the long term is given by the quality of its management. *As is currently the case*, it is important that the SBEF continue to devote significant time to assessing management and credit control systems for financial institutions. Further, it should be noted that inspectors and analysts should work in as much as a proactive, teaching role as in a policing role to urge banks themselves to evaluate loan quality and closely supervise loan performance. In order to accomplish these tasks, SBEF inspectors should require audited financial statements for commercial loans to clients over a threshold size as well as encourage the use of business plans and active review by credit officers in lieu of collateral-based lending as is often the case.

H. Evaluation of Other Risks

25. Managers of financial institutions, external auditors and SBEF inspectors should examine other risks which affect the financial position of the institution. These risks include: interest rate (liquidity) risks, counter-party (settlement) risks, transfer risks, country risks (for the very small amount of credits from Bolivian banks overseas), geographical concentration of credits, and risks of economic sector concentration. In place are parameters for managing foreign exchange exposure risks. In each case, parameters should be established in order to limit such risks in relation to an institution's capital. Even more important however, financial institutions should demonstrate that they are aware of such risks, have mechanisms for measuring and reporting such risks, and have taken actions to minimize the risks, hedge for them, or compensate for them with dedicated capital.

Mechanisms for Handling Financial Institution Crises

Background - Introduction

1. Public confidence in the banking system and efficient regulation require an effective and expeditious method for resolving banking crises. Existing procedures provide regulators considerable discretion in bank intervention and liquidation.[1] The Financial Sector Adjustment Credit (1925-BO) assisted the Central Bank (BCB) in establishing an administrative unit (Gerencia de Sistema Financiero, or GSF) to manage banking crises, and also established guidelines for the rehabilitation or liquidation of banks. However, the GSF has failed to act effectively to rehabilitate or liquidate banks in crisis which points to the need for more precise mechanisms for intervention and the importance of reinforcing these mechanisms through provisions in a revised banking law. The Credit will support changes in the banking law to specify the means for managing and resolving financial institution crises, including precise responsibilities for the Superintendency of Banks and Financial Institutions (SBEF) and the Central Bank.[2]

2. This annex describes the program for handling bank crises that has been discussed with the Government. All institutions that receive public deposits should be subject to the same requirements and sanctions.[3] The program would contain the following elements:

a. A preventive surveillance regime for banks that violate discrete objective criteria after being provided with a reasonable period of time to take corrective action (no more than 90 days).

b. Intervention of banks that do not comply with a rehabilitation plan agreed to following imposition of a preventive surveillance regime,

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[1] Existing rules permit the Superintendency to initiate liquidation procedures when the bank is not complying with the solvency and operating criteria defined in the General Law of Banks of 1928. Banks that violate minimum capital requirements are cut off from any new Central Bank support and must for 90 days place all new public deposits in Central Bank Certificates of Deposit. If at the end of 90 days the bank is not in compliance with capital requirements, all new deposits and receipts from loans must be placed in a special unremunerated reserve account at the Central bank. The Superintendency can exact further measures, including seizure of any excess reserve requirement balances held.

[2] These functions of the Central Bank could be carried out by a well functioning GSF which will be supported by technical assistance funds.

[3] As a practical matter, the SBEF does not to date fully supervise all deposit-taking institutions. In this way, extension of these requirements to these institutions will take place gradually as the capacity and penetration of the SBEF continues to improve.

have lost more than 50% of their capital, or have committed egregious violations of prudential regulations.

c. Rehabilitation or liquidation of intervened banks, at the discretion of the Central Bank (GSF), with the Central Bank providing the capital required to allow the bank to meet the capital requirements established by SBEF. This capital infusion will occur by acquiring shares of the bank. Since intervention due to capital deficiencies will only occur after an institution has lost more than 50% of its capital, this implies that the Central Bank becomes the majority owner of the institution and can take any step it finds necessary to rehabilitate and sell the bank.

d. Rules for the provision of short-term liquidity support by the Central Bank.

e. Rules for the limited compensation of certain deposits.

Preventive Surveillance Regime

3. The SBEF would impose a preventive surveillance regime on an institution that:

a. Has failed to meet reserve requirements for more than 30 days;

b. Has violated leverage requirements for 60 days (but has not lost more than 50% of its capital and reserves or its net worth is not below 3% of total assets);

c. Has violated other prudential regulations and not taken corrective measures (in this the SBEF will have a degree of discretion, including provision for intervention); or

d. Requires a rollover or expansion of liquidity support from the BCB after more than 60 days.

4. An institution under a preventive surveillance regime would be subject to the following requirements:

a. The institution would be forced to deposit all net proceeds into a special non-remunerated reserve account at the BCB. Such an account would be constituted by: (i) the increase in the level of deposits or other obligations by the bank over and above their level on the date in which the regime was imposed; and (ii) any loan recoveries after that date.[4]

b. The institution would be rendered temporarily ineligible for development credit.

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4 Institutions exceeding their leverage limits will be obliged to deposit any new deposits in a non-remunerated account in the BCB from the time they are notified by the SBEF even prior to being placed under preventive surveillance.

c. The institution would be required to submit a financial rehabilitation plan acceptable to the SBEF within 10 days following the imposition of the preventive surveillance regime, and demonstrate recuperation at agreed upon intervals during the 60 days following agreement on the recuperation plan.

d. The rehabilitation plan may require additional capital to be provided during the 60 day period. Similarly, if further losses are detected which would undermine the institution during the 60 day period, the SBEF will require shareholders to put up the additional capital required.

   i. The required capital can be put up by another bank with the authorization of the SBEF in the form of a subscription of shares or a subordinated loan convertible to shares in one-year. This capital subscription or support cannot exceed 40% of the net worth of the assisting bank, and must be sold to a non-related third party in a period not to exceed 15 months, otherwise the two banks will have to be merged.

   ii. If additional capital is required, the BCB will have <u>limited</u> discretion to provide bridge financing in order to facilitate either a merger of banks or entry of a new shareholder. Such financing will be limited in that: (i) as above, it cannot exceed 40% of the net worth of the assisting bank, (ii) it must be repaid <u>before</u> the end of the 60 day rehabilitation plan period, (iii) it cannot exceed the amount of the additional capital requirement specified by the SBEF, (iv) it must be fully secured by bank paper or real assets, (v) it cannot be used to repay liquidity support, and, (vi) it must be financed at a rate no less than CEDES.

e. Depending on the nature of the problems and the prospects for their solution, SBEF can retain veto power over decisions by bank directors during this period.

<u>Intervention</u>

5. The SBEF would intervene an institution that:

a. Has not complied with the capital requirements, reserve requirements or prudential regulations provided for in the rehabilitation plan agreed to with the SBEF by 60 days following imposition of a preventive surveillance scheme;

b. Has not repaid BCB liquidity support 60 days after agreement on a rehabilitation plan;

c. Has lost more than 50% of its capital;

d. Has not repaid the interim BCB bridge financing; or

e. Has committed egregious and recurring violations of prudential regulations, or when strong reasons exist to suspect fraud or significant modifications to the institution's financial position.

6. While the SBEF intervention is essentially automatic because of the objective conditions indicated above (except "e"), the Superintendent nevertheless should consult with leaders in the BCB prior to an intervention. In this way, the financial implication for the BCB can be better accomodated.

7. An intervened institution would be subject to the following measures:

a. Displacement of owners or shareholders and removal of directors, with the SBEF assuming temporarily the management of the institution;

b. Charge-off of losses against equity[5]; and

c. Transfer to the Central Bank (GSF) for rehabilitation or liquidation after a period not exceeding *48* hours. Interventions are only temporary mechanisms, used to displace owners or shareholders in order to force final resolution of the problems.[6]

Rehabilitation/Recapitalization or Liquidation

8. The SBEF and the Central Bank would determine whether to rehabilitate or liquidate an institution based on: (i) a comparison of the estimated cost of capitalization to put the institution into a positive equity position with the cost of compensating insured deposits, and (ii) the feasibility of rehabilitation based on the circumstances that led to the intervention.

9. If the rehabilitation option is chosen, the Central Bank (BCB) will be provided a capital subscription offering an amount necessary to provide a positive capital position for the institution. The Central Bank will have subscribed the new capital and taken control of the institution within *48* hours after the SBEF's intervention. Once the BCB has subscribed the new capital, the institution ceases to be under intervention as the BCB then acts as the majority owner of the institution. If larger than expected losses become apparent later on, the BCB can subscribe additional capital. This procedure is designed to recognize losses and inject new capital without undermining public confidence. As owner of the institution, the BCB can increase, diminish, restructure or change the value of the bank's stock, and can restructure the bank's operations, personnel and internal policies and procedures. Within a period of one year, the BCB must sell its entire ownership participation.

10. If the institution is to be liquidated, the BCB would pay off guaranteed deposits and assume the claim on those deposits. Such compensation will be limited to the equivalent of SDR 4,200 per account holder, with the exception of non-remunerated current accounts that would be fully covered. The BCB's claims on liquidation proceeds will have the same priority as any other depositor. The BCB, as the receiver of the liquidated bank, would be authorized to sell any

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[5] Once intervened, the SBEF would take a full inventory of all assets and liabilities of the institution, including portfolio folder labeling and restate the institution's balance sheet to reflect a revised valuation.

[6] While the restatement of the balance sheet would take more than 48 hours, the SBEF would continue such work under the ownership of the Central Bank once the transfer had occurred.

assets individually or in bundles, or to set up trusteeships (fideicomisos) holding those assets under litigation. The BCB would appoint a Liquidator who, working in direct consultation with authorization of a judge, would be in charge of liquidating the assets of the institution and appropropriating the proceeds to liability claimants. Consideration should be given to granting the BCB special coercive powers to recover assets. The BCB should strive to complete liquidation procedures within two years.

Deposit Insurance in Case of Bank Liquidation

11. A Deposit Guarantee Fund will not be set up because it seems that it is not justified to establish another institution considering the small size of the system. Nonetheless, considering the high cost of financial information to small depositors the Government has decided to provide deposit insurance up to SDR 4,200 per person per financial institution (excluding children of insured account holder). It is estimated that this insurance will cover 12% of the total value of deposits and 90% of depositors. Furthermore, to minimize the negative impact of a bank liquidation on the payments system, all non-remunerated checking accounts will also be fully insured. Financial institutions will pay a small fee (to be determined) for this insurance. The fees will be collected by the Central Bank which will hold them in a special separate account. The Central Bank will provide the Liquidator with the funds to pay off insured depositors in the name of the Treasury, which is then expected to reimburse the BCB if funds provided exceed the balance in the deposit insurance account.

12. No person will be entitled to receive the equivalent of more than SDR 12,600 per year due from the system as a whole, due to the failure of various financial institutions. The precise mechanisms for compensating depositors have been included in the Draft Bank Law to be presented to Congress. The liquidator will have 30 days from the time the institution is liquidated to payoff insured depositors. Depositors are not entitled to any interest if they are reimbursed within the 30 day period.

13. The Superintendency will regulate the advertisement which institutions will make of the availability of deposit insurance, highlighting the existing limits.

Short-term Liquidity Support

14. Currently, liquidity support from the BCB potentially can be used to hide bank solvency problems, which would expose the BCB to losses in the event of a bank failure. Furthermore, the procedures to grant liquidity support are very cumbersome which sometimes result in long delays in the granting of credit thus rendering it useless. Rules would be proposed under the Credit to limit this exposure and link such support with solvency surveillance and intervention, and to establish the automaticity of access to limited rediscount facilities. These measures would include:

a. Access to liquidity rediscounts will be provided by tranches. The first tranche will involve an automatic rediscount line which will allow to solve small liquidity deficiencies which were not covered by the interbank market. The first tranche would be given for amounts no greater than 30% of the bank's net worth, would not exceed 15 days, and would carry an interest rate not lower than the CD rate. Further tranches would imply: (i) less automaticity, (ii) lower maturities, and (iii) higher rediscount rates.

b. In no case would the BCB provide liquidity support to institutions which are known to have an estimated capital deficiency of more the 15% of its required net worth.

c. Rediscount credit would be provided for a period of up to 15 days, (as presently), and could be rolled over once without penalty.

d. A rollover or expansion of such credit after 30 days would require an <u>even higher</u> premium interest rate and certification by the SBEF that the institution is fully complying with prudential regulations including capital requirements. If the institution is not in compliance, it will enter into a preventive surveillance regime (see above) under which it will be required to establish a financial recovery program with the SBEF.

e. A further rollover or expansion of such credit after 60 days would require the approval of the SBEF, would cost an additional premium and automatically would place the institution under a preventive surveillance regime.

f. A rollover or expansion of such credit after 120 days would be available only if the institution has complied with the provisions in the financial rehabilitation plan under the preventive surveillance regime.

Evaluation of Recommended Measures for the Banco del Estado

1. The purpose of this Annex is to evaluate the various functions of the *Banco del Estado* (BANEST). It was used as a basis for agreeing on conditions of the proposed Structural Adjustment Credit[1]. Each of BANEST's principal operations is described and evaluated below, along with recommendations. An integrated program of recommended reforms is then indicated.

I. Deposit Taking

2. Description and Evaluation. BANEST currently collects public deposits from its network of 46 branches[2]. Over half of BANEST's branches are in locations served by other banks and most are in locations served by banks, savings and loans or credit cooperatives. Informal competitors are difficult to measure. Such deposits are primarily sight deposits and are often held for short periods in connection with other transactions or services provided such as tax payments and funds transfers. Some deposits on BANEST's own books are from other public entities (e.g. BAB). The stock of deposits in relationship to the number of employees in most BANEST offices is very low. Thus, the cost of maintaining such deposits may be very high, depending upon how much of staff time is devoted to these deposits or to processing other transactions. BANEST does not have a means of estimating the actual costs associated with the various services it provides.

3. BANEST holds a disproportionate stock of deposits denominated in *Bolivianos* in relation to its assets which are mostly denominated in US$ or *Mantenimiento de Valor*. This practice violates an exposure limit mandated by the SBEF. If it wasn't for the foreign exchange revenues generated from this mismatch during recent years, BANEST would have suffered severe losses in each.

4. Under the formula established for BANEST upon its founding in 1970, BANEST is subject to lower reserve requirements than other banks. Such formula requires that BANEST hold reserves for essentially only 1/2 of its deposits.

5. Recommendations. While deposit-taking can be justified at BANEST, it should be evaluated on a branch-by-branch basis, taking into account: (i) the degree to which such deposits are imperative to the functioning of other services offered by BANEST such as tax collections, (ii) the degree to which the same services could be offered by alternate institutions either in the same location or nearby; (iii) the degree to which deposit-taking and other services could be offered only on select days, and potentially be offered through a Post-Office window rather than supporting a separate infrastructure; and (iv) the net cost of providing such services relative to the Government's benefit received. In addition, 100% of deposits should be invested in BCB CEDES (replacing reserve requirements) to neutralize BANEST's lending capability (See II and III below) and to fully guarantee the funds of depositors.

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[1] Some of the recommendations included in this annex go beyond those recommended in the policy matrix and policy letter.

[2] At this writing, one branch is temporarily closed.

II. Commercial Lending Operations

6. Description and Evaluation. A portion of BANEST's funds are lent for working capital and other short-term financial needs of companies. These loans are up to 2 years in maturity, are secured by mortgages, and had an interest rate of 22% (US$) at December 31, 1990. At the end of 1990, BANEST had authority to lend up to US$6.25 million yet the outstanding balance was US$2.17 million.

7. New commercial lending has only transpired at BANEST since late 1989, having been held in abeyance since 1985 because of a lack of funds, and, from 1987 to 1989, because of negative equity. At this writing, it is difficult to evaluate the performance of such loans because no SBEF inspection has been conducted at internal monitoring by BANEST may be suspect. Further, no data is available indicating the distribution of such loans by branch and in this way, an evaluation of the provision of working capital to unserved areas cannot be performed. While BANEST representatives have indicated that the non-performance of these loans is under 5%, it is doubtful that credit initiation, monitoring and supervision has improved sufficiently to result in such strong performance by such loans relative to BANEST's earlier portfolio.

8. While BANEST's failure to efficiently allocate credit is its principal shortcoming, much of its lending program may be hard to justify even if such loans are of superior quality. For those clients that BANEST claims to serve in remote locations, it is likely that some could obtain credit from other commercial banks provided they traveled to seek out such credit. Similarly, it is likely that some of such credit could be provided by commercial banks in the same locations, provided that these banks had the opportunity to purchase BANEST's offices.

9. Recommendations. BANEST should cease all new commercial lending in the context of an entire restructuring of the institution. In those branches where lending is commercially viable, BANEST should consider a sale of such branches to commercial banks or non-bank financial institutions.

III. Development Lending Operations

10. Description. BANEST currently provides medium-term loans (2-5 years, with one year of grace) for small- and medium-sized craftsman at an interest rate of 18% denominated in US$ (Bolivianos with Mantenimiento de Valor) and guaranteed by mortgages. Under this "PRAFINPIA" program, loans range from US$1,500 to US$100,000. While the total amount of these loans was allocated to be US$5 million in 1989, other loan recoveries have permitted loans outstanding to increase to approximately US$6 million at the end of 1990.

11. Evaluation. Because new lending was only begun in late 1989 and PRAFINPIA loans have a year grace period, performance indicators are limited. However, a preliminary review by the SBEF of 20 sample loans in the PRAFINPIA indicated: (i) insufficient or no evaluation of credit, (ii) credits past due not registered as such, (iii) credits rescheduled, and (iv) no evaluation of the use of funds. The implications of this initial review are that BANEST's ability to lend to credit-worthy borrowers and ensure repayment may have not improved

sufficiently since beginning to lend again in 1989. Further, such credits may not have their desired developmental impact.

12. Recommendations. BANEST should cease all new development lending operations. In order to accommodate the generation of funds through deposits which remain (See #I above), BANEST should place all deposits into Certificates of Deposit in the Central Bank. Further, all proceeds from recoveries of existing loans, loan sales, and asset sales (above operating expenses and liquidity needs) should also be placed in CEDES.

IV. Extinct Lending Operations.

13. Description. BANEST holds on its books loans and guarantees made before 1987 which have been past due for several years (See below). 100% provisioning of these loans had rendered BANEST with inadequate capital to operate from 1987 to 1989. These loans also represent liabilities with foreign banks. In May of 1989, a Supreme Decree resulted in the subrogation of this external debt by the Treasury and, as a result, an increase in BANEST's capital.

Table 1: Principal Debtors of BANEST
(US$ in Thousands, December 31, 1990)

	Debt Otstndn US$ ('000)	% of Total	Debt Source: U.S. Banks	Paris Club	BCB	Others	Status of Debt Negotiation
Hotel Crillon Sheraton	11,075	25.7	7,211			3,864	Under negotiation.
Unagro S.A.	6,479	15.0	4,749	1,730			Final phase of Negotiation.
Turin Motors	5,278	12.3	5,278				Legal action to rec. collateral.
Cartera Agropecuaria 1/	2,877	6.7			2,877		Under legal action.
Ing. Azuc. Belgica	2,081	4.8	812		1,269		For consid. of Inter-instit. com.
Ing. Azuc. Bermejo	2,049	4.8	1,731			318	For consid. of Inter-instit. com.
Ing. Azuc. Guabira	1,332	3.1	1,332				For consid. of Inter-instit. com.
Ing. Azuc. San Aurelio	1,075	2.5	430		645		For consid. of Inter-instit. com.
El Diario	1,310	3.0	705		40	565	For consid. of Inter-instit. com.
Confecciones Mariana	959	2.2	959				Under legal action.
Alubol S.A.	741	1.7	741				Under legal action.
Aserradero Salek	724	1.7	724				Under legal action.
Emp Ind. Rockett	675	1.6				675	In process of collat seizure.
Cred. Sub. Eulabank	449	1.0				449	Under consid. of BANEST Directors
Universidad Catolica	388	0.9	388				For consid. of Inter-instit. com.
Other Borrowers	5,584	13.0	283		11	5,290	
TOTAL	43,076	100.0	25,343	1,730	4,842	11,161	

1/ Multiple borrowers.
Source: BANEST

14. BANEST also holds guarantees for credits from foreign banks in the amount of US$35 million (December 31, 1990). According to SBEF norms, when a borrower fails to make a payment on a guaranteed loan, the guarantee for such a loan must be transferred as a liability directly on the guarantor's balance sheet. Approximately 80% of the amount of funds guaranteed represent loans past due. However, such loans have not been recognized as direct liabilities by BANEST. If they were, the impact would be to largely eliminate BANEST's equity base. Officials at BANEST have indicated that the institution will recognize such liabilities only once agreements with foreign banks for such funds are signed. At that time BANEST will recognize only approximately 22% of such liabilities according to the *reglamento* of foreign debt which requires that intermediaries of external liabilities pass along the discount received in debt renegotiation (11%) plus a premium of 100% (11%).

15. An inter-institutional commission reporting to the Minister of Finance established in May 1989 to renegotiate outstanding loans and guarantees has to date expedited little renegotiation and no concrete agreements as to restructuring or liquidation of these loans have been reached. In late 1990 however, some disposition of assets held in receipt of non-performing loans have begun to be liquidated.

16. Evaluation. Many believe that the inter-institutional commission has been lax in its effort to renegotiate internal debts because domestic borrowers have exerted considerable influence to ensure that, in the least they receive the discount on the original foreign obligation, or that at best they never have to repay the outstanding obligation with BANEST. SBEF analysts estimate that effective recovery of these loans could be approximately 30-35%.

17. Recommendations. Once it is clear that BANEST will no longer lend funds, it may prove easier to take the political decisions to expedite renegotiation of outstanding credits or to expedite legal proceedings. It is imperative that: (i) outstanding loans are renegotiated, recovered or sold as quickly as possible; (ii) BANEST recognize associated liabilities stemming from guarantees yet to be honored (even if at a discount), (iii) that assets received in lieu of loan recovery be liquidated as quickly as possible, and (iv) that those performing loans existing on BANEST's balance sheet before 1989 be sold to other institutions as part of a liquidation strategy.

V. Window for the Central Bank

18. Description. In its role as a window for the Central Bank, BANEST receives and transfers funds serving as commercial bank reserve requirements, as well as makes other funds transfers to and from Central Bank's accounts. It also maintains all of the current accounts for Government bodies including provinces, municipalities and public enterprises. In each case, funds are held in Bolivianos with no interest paid. While BANEST serves as the agent to maintain such accounts, all of these accounts are kept on the books of the Central Bank and separate from BANEST's own accounts.

19. Evaluation. Because BANEST had served prior to its founding as the banking department of the Central Bank, it is understandable that it maintained its functions as a window. However, most of BANEST's functions as a clearinghouse for Central Bank transactions could be performed directly by commercial banks. The requirement that public entities deposit funds in BANEST without remuneration is an effective tax on public entities which has cross-subsidized BANEST, reduced transparency of public accounts, and distorted the financial position of public enterprises.

20. Recommendations. A Supreme Decree should be issued that: (i) eliminates the requirement that public entities deposit their funds in BANEST; (ii) ensures that deposits by public entities not be restricted to Boliviano current accounts but, rather, be deposited also in CMV and US$ accounts as desired by the depositor; (iii) ensures that all deposits of public entities in BANEST or other institutions are subject to a 100% reserve requirement with payment at the 30 day CEDES rate according to the currency; and (iv) establishes direct links between commercial banks and the Central Bank for purposes of

account settlement. The latter could include the reopening of regional offices of the Central Bank. Adoption of the measures indicated can only be successful in the context of an important downsizing of BANEST's operations and establishment of effective cost control and reimbursement mechanisms so that it can be viable without the effective subsidy of the Boliviano demand deposits.

VI. Fiscal Services

21. Description. BANEST had until 1970 been a department in the Central Bank and retains many of the functions it held before being separated out as an independent entity. Prior to 1987, the Central Bank had offices in four provinces and BANEST only served as a window for funds in areas not served by these offices. In 1987 it also acquired additional responsibilities as an agent of the Treasury. The most important of these services is receipt and transfer of corporate taxes to the Treasury's account in the Central Bank. Since October of 1987, the 1,300 largest private corporate taxpayers (selected in terms of sales and prior tax assessment) in Bolivia have been required to pay their taxes to BANEST. Such receipts represent 82% of the tax receipts in Bolivia yet 0.2% of contributors. Payments from these companies are made at BANEST's offices in La Paz (600), Santa Cruz (350) and Cochabamba (350). BANEST receives a commission for each of these transactions. BANEST also receives and processes tax payments for smaller taxpayers that also have the option of making such payments through private commercial banks. In each case, BANEST or commercial banks receive commissions based on the amount of funds processed as well as the number of individual transactions. A schedule of fines is imposed for either inaccuracies in money transfers or in processing such funds not according to the time limit provided.

22. BANEST also serves to process revenues, guarantees and import documentation generated in connections with customs duties and administration. BANEST's automated information system serves to reconcile import records with the custom duty receipts and BANEST monitors and transfers duties received from border locations and selected airports. BANEST is compensated for processing these transactions according to the volume of funds as well as for each customs certificate and each pay order.

23. A third important fiscal function performed by BANEST is the payment of salaries and benefits to public employees, veterans and retirees. While a 1986 decree mandated that BANEST perform this function for all public employees, it is believed that BANEST actually disburses approximately 90% of the public sector salaries and benefits, concentrated in teachers, university professors and retirees.

24. Evaluation. While it does appear that BANEST's automated system of account reconciliation (developed with technical assistance from UNDP) performs efficiently, this in no way discounts the fact that some functions currently performed by BANEST had been and could in the future be performed as efficiently by private commercial banks. BANEST representatives have indicated that BANEST has consistently had a lower error rate and higher on-time deliveries than commercial banks. Were commercial banks however enabled to process a larger volume of transactions (including tax collection for larger taxpayers) and ensured a sound commission structure for such transactions, it likely that BANEST could face stiff competition for such business. Because BANEST does not have a

cost center system to ascertain the exact costs of providing such services, it is difficult to discern if commissions received reflect their costs.

25. Recommendations. It is recommended that: (i) a careful analysis of the costs associated with the provisions of these services on a branch by branch basis; and (ii) provisions to enable commercial banks to provide the same fiscal services provided that all funds are deposited in a remunerated reserve account at the Central Bank (with a rate, at a minimum equal to the average cost of funds of the banking system).

VI. Other Services

26. BANEST performs a number of other functions, including various account clearings, reconciliations, processes payments to utilities, conducts funds transfers, and other fiscal services and services as a Central Bank window. It should also be noted that it seems that an implicit goal of having BANEST branches in some remote locations is to maintain a state presence in addition to post offices, police stations and military installations.

VII. Recommended Program

27. The proposed SAC should include a comprehensive program for the restructuring of the functions of BANEST:

a. Issuance of a Supreme Decree indicating that BANEST's functions will be limited: (i) to serve as a window for the Central Bank, (ii) to offer select fiscal services, including some receipt and transfer of taxes and duties and payment of Government salaries and benefits, (iii) to receive public deposits, and (iv) to make funds transfers and select other financial services. BANEST will perform no new lending, be it commercial or developmental and will place all deposits in Central Bank CEDES and remit all profits from commissions, services and loan recoveries (above those needed for liquidity purposes) to the Treasury. It will only provide selected services in those locations where commercial banks are not located and where the Government believes it is cost effective and worthwhile public policy to provide such services. Such a decree should indicate that BANEST will be systematically decapitalized, with capital gains accruing to the Treasury.

   Such a decree should also indicate the specific proportion of BANEST's employees (involved in lending operations) that will lose their jobs from the restructuring as well as the means of compensation including accumulated benefits and specified severance pay.

   Such a decree should indicate that the Government will evaluate the cost effectiveness of services offered by each branch and explore the possibility of providing the services indicated through mobile bank buses to small communities once or twice per week, through special windows in post offices, and through permanent structures also only open on selected days. From such evaluation, the Government will develop a plan for restructuring BANEST consistent with its new functions.

b. Initiation of a branch-by-branch evaluation of the costs and benefits of providing the services indicated above, including an evaluation of offering such services through post-office windows or institutions operating on selected days.

c. Issuance of a Supreme Decree indicating that public enterprises will no longer be required to hold deposits in BANEST but can use commercial banks as desired and that deposits held in BANEST can be held in CMV or US$ accounts.

d. The Government will have indicated in the Policy Letter its intent to accelerate the liquidation of BANEST's past due loan portfolio, assets received in lieu of loan payments, and other fixed assets.

e. Issuance of a Supreme Decree providing that: (i) large taxpayers can make contributions into commercial banks rather than being restricted to BANEST; (ii) public enterprises and other public entities will be able to deposit their funds in either BANEST (with proper remuneration) or other commercial banks; and (iii) that 100% of these funds at both sets of institutions must be placed in special remunerated reserve accounts at the Central Bank.

Intervention and Liquidation Procedures for State Banks

1. Under the existing Banking Law of 1928, exact procedures are specified for bank intervention and liquidation[1/]. However, given the nature of the operations of State banks in Bolivia, it has been recommended that the procedures of the law be followed but that, in addition, the liquidation be carried out according to a Supreme Decree which specifies the objectives of the liquidations and the procedures which would be used. While these institutions may not be in specific violation of prudential regulations which can precipitate intervention, because they are State-owned the Government can take measures for their liquidation. The following procedures are recommended:

STEP 1

2. The Government should set out in a Supreme Decree its action as principal shareholder to intervene and liquidate the Bolivian Agricultural Bank (BAB), Bolivian Mining Bank (BAMIN) and Bolivian Mining Exploration Fund (FONEM) as follows:

(a) The SBEF should intervene the institutions and conduct a full inventory of financial and fixed assets, including the notation and copying of the contents of each credit folder.

(b) Special security should be imposed in order to ensure that credit documentation and fixed assets are maintained in the Bank offices, and that security safes and boxes are sealed.

(c) The Ministry of Finance should appoint a liquidator who will have the authority and resources to contract for external support for valuation, adjudication and asset sales.

(d) The institutions should immediately: (i) cease all new lending operations; (ii) stop further disbursement on existing credit lines; (iii) institute a hiring freeze; (iv) deposit all proceeds beyond day-to-day liquidity needs from loan recoveries, asset sales, and liquidation of liabilities in a special non-remunerated account established in the Central Bank of Bolivia (BCB).

STEP 2

(a) The liquidator should, as soon as possible, contract with external auditors to use the account inventories to conduct a full audit of the financial statements of the institutions, including an approximate valuation of fixed assets and assets received in lieu of loan payments. The Auditors' Report should be submitted to the liquidator within 90 days of appointment. All future liquidation actions should be based on the revised financial statements and thus separate pre- and post- liquidation procedure financial measures. Further, if the audit indicates that the institution is bankrupt,

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1/ Procedures will also be specified in the proposed Banking Law.

such a bankruptcy has to be declared publicly and the provisions of the Bankruptcy law applied accordingly.

(b) The liquidator should inform all creditors to the institution of its closure and initiation of liquidation and request that such institutions submit a request for compensation and settlement of all outstanding balances.

(c) The liquidator should submit to the court the intent to liquidate upon which a single judge would be appointed to pass judgement and sanction each legal action taken in accordance with the Banking Law and Bankruptcy Law. Subsequently, each legal action taken by the liquidator would be approved by the judge assigned (See Step 5).

(d) The liquidator would prepare a liquidation program which should include:

(i) A program for the specific termination and compensation for employees not directly involved in loan or asset recovery or in liquidation, and the severance pay for each. Such a program should be developed based upon an individual's years of service and average salary during the 2-3 years before liquidation. In addition, those employees that are considered important to stay with the individual institution should be provided a special premium to provide an incentive for their staying with the institution.

Those individuals who are terminated should be required to sign a writ which absolves the bank from any future obligations with the individual.

(ii) A program for loan sale, transfer, recovery or liquidation including:

a. A global mechanism for enabling borrowers to prepay loans at a discount.

b. An evaluation of the loan portfolio to determine which loans could be sold to banks and a valuation of the possible price, which loans could be sold to the borrower and at what price, which loans need to be liquidated through court actions, and which loans should be written off at a price of zero.

c. Establishment of loan sale procedures.

(iii) A program for the recovery of fixed assets and assets received in lieu of debt repayment. Such a program should include sales of these assets in public offerings with a floor price determined beforehand by the valuation performed with the assistance of external firms.

(iv) A program for the reduction and eventual elimination of branch offices, including means of sale.

(v) A program for the recovery of permanent investments.

(vi) Development of mechanisms for transfers from a special BCB account to the Treasury of funds deposited from liquidation proceeds.

(e) It is important to note that the Liquidator must submit for approval by the assigned judge all measures including: (i) approval of liquidation costs, (ii) authorization of the sale of all assets, (iii) condoning or lowering or interest or renegotiation of credits, (iv) determination of judgements on payments of liabilities, and (v) accounting treatment of liquidation and refinancing measures.

STEP 4

(a) The liquidator should convene a formal meeting of bank creditors to explain the financial position of the institution, to submit the revised audited financial statements, to indicate the basic liquidation procedures which will be followed, and seniority of creditors according to the Banking Law.

(b) It is important that the liquidator put before the public eye all actions taken in order to mitigate the possibility of criticism (or litigation) based on charges of cover-ups.

STEP 5

(a) After development of the liquidation program, the liquidator should:

(i) Initiate the termination and compensation program for employees not involved in recovery or liquidation. Within 30 days after the initiation of the program, all employees not involved in asset recovery or liquidation should have been terminated and compensated.

(ii) Appoint a staff of lawyers to initiate loan liquidation procedures.

(iii) Appoint a staff of trained individuals in fixed asset sales.

(b) Within 30 days after the appointment of lawyers and staff to expedite liquidation, the following measures should be taken:

(i) Initiation of liquidation of fixed assets through public auctions and placement in the stock exchange, with a floor price as determined by external valuation experts. It is important that a floor price be sufficiently high enough to discourage corruption even if assets have to be auctioned several times. Private placements should be avoided because of potential criticism.

(ii) Initiation of renegotiation measures for external debt.

(iii) Initiation of measures to reconcile asset and liability BCB accounts.

(iv) Initiation of loan sales.

(v) Initiation of litigation of non-performing loan recovery.

Terms of Reference for Legal Study

A. Background

1. A legal study will be financed. The coverage, objectives, and process and timing for undertaking the study are each described in turn. The need for such a study arises, because the bodies of law and regulations that govern all forms of credit contracts and securities transactions in Bolivia have hindered the competitiveness and efficiency of capital markets. For example, legal ambiguities have hindered certain forms of credit contracts (e.g. issuance of commercial paper by corporations). Others have created inequities in the recourse of Banks versus nonfinancial institutions in re-possessing collateral and thereby reduced competition. Finally, legal restrictions have limited access to credit for persons that cannot pledge real property as collateral.

2. The study will also provide an input into reforms of Bolivia's contractual savings system (i.e. social security, pensions, and insurance) and into revision of arrangements for supervising and enforcing securities market regulations. In both these areas reforms in laws, resolutions or circulars will be needed.

B. Coverage

3. The exact coverage of the study will largely be dictated by the objectives noted below. The study will examine all bodies of Bolivian law necessary to achieve the objectives set out below where the study itself is broken down into two distinct parts or phases. The major bodies of law to be examined will include: (i) the commercial code (i.e. Código de Comercio); (ii) the civil code and associated processes (Código Civil, Código de Procedimiento Civil); (iii) the insurance law; (iv) the laws relating to pension funds; (v) the banking law and (vii) all legal dispositions relating to securities markets. Where relevant, the related resolutions and circulars will also be reviewed. The study will set out options for changing this body of law to achieve the ends set out below. Where more than one feasible option exists for achieving the end, the study will set out these options and discuss the relative merits of the options. Recommendations will be made in regard to the exact process needed to achieve various objectives (i.e. issuance of a new law, a supreme decree, resolution etc.)

C. Objectives

4. The objectives of the study are twofold and will be conducted in two distinct phases. The first phase of the study will provide legal support to the Government in order to implement specific changes in laws and regulations that have created barriers to the competitiveness and efficiency of Bolivia's credit and nascent securities markets. The specific objectives of this part of the study reflect agreements with the government in a letter of development policy. The second phase of the study will support government efforts to modernize the overall legal framework governing securities markets and the contractual savings system. It will focus on additional legal and regulatory reforms that will

improve the efficiency of the contractual savings system or strengthen the supervisory authority of regulatory agencies.

5. Phase 1: This part of the study will identify specific legal or regulatory changes to achieve the following objectives:

(i) Permit issuance and trading of commercial paper and more generally of all types of securities by as broad a set of corporations as possible including sociedades de responsabilidad limitada. These are closely held companies consisting of no more than 25 persons each of which has a capital quota. This form of company constitutes 95% of all corporations. The study will examine all legal barriers to the issuance of these types of securities. If there is no legal barrier as such, but companies are reluctant to proceed because they are not specifically entitled to proceed, the study will give options about the best way to empower companies to do this. For example, article 195 of the Commercial code appears to not permit these corporations to issue any type of security (i.e. titulos valores) or equity even if some forms of securities will not effect existing capital quotas. Also article 739 that defines the concept of the public securities market, explicitly excludes these forms of societies as eligible to issue securities. The legal dispositions relating to CNV may also need to be modified as would other parts of the commercial code so as to explicitly define commercial paper and the types of paper issued (e.g. commodity-linked or backed etc.). In addition the functions and ownership of rating agencies will need to be established as well as the regulatory role of the CNV.

(ii) permit origination and trading of bankers acceptances based on storage warrants issued by licensed warehouses (Almacenes Generales Depósito). Direct issuance by sociedades de responsabilidad limitada of commercial paper backed or linked to these warrants should be permitted as well as acceptances originated by commercial banks. The study will set out the legal changes necessary to facilitate this, including changes to the commercial code as well as to the Banking law. The study will also indicate necessary changes in the commercial code to permit the trading of the warrants (bonus de prenda) issued by licensed warehouses. It will also indicate modifications in the part of the commercial code dealing with trusts and depositories to permit either the warehouse or the bank to undertake the custody of the warrants to be traded.

(iii) permit brokers to act as underwriters since they have only been able to operate on behalf of third parties. This will require that the commercial code permit stock agents to operate for their own account as well as behalf of third parties. The study will set out legal changes necessary to permit this, including modification of article 765 of the commercial code.

(iv) Improve legal procedures for permitting assets other than real estate to serve as collateral for loans. Amend Bolivian law to permit lenders to businesses to foreclose on chattel collateral more quickly, thereby enabling business borrowers to use such collateral for loans. Strengthen legal safeguards for consumer borrowers. Shorten collection procedures from their present 6 month - 2 year duration, including possible extension of 'proceso coactivo' to non-bank lenders. Improve collateral registration systems (see Annex XII).

(v) Change negotiable instruments law to permit a variable rate note to be a negotiable instrument, permitting effective private placement of commercial paper, bonds, and debentures issued by Bolivian companies.

6. Phase 2: The ultimate goal of this phase of the study will be to prepare a new draft capital markets law that will require associated changes in complementary bodies of law (e.g. the insurance law, laws relating to pensions and social security, the commercial code etc.). It will focus on a broader set of objectives that relate to economic reforms of the contractual savings system (see Annex X that describes this study), further improvements in the efficiency of securities markets, and efforts to improve effectiveness of capital markets supervision. The objectives are grouped under the following headings: (i) securities; (ii) insurance; and (iii) pensions. In each case options for changes in the law to improve efficiency or supervision are distinguished.

Securities Markets

7. Efficiency: The objectives in this area should include:

(i) options for broadening the definition of a security as well as the set of originators and eligible holders should be indicated. This will involve modifications to the existing commercial code (see articles 739, 741-746 of the commercial code). These should include, but need not be restricted to commercial paper, bankers acceptances, bonds, debentures, securities with various forms of imbedded options, or linked to various price indices etc. The set of issuers should include sociedades limitadas, and other new forms of companies (e.g. unit trusts or mutual funds etc.).

(ii) present options to expand the types of corporations defined in the commercial code (e.g. in article 126) to include new forms of companies such as investment companies,unit trusts, or other entities that could manage assets for third parties (i.e. pension funds). These institutions could provide a vehicle for smaller investors that would compete with deposits held at commercial banks. To permit this, the CNV has proposed that new societies would have to be legally defined (Sociedades de Inversion), both in the capital markets law and in the commercial code.

(iii) Give options to change the legal system to distinguish clearly between the concept of an open versus closed company. The current commercial code does not do so. Both in the case of sociedades anónimas and comandita por acciones the companies are effectively closed in the sense that families control the companies and their is no legal definition of the amount of voting shares necessary to retain control of a company. The specific changes needed to the commercial code should be investigated and the rights of minority shareholders defined. Consistency between the proposed changes in the commercial code and other legal codes should be checked.

8. Supervision: Objectives in this area relate to specific legal or regulatory reforms to improve the capacity of the Comisión Nacional de Valores (CNV) to supervise and regulate Bolivia's securities markets. Objectives include:

(iv) development of options for improving the managerial independence and continuity of management of the CNV . This should include a review of the organic law defining the functions of the CNV and articles 781 and 782 of the commercial code that also deal with the role and functions of this agency. The possibility of letting directors serve staggered terms where their appointment would be subject to congressional approval instead of being subject to political changes should be reviewed. Options for determining procedures for appointing the president of CNV should also be presented. As now, directors would have to represent different segments of the investor community but an effort should be made to assure that directors have certain areas of specialization--accounting, law, economics etc.

(v) consideration of changes in the organic law of the CNV to increase its capacity to enforce securities regulations in administrative proceedings. This should include: (i) increases in the penalties that can be levied for infractions and (ii) improvement in procedures for imposition of these fines (e.g. use of consent decrees).

(vi) consider changes in CNV's organic law to broaden CNV's authority to register auditors,financial analysts, and other direct or indirect participants in Bolivia's securities markets. It should be made legally possible for CNV to charge for providing these services. This will improve CNV's financial independence and permit retention of staff with adequate technical skills.

(vii) options for changes in laws and regulations that will permit CNV to obtain information necessary to properly supervise (a) the Bolsas; (b) the intermediaries and (c) issuing firms. These reforms should be developed with the external consultant that will advise CNV on how to upgrade its systems for off-sight and on-site surveillance. Examples of the types of information include: a) data on concentration of positions in securities, b) register of participants, c) records of executed trades; and d) clearing and settlement information.

(viii) alternative changes in laws and regulations that will begin to create incentives for self-regulation and will reduce credit risk associated with securities trades should be presented. Issues to be addressed should include; the functions and role of the Bolsa in custody operations versus explicit non-exclusion of the Bolsa from providing this form of service; setting of minimal standards for the form of custody operations (e.g. double entry system of recording trades to reduce need for physical transfer of government securities and reduce credit risk); distinctions between clearing and non-clearing members and establishment of greater capital requirements for clearing members to create incentives for policing of exchange members. These actions would have to be evaluated in light of the very limited development of Bolivia's government securities market.

9. Insurance: The specific objectives for reform to the Insurance Law and related laws or resolutions are linked to the final results of the economic study of contractual savings (see section C below that discusses the timing of this component of phase 2 and Annex X that presents terms of reference of the contractual savings study). Thus, the specific objectives below represent some of the issues already identified (based on information obtained by the mission) that merit investigation in this component of phase 2.

Efficiency:

(i) Options for changes to the Insurance Law to permit insurance companies flexibility in the asset allocation decision through imposition of overall asset diversification guidelines.The insurance law presently requires that a large proportion of capital and reserves be invested in real estate (e.g. in excess of 50% of the asset portfolio). Also there is evidence that the government has required Insurance companies to take certain government securities into portfolio at non-market rates.

(ii) Changes in the Insurance Law should be considered that would not permit the insurance superintendency to set explicit minimum premiums for different lines of insurance. Greater freedom in setting premiums will improve efficiency and competition as long as minimum capital and technical reserve requirements are enforced.

(iii) Changes should considered to the insurance law and the commercial code to permit insurance companies to act as managers of third party funds(i.e. managers of pension fund assets such as the complementary pension funds or completely private voluntary funds). This will start to create some competition for the right to manage pension fund assets.

(iv) Insurance companies are presently not permitted to issue debt. The legal restrictions in this area should be reviewed and consideration given to permitting these companies to issue certain forms of debt if properly accounted for in calculating legal leverage and capital requirements.

Supervision

(v) The percentage of premiums to be retained as technical reserves in offering different types of insurance should be reviewed and based upon actuarial calculations based on historical Bolivian data. Also the majority of technical reserves should be held in liquid assets whose real value can be maintained with inflation(inclusive of holding foreign currency denominated assets abroad), as opposed to current practice where substantial proportions of reserves must be invested in real estate. This will require review and modifications to chapter 3 section 2 of the insurance law. The ratio of retained premiums to precautionary reserves and capital should be calculated and monitored.

(vi) All sections of the law relating to conditions triggering liquidation (whether forced, voluntary or administered by the courts) should be made as precise as possible. Conditions relating to leverage, technical reserves and minimum capital should be set out explicitly and processes for either recapitalization or liquidation should be subject to explicit procedures.

(vii) Disclosure requirements for insurance companies , insurance brokers and adjusters should be reviewed so that only essential information be given to consumers (e.g. technical reserves,capital, financial and income statements, specifics of policies, and actuarial calculations upon which premia are based etc.). At present a lot of extraneous information must be reported that simply increases transaction costs and premiums charged to consumers.

(viii) Changes to the insurance law and associated regulations should be considered to strengthen the ability of the insurance superintendency to undertake on-site and off-site inspections. More broadly if the Superintendency of Insurance is merged with the Securities Exchange Commissison(CNV) as now proposed the Insurance law will need to be modified to establish new lines of authority.

10. Pensions: This component of phase 2 like that relating to insurance will be undertaken after the study of contractual savings is completed (see section C below and Annex X). This component of the study will support government efforts to reform the social security and complementary pension system.

Efficiency

(i) Changes in the social security code and subsequent decree laws and supreme decrees should be considered in order to develop the concept of Administradores de Fondos de Pensiones (AFP's) as defined in Chilean decree law 3500. Creating this type entity will also require changes to the commercial code, the insurance law (i.e. to let insurance companies act as AFPs) and to laws relating to securities markets so that AFPs can undertake investments on the Bolsa's or buy shares of firms to be privatized. Specific attention should be given to the types of AFPs that can be created including, worker-owned funds.

(ii) changes should be considered to permit employees greater choice as to the form in which their retirement contributions will be managed or in the form of plans (e.g. voluntary plans in place of a compulsory complementary scheme). This will require changes to the present system in which employees must contribute to the basic plan (part of social security) and to complementary pension funds associated with different sectors (e.g. mining etc.) In these cases competition with private pension plans administered by insurance companies has not existed. In addition by law the investments of either of these funds are now controlled by government regulation and must be deposited in accounts with the state banks.

Supervision

(iii) changes in decree law 10776 that defines the role and functions of IBSS in regulating and supervising pensions will need to be considered if wholly voluntary pension plans can be permitted aside from the basic plan (i.e. part of the social security system) or complementary pension plans that are mandatory and mainly serve public sector enterprise employees. This is because current laws do not specify what agency would have regulatory jurisdiction over these types of funds. Similar issues will arise if the present pension system is reformed to permit greater private management of existing pension fund assets or if both the administration of the basic plans and that of the complementary funds are privately managed as proposed by the Ministry of Finance. In this case no provisions exist in the law as to what agency would have regulatory jurisdiction.

(iv) If the basic pension funds associated with the social security system as well as the complementary pensions are privatized the investment and technical reserve guidelines for pension funds would have to be revised. At present although the amount of reserves required is based on actuarial calculations the investments of reserves for the basic plan must primarily be in government related "development projects" such as hospitals or other types of fixed investments. In the case of complementary pensions no specific diversification guidelines appear to exist. Efforts should be made to develop realistic diversification guidelines for pension funds, particularly if the existing system is partially or completely privatized.

D. Timing and Organization

11. The two phases of the study will be undertaken sequentially. The first phase of the study will start immediately. The second phase of the study

will not begin until the economic study of the contractual savings system has been concluded (see Annex X) and the terms of reference for the second phase are appropriately modified. The present assistance of AID to the CNV in order to begin to draft a capital markets law will also have been completed by this time. It is envisioned that phase 1 of the study will not take a long time to complete while phase 2 will require more time.

12. To undertake Phase I of this study, the Government of Bolivia will pick an Advisory Group from a representative short list agreed by the Bank and the Government of Bolivia. This group will include Bolivians from the public and private sector with legal and other backgrounds that will advise the working group as various stages of the work is completed. A Working Group, comprising internal consultants and relevant staff in agencies chosen jointly between the government and the Bank will produce documents and proposals for consideration by the Advisory group. The group will be assisted by foreign consultants with expertise in the areas under review.

13. To undertake Phase II of the study, the Bank and the Government will be guided by the findings of the Advisory Group in determining the further legal drafting requirements that develop in view of the results of the audits and economic study of contractual savings(see Annex X).

Study of the Bolivian Contractual Savings System

A. Background

1. Consistent with the government's desire to privatize public sector enterprises under the SAC it is concerned that the set of possible investors be broadened. One means of acheiving this objective is to simaltaneously reform the system of contractual savings (e.g. social security, pensions, and insurance) as a means of creating a class of private investors that is somewhat broader than that now in existence.

2. Coverage and provision of benefits under the government social security system that provides health and retirement benefits has been judged to unsatisfactory by the government. Thus, reforms are being proposed that would (i) seperate the provision and financing of health and retirement benefits; (ii) partially or completely privatize the component of the social security system providing basic retirement benefits; and (iii) limit government provided health benefits with a greater proportion provided by private insurance companies.

3. At the same time, reforms of the complementary pension funds that are essentially occupational involuntary pension plans that operate on an industry-wide basis (e.g. mining, banking, petroleum etc.), are also being proposed. These would create greater possibilities for the private management of these funds and for the possibility for workers to switch between funds under certain conditions (e.g. portability in the case of switching employement). Thought is being given to creating Administradores de Fondos de Pensiones (AFPs) ,developed in Chile, to facilitate greater private management of assets.

4. Finally, a program of reforms to the insurance industry is being considered that will complement a restructuring of this industry (see Annex XI describing the audits to be undertaken of these companies and the description of this restructuring program). These reforms could include de-regulation of the asset portfolio of insurance companies inclusive of permiting investments offshore, permiting insurance companies to issue debt, permiting them to act as managers of pension fund assets (i.e. act as AFPs), and deregulation of premiums through abolishing floors for premiums.

5. All of the types of reforms noted above would be complemented by improvements in the supervision of insurance companies and pension funds (see Annex XIII that describes the technical assistance to be provided in theis area).

B. Objectives

6. The primary objective of this study will be to analyze the options for reforming the contractual savings system so as to assist the government in developing its program of reform. The study will build on work already undertaken or in process. This includes work by Jose Pinera and Claro and Associates (a Chilean consulting firm) in the areas of: (i) strategies for

reform of Bolivia's system of social health benefits (e.g. part of the social security system); (ii) strategies for reform of Bolivia's pension system that is linked to the operation of the Social Security System; and (iii) estimates of the fiscal cost of privatizing the basic retirement benefits component of the social security system (i.e. the system of pensiones basicas). It would also build on reports about the insurance industry by companies within the industry or the superintendency of insurance as well as reports financed by AID (e.g. Price Waterhouse Financial Sector Report). Specific objectives are outlined below under the headings of (i) Social Security, (ii) Pensions, and (iii) Insurance.

7. Social Security: This component of the study will examine the economic impact of reforms to the social security system with special attention to fiscal impacts and primarily to reforms of the retirement component of Social Security. Specific issues to be addressed would include:

(i) examination of the demographic characteristics of payers versus eligible recipients of health, retirement, and disability benefits as well as geographical location of recipients. Actuarial work would also be included to ascertain the expected liabilities of the system where health versus retirement related liabilities would be distinguished. This would be applied to all types of plans now supported as well as to alternative "social insurance" schemes proposed that involve an increase or decrease in coverages.

(ii) establishing criteria used in order to ascertain minimum benefits(e.g. income levels of recipients;degree of access to private services) and the types and size of benefits to be provided should be indicated. Procedures for financing the benefits to be provided as well as the degree to which the system will be funded or unfunded would be studied and the implications presented.

(iii) examination of the fiscal implications of reducing the degree of publically provided benefits. An explicit model should be developed that can be used by the fiscal authorities to simulate the fiscal deficits that will have to be covered under differing assumptions about the degree of privatization of the pension and health benefit system. This model should permit users to make differing assumptions about demographic characteristics of payers and recipients, interest rates, wage rates etc. This can build on the work already done by IBSS and Pinera and Claro Associates.

(iv) scenarios for financing deficits associated with the existing or future social insurance system should be considered. The macroeconomic implications for domestic debt service and growth of the domestic debt should be carefully considered.

8. Pensions: The analysis of Bolivia's pension system will include:

(i) A description of the operation and a characterization of the financial condition of Bolivia's two layered pension system that include Fondos Basicas that are part of the Social Security System and Fondos Complementarios that are closed-end pension schemes(for employees only) that are grouped by industry. This will be coordinated with the external audit of all pensions financed separately as part of the technical assistance component (see Annex XI). It will also draw on material already available (e.g. the study of Pinera et. al.).

(ii) An analysis of the payment record to recipients under the existing two-layered pension scheme and an evaluation of problems. Included will be an investigation of the degree to which the complementary pension fund resources have been invested in related enterprises(e.g. particularly in case of parastatal companies). Rates of return on the assets of these different funds will also be calculated if possible. This can build in part on work of Pinera and Claro Associates.

(iii) analysis of the proposal to exclude or diminish minimum retirement benefits made available under the basic pension plans that are now part of the Social Security system. The implications for changes in the contributions that would be implied by employers and employees under the complementary pension schemes should be investigated as part of this work as well as implications for employees in firms not covered by cumpolsory complementary pension plans.

(iv) analysis of options for creating voluntary private open-end (open to public at large) pension funds. The analysis should include the legal or regulatory constraints to the creation of these types of pension plans, if any, and implications for efficiency of the existing two-layer system.

(v) analysis of implications of permiting public or private complementary or voluntary pension funds to provide either defined contribution or defined benefit plans.

(vi) analysis of options for creating more competition and independence in management of pension fund assets through creation of AFPs. This should include an evaluation of the types of institutions and associated requirements to act as AFPs (e.g. Banks, Insurance Companies, Mutuales) The analysis provided should consider how concentration in the banking and insurance industries will effect competition among AFPs, if some existing complementary pension funds were converted into worker-owned AFPs.

(vii) examination of options for improving incentives for more efficient management of assets through increases in the mobility of payees across plans. This can include portability where withdrawl of benefits from one plan due to a change of employment can be rolled into a new plan or free withdrawl at any time with no penalty especially if there is no income tax as at present in Bolivia. It should also include an examination of the impediments to participation of residents in different forms of voluntary offshore private pension plans.

(viii) The role of the government in the context of the operation of the pension system needs to be considered. This should include the forms of regulation and supervision with particular attention to information that should be disclosed by pension fund managers etc. For example data should be made available on technical reserves of different funds as well as profitability of a given AFP not only of each specific fund administered by an AFP. Explanations of the costs of commissions charged should also be made available. Finally, the degree to which the government will guarantee participants in public or private pension funds against loss should be made clear.

(ix) An evaluation of the proper role of the insurance industry in either administering or directly providing retirement benefits or disability coverage and the legal/regulatory impediments to this possibility.

(x) Options for assuring adequate regulation and supervision of public and private pension funds should be assessed. The degree to which minimum standards of fiduciary responsibility are assumed by pension fund managers should be examined and specific recommendations made to improve inspections and off-site supervision. This should include measures to permit regulators to enforce the regulations with adequate enforcement tools.

9. Insurance: This part of the study should have the following objectives:

(i) describe the history of the insurance industry, types of policies (e.g. life,health,property/casualty, surety bonds, crop or disaster insurance etc.) that can be provided and their size (e.g. in terms of premium income). This should also indicate the types of sectors where insurance is prevelant (e.g. industry,mining and agriculture). Explanations should be given for the small size of total premium income (e.g. $U.S. 28 million in 1990 vs. $U.S.40 million in 1980) for the industry and the extent to which residents insure abroad or engage in informal arrangements. An explanation for the concentration present in the industry (i.e. 3 companies provide 70% of all premiums, LAB,YPF and FAB) should be provided.

(ii) analyze the implications for the insurance industry of reforms to the social security system such as reductions in certain forms of health coverages, disability or retirement benefits.

(iii) the exact reasons for the lack of re-insurance by offshore companies as well as for their small presence should be investigated. Recommendations should be made for removal of legal and regulatory impediments to the offering of this form of finacial service in Bolivia, if applicable, aside from obvious political risk considerations.

(iv) A discussion should be provided in regard to the extent of activities that can be insured given the size of the informal sector. Are the costs now being paid informally for various types of guarantees far greater than the actuarial value, particularly in obtaining guarantees sufficient to obtain credit.

(v) An analysis of the roles of insurance brokers and adjusters in the Bolivian insurance markets should be provided. Recommendations for improving the efficiency of the operation of these companies as well as that of the 16 insurance companies should be provided. This part of the work should be coordinated with the external audit to be undertaken of the companies operating in the Bolivian insurance industry.

(vi) The economic implications of permitting insurance companies to become AFPs or to manage the assets of AFPs should be examined.

(vii) The implications of liberalizing certain aspects of insurance operations should be assessed. This should include: (i) free setting of premia rather than setting minimum floor prices (ii) permiting insurance companies to issue debt; (iii) relaxing restrictions on investments that currently require that insurance companies invest over 50% of their assets in real estate; and (iv) permitting a greater proportion of assets to be invested abroad.

(viii) Leverage requirements, minimum capital requirements, technical reserves requires against issuance of different policies, and prudential diversification guidelines should all be reviewed to assess if changes are needed to improve the efficiency of the Insurance industry and its solvency.

<u>Process and Timing</u>

10. The study will be undertaken by one or more internal Bolivian consultants with assistance from external consultants that will be agreed upon with the Bank. It is estimated that this study could be completed within 6 months since it will build on work already completed or that will be completed by July 1991. The consultants should work closely with relevant government agencies: the Institute of Social Security , the superintendencies of Insurance and Banking, the Securities Exchange Commission , and the Ministry of Finance. They should also coordinate with relevant private sector groups (i.e. the Bolivian Insurance Association, Confederation of Private Enterprises etc.). The Ministry of Finance will be the primary counterpart for this work and will coordinate closely with the Ministry of Planning. The technical Advisory group composed (also established to review the results of the legal study, see Annex IX) will review this work.

11. This study will begin at the same time as phase 1 of the legal study and will precede phase 2. This is because specific legal reforms will be implied by recommendations coming out of this study.

External Audits of Insurance Companies and Pension Funds

1. Assistance will be provided in order to determine the financial condition of institutions operating in the insurance industry (inclusive of Insurance companies, Insurance Brokers, and Insurance Adjusters). Also audits of the pension funds (both public and private) would be financed.

2. Insurance: There are currently 16 insurance companies operating in Bolivia, 13 insurance brokers of small size, and 17 companies that serve as insurance adjusters. Total premium income was about $ 28 million in 1989 or only about .5% of GDP substantially below the level for the industry of $U.S. 40 million in 1981. Due to a lack of human resources in the superintendnecy of insurance and re-insurance(SNSR) precise information about the financial condition of these different enterprises within the insurance industry is not available. In addition, the reputation of the industry has suffered due to a lack of supervision and associated abuses by insurance companies(nonpayment on policies issued). Thus, a key step in restructuring the industry is to ascertain its financial condition and develop a plan for its restructuring. The undertaking of this audit as well as a plan for recapitalizing companies within 90 days or forcing liquidation is set out as an explicit condition in a Supreme Decree that will be issued by the government. The decree also indicates that this audit must be undertaken at the same time as the Superintendency of Insurance is restructured.

3. The audits of the companies operating within the Insurance industry will be organized by a general coordinator that will be an external consultant agreed upon between the government of Bolivia and the Bank. This person will be responsible for assisting the government in selecting an appropriate external auditing firm. He will also have overall responsibility for drafting a report that will indicate the findings of the audit and propose a plan for reorganization of the industry . He will be assisted in this task by a financial analyst, and an attestor that will certify the results of the audits.

4. The audits will be carried out by a team of three persons that will be supervised by the coordinating group. They will include: (i) an actuary that will be responsible for determining appropriate levels of technical reserves based on actuarial calculations of the different risks inherent in different forms of insurance issued by local companies, (ii) a valuer that will value the assets of the insurance companies the majority of which are in real estate; and (iii) an accountant that will put the information together so as to ascertain the capital of the company and prepare the income and financial statement.

5. With the information obtained from the audits an analysis of the financial condition of each insurance company, broker, etc. will be undertaken by the coordinating group. The attestor will first certify the results of the audits. The financial analyst and coordinator each with experience in restructuring different kinds of companies in the insurance industry will conduct a financial analysis of the companies. Certain indicators will be used to classify companies into groups:

(i) severe problem companies will have deficient capital(including technical reserves) as measured relative to actuarially calculated liabilities. This will occur if they are below legal minimum levels as specified for different types of policies;

(ii) problem companies will be those that are not showing sufficient expected increases in premium income to meet minimum technical reserve and capital levels, but capital is not yet negative; and

(iii) companies exhibiting satisfactory performance will be within leverage and capital requirements as indicated in the insurance law.

6. After clasifying the companies actions will be taken to resolve the problems of severe problem and problem companies. The companies experiencing severe distress will be intervened by the superintnendnecy of insurance and the owners will be given 90 days to bring capital levels to minimum levels(inclusive of arranging a merger) or the company will be put into bankruptcy proceedings. Companies that are classified as problems will be required to submit a recapitalization plan within 30 days. If this is not satisfactory they will be intervened by the Superintnendnecy of Insurance and will have 90 days to bring capital to acceptable levels as in the case of severe problem companies.

7. <u>Pension Funds</u>: In the case of pension funds financing would be provided to audit all 29 complementary pension funds. Employers and employees make contributions where all companies within a given sector (e.g. mining) joinlty contribute to an account called a Caja. The accounts, that apply to public sector enterprises, must be placed by law in BANEST-- a public bank.

8. Given the operation of this system the audit to be financed will not involve the valuation of government assets. Instead it will try to determine the extent of unfunded liabilities that are present for both the complementary pension funds and that portion of the social security system that provides retirement benefits to workers (i.e. the basic pension funds). Thus, it will only try to ascertain the liabilities of each pension scheme and the cash balances available in the different government accounts associated with each fund in order to meet these liabilities.

9. The findings of these audits will assist the government in efforts to evaluate the fiscal cost of a partial or complete privatization of the portion of the social security system relating to payment of retirement benefits. The audits would be conducted by external auditors that would work closely with the coordinating group and staff of the superintnednecy of Banks and Insurance. In this way expertise in auditing and examining the accounts of pension funds would be transferred to the supervisors that will eventually have authority to regulate and supervise private pension funds.

Organization and Timing

10. The general coordinators will report to the Ministries of Finance and Planning and will work closely with consultants undertaking the contractual savings study as well as with counterparts within relevant superintendencies (e.g. the new superintendency of insurance and securities and the pensions unit within IBSS).

11. The audits will be undertaken at the same time as the contractual savings study and will be consistent with efforts to strengthen supervision.

Annex XII: Improvement in Registration Systems

1. Sometimes, lenders take physical possession of the collateral when granting a loan, as would a pawnbroker. In most other cases, the debtor will retain possession of the collateral: for example, the owner of a mortgaged house might reside in it or a farmer purchasing a tractor on credit would use it on the farm. In such cases, lenders typically need to register their security interest. They will wish to do this to be sure they have the agreed-upon position in the list of claimants against the asset (has the tractor been pledged elsewhere?) and to be sure they can establish the priority of their lien in a law court if the borrower is unable to pay. Typically the law designates a place where the interest must be filed and that place becomes the monopoly filing agency. Typically, therefore, registries are maintained by the public.

2. At present, Bolivian lenders register security interests in a variety of places: secured interests in real estate are registered in the real estate office (Oficina de Derechos Reales); secured interests in road motor vehicles are registered in the Motor Vehicle Bureau (Direccion General de Transito); chattel mortgages on movable physical property are registered in the Commercial Registry (Registro de Comercio); publicly and privately issued bonds and debentures are registered with the Securities Commission (Comision National de Valores).

3. This technical assistance component would improve the registry systems to permit more flexible used of these lending instruments. Of crucial importance is the Registro de Comercio, which presently files its claims in the order in which they are presented. This system permits lenders to locate their own claims in the registry, but would only permit locating another lender's claim if the entire record of claims were searched. Therefore, no lender could be sure that the claim in question was the first claim on the chattel. Consequently, no lender would lend on the strength of that collateral alone; rather, the lender would insist on additional collateral, like a real guarantee.

4. This component would pay for computing equipment for the main registries (estimated at $10,000 per registry) and for software packages that would permit locating claims by name of debtor, creditor, and identification of the chattel. Total cost inclusive of hiring of external consultants and training is estimated at $150,000.

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Supervision of Securities Markets.

A. Background

1. Technical assistance will be provided in order to restructure the Superintendency of Insurance(SNSR), the Securities Exchange Commissiion (CNV) and that part of the Social Security Institute (IBSS) that is charged with regulating and supervising the government Pension system. Although decisions in this area are not final it does appear that the government will pursue the following course of action in order to improve overall supervision of the securities markets.

(i) Qualified staff of the CNV and the SNSR will be merged into a new superintendency of securities and insurance. This superintendency would have authority to regulate and supervise the securities markets and insurance. Although most CNV staff will be transferred directly only a small portion of the existing SNSR staff (i.e. about 60 persons) will be retained. It is expected that this transfer will not occur until some of the results of the external audits of the insurance companies are known so that it is clear how many companies will actually continue to exist that will require supervision. It is not envisioned that staff from IBSS , that have been regulating and supervising the Pension funds, will be transferred to the new Superintendency. However, if the pension system is partially privatized or if the assets of complementary pensions are subject to private management the need may also arise to transfer this function to the superintendency of securities and insurance. This question will be addressed after completion of the contractual savings study (see Annex X) and legal questions will be investigated in phase 2 of the Legal study (see Annex IX).

(ii) Exams will be given to staff in each of the superintendencies to be transferred to the new Superintendnecy of securities and insurance to assure that minimum quality standards exist for staff.

(iii) Wages paid to exisitng staff retained or to new staff will be increased to levels comparable to those of Banking Superintendency staff to permit retention of well qualified staff.

(iv) Some staff of the Superintendency of Banks will be transferred to this new superintendency to assist in its initial development.

B. Training and Information Systems

2. Different types of training programs will be organized for staff of the CNV and SNSR. It is estimated that external training as well as retention of an external consultant to manage the program and build up the capacity of the new superintendency will cost about $416,000.

3. SNSR: Assistance will be provided to the Superintendency of Banks that will be temporarily housing the function of supervision and inspection of insurance companies. The assistance will primarily involve: (i) retention of an external consultant that will manage the process of restructuring the existing Superintendency of Insurance ; (ii) the financing of external and internal training programs for new and exisiting staff that are retained; and (iii) the financing of some software and hardware needed to adequately carry out supervision and inspections of insurance companies.

4. External Consultant: Financing will be provided for the retention of a long-term external consultant that will manage the process of restructuring the superintendency of insurance and its transfer to the Superintnendency of banks. This person will coordinate closely with the Bank and relevant government officials. The responsibilities of this person will be to: (i) choose existing staff with appropriate skills and hire new staff; (ii) administer a training program for new and old staff that will last two years; (iii) manage the process of auditing the Insurance companies and evaluate their solvency and technical capacity of management; and (iv) lead efforts to modify the insurance law to improve the authority of the superintendnecy to supervise the insurance industry. Efforts to improve the insurance law will be coordinated with the group of lawyers assigned to undertake the legal study (see Annex IX).

5. Training: The SNSR has no staff that are actuaries--an essential skill in the proper calculation of technical reserves for insurance companies. In addition, very few staff are trained financial analysts or accountants -- skills that are necessary to carry out adequate inspections of the insurance companies. Finally, no staff have skills in valuation techniques and there are no well trained economists on the staff to assist the legal staff in the drafting of regulations that effect the Insurance industry. Thus, both internal training through use of outside trainers from Chile and other Latin American countries and external training involving the financing for staff to attend courses of varying duration in the areas noted above will be financed. Emphasis will be placed on estabishing a program of training in the areas of (i) actuarial techniques; (ii) financial analysis; (iii) accounting; and the (iv) the economics of insurance.

6. A standard manual of accounts will be prepared for inspectors charged with undertaking on-sight inspections of the insurance companies. The manual will: (i) indicate what information insurance companies, brokers or adjusters must provide to authorities, the frequency of provision, and the types of indicators that inspectors will want to calculate in doing a financial analysis or audit; (ii) methods for processing the information; and

(iii) class of information that will be given to the public or can be made available.

7. Office Technology: Upon transfer of some staff of SNSR to the superintendency of banks there will be a need to provide appropriate computer software and hardware to these staff.

8. CNV: The program of assistance to Bolivia's securities exchange commission will build upon the program of assistance that has been developed by AID that has stressed basic training for staff of CNV and specific assistance in the development of regulations (i.e. circulars) relating to the operation of the Bolsas. Besides assistance in developing a capital markets law that will more carefully define the functions and jurisdiction of the CNV (see Annex IX describing the legal study), assistance will also be provided to strengthen four key functions of the CNV: (i) offsight surveillance of the Bolsas and securities brokers, (ii) onsight inspections of these same institutions, (iii) enforcement authority of the CNV and (iv) capacity to undertake economic analysis in the context of developing new regulations.

9. Training: The objective would be to provide primarily external training in the four areas noted in paragraph 8 above. The training program will involve two phases. First, an external consultant with expertise in regulation and supervision of capital markets will develop a specific program of training to meet the needs of the CNV--that will focus on the four areas noted above. Second, external training in the areas noted will be arranged both in other Latin American countries and with the Securities Exchange Commission in the United States.

10. Office Technology: There is a need to modernize the CNV's information system. Although computer hardware is sufficient software necessary to monitor operations on the Bolsa is not available. It is also apparent that information disclosed by corporations is not being made available to the public in a comprehensible form and information regarding the registration of auditors, accountants, or financial analysts is not kept on file or made publically available.

C. Process and Timing

11. It is expected that implementation of the assistance noted will occur over a two to three year period. Two external consultants would have primary responsibility for organizing the programs of training for the staff within the new Superintendency of Securities and Insurance. The start of the training programs will begin at the same time as the studies (see Annexes IX and X). Assistance to strengthen supervision of pensions will not be provided until decisions are taken in regard to the structure of the pension system as determined in the legal and contractual savings studies.

Public Enterprise Reform

Privatization Targets

The conditions for tranche release for the privatization program are defined in terms of the numbers of enterprises, formed into three groups according to the dollar value of fixed assets (see attached list based on available data): (i) Lloyd Aero Boliviano; (ii) large enterprises (the 6 enterprises with fixed assets valued above US$9 million); and (iii) smaller enterprises (the 7 enterprises with fixed assets valued from US$1-5 million). Note that there are no enterprises for which we have data with a fixed asset value from US$5-9 million.

Second Tranche Condition The Government will bring the following to point of sale:

(i) Lloyd Aero Boliviano, 2 large enterprise, and 3 smaller enterprises; or (ii) 3 large enterprises and 5 smaller enterprises.

Third Tranche Condition The Government will bring the following to point of sale:

(i) Lloyd Aero Boliviano, 4 large enterprises and 5 smaller enterprises; or (ii) 5 large enterprises and 6 smaller enterprises.

Bringing to point of sale will include approval for privatization, completion of valuation and sales documents, and offered for sale. In the case of sociedades anonimas mixtas, the Government may satisfy the criteria either by bringing the present assets to point of sale or by bringing to point of sale sufficient shares to reduce the public sector's ownership of the company below 50%.

ENFE Restructuring

The SAC will support the Government's program to restructure ENFE. The performance contract for 1991 should foster ENFE's commercial autonomy by incorporating realistic performance targets and a clear statement of obligations on the part of the Government as well as ENFE. The principal elements of the performance contract should include:

(i) ENFE will list all passenger services which ENFE is required by the Government to operate at a loss, and specify the amount of compensation which the Government is obligated to pay ENFE.

(ii) To ensure ENFE's commercial autonomy, the contract should state that the Government cannot force ENFE to provide new services and that the Government will permit ENFE's management to freely establish tariffs and discounts.

(iii) The contract should have no more than two performance criteria, a working ratio and the maximum number of personnel to be retained by ENFE at year-end.

(iv) The cost of retirement payments for 1,000 employees is about US$10 million, and the cost of severance payments for the first wave of redundant staff is about US$3 million. The US$10 million in retirement payments will be financed with the counterpart funds of the SAC. ENFE should be given authorization to sell unproductive assets to finance the severance payments.

(v) The contract should specify the incentives and sanctions facing ENFE for compliance or non-compliance with the terms of the contract.

YPFB Contracts with the Private Sector

The new hydrocarbons law authorizes YPFB to enter into joint ventures with private firms for the exploration and development of Bolivia's hydrocarbons resources. Since the passage of this law, YPFB has signed contracts with 8 foreign petroleum firms calling for expenditures of US$189 million by the firms. Negotiations are underway for additional exploration and development contracts. In addition YPFB is expected to sign contracts with several firms for secondary extraction and is proceeding with the privatization of its retail distribution system. The involvement of private sector firms through joint ventures with YPFB can make a significant contribution to hydrocarbons production. However, the signing of contracts does not, in and of itself, guarantee that substantial hydrocarbons investments will be made. It is essential that the contracts be structured to ensure a sufficient commitment of funds from the private sector firms.

To assist the Government in this effort, the technical assistance component would finance a review of YPFB's procedures for contracting with the private sector for the exploration and development of hydrocarbons fields. One potential problem with the present contracts is that they do not require the companies to actually undertake exploration activities. For a small fee, the companies could maintain their rights to the fields while preventing any development. The consultant would review the operations contracts already entered into by YPFB, and propose a new form of the operations contract and association contract to ensure that the incentives facing companies are conducive to rapid development. The consultant also would advise on an appropriate legal and regulatory framework for construction and maintenance of natural gas pipelines by the private sector.

Trade and Registration Procedures

Streamlining of Export Procedures

Despite some efforts at simplification, required export procedures remain highly cumbersome. Exporters must receive a number of approvals from different offices, including Internal Revenue and other parts of the Ministry of Finance, various offices of the Ministry of Industry, the Ministry of Agriculture, Customs and the Central Bank. These requirements particularly discriminate against smaller exporters for whom the per unit cost of administrative procedures is relatively high.

The technical assistance component would finance a consultant to recommend simplified export procedures. The objective would be to streamline existing export procedures in order to simplify and speed up the processing of exports, while still allowing for the necessary controls and collection of essential trade data. Existing export procedures will be reviewed and any unnecessary steps, procedures, requirements, forms, registrations and requests for information would be proposed for elimination. Remaining procedures would be those necessary to meet legal requirements maintain minimum control and data collection, and ensure accepted international norms and practices. The simplified system should be as fully automatic as possible, and should minimize opportunities for administrative interference, corruption and delays. The consultant will examine the appropriateness of unifying all export approvals into one office, and propose design and implementation procedures.

This work would be based on existing studies and flowcharts on the nature and type of export requirements, and on experience in other countries in establishing a ventanilla unica for exporters. Any proposed simplification must be consistent with efforts to reform customs administration (in particular the standardization and computerization of customs procedures), with requirements of the recently established duty drawback and temporary admission systems, as well as with ongoing efforts to design standardized for export policies in the Andean Common Market.

Streamlining Registration and Supervision Procedures for Small Firms

Registration, regulation and supervision requirements remain highly burdensome for small firms. The technical assistance component would finance a consultant to review existing procedures and develop a proposal for a radical deregulation and simplification of registration, regulation and supervision requirements, while still allowing for essential public controls and data collection. The system should be as fully automatic as possible and should minimize opportunities for administrative interference, corruption and delay.

The consultant would compile a complete list of administrative requirements at the national and regional level which small enterprises have to comply with, including the objective of each requirement, the costs involved, the institution in charge and the legal base for the requirement. The consultant would develop a proposal for the elimination of any unnecessary and/or unjustified steps, procedures, fees, forms, registrations, information requests and other requirements. Further work would be done to simplify those administrative requirements which are found to be necessary for public control and supervision, or which represent legitimate obligations of firms.

Tax Evasion

As explained in the section on medium-term prospects, an increase in fiscal revenues is necessary to raise the supply of infrastructure and public services essential for sustained development. Raising tax revenues would require either adding new taxes, raising tax rates and/or improving enforcement. There are a number of reasons why the most efficient and equitable means of raising revenues would be to improve enforcement of the existing tax system, whose main source of revenues is the value added tax:

(i) The addition of new taxes raises a number of difficult issues. Some potential for increased excise taxes may exist, and specific taxes on luxury goods may be desirable to improve the progressivity of the tax system. However, the imposition of a large number of individual taxes would have limited results in terms of revenue, would be difficult to enforce and would risk introducing serious distortions. By contrast, an income tax could be an important source of additional revenues. However, the Bolivian Government has had serious difficulties in enforcing collection of an income tax, and it would require substantial time and effort to implement.

(ii) Raising tax rates (particularly on the VAT) may be necessary to meet targets for increased revenues. However, higher rates have a substantial cost: they would further penalize those people who do pay taxes while increasing incentives for firms and individuals to cease reporting. Thus, on the grounds of both equity and efficiency, every effort should be made to increase revenues through improved enforcement before raising rates.

(iii) According to a recent UDAPE study, there is a considerable untouched potential for raising collections within the existing system. Therefore, at least as a first approach to increasing revenues, it is necessary to consider how to improve enforcement and reduce tax evasion.

The Fiscal Affairs Department of the IMF has been involved for some time in providing technical assistance to the Bolivian Finance Ministry to improve tax administration. The Government has requested IMF assistance in undertaking a study of means of increasing the revenue yield from the existing tax system, along the lines of similar efforts in other countries. The study would involve: (i) preparation of an estimate of the base of the value added tax and a calculation of the amount of VAT evasion; (ii) selected improvements in administration to target groups which owe substantial amounts under the VAT; and (iii) consideration of modifications to the VAT, including broadening the tax base. After completion of the study, the Government will develop and implement an action plan for reductions in tax evasion.

Technical Assistance

1. The technical assistance program will help to ensure that the Government has sufficient resources to undertake the policy reforms supported under the proposed Credit. This annex summarizes the proposed technical assistance activities. Further detail on various aspects of the program can be found in the annexes referred to in each section. Please note that the technical assistance activities financed under the Credit and by co-financiers are expected to end well before the closing date of the Credit.

Financial Sector Component

2. Prudential Regulations and Supervision. A senior consultant would be hired to improve prudential norms and regulations, according to the program set out in Annex IV. In particular, the consultant would assist in the design of implementing circulars complementing a revised Banking Law, in the implementation of mechanisms for managing bank crises and in the development of implementing circulars for the regulation and supervision of non-bank financial institutions.

3. In order to provide the expertise necessary for continued improvement in prudential norms and regulations a consultant with a broad experience (10 years) in banking supervision would be hired for a two-year term in order to elaborate the norms and coordinate other consultants' work. The consultant would be paid US$ 8,000 per month, totalling US$ 192,000.

4. Inspector Training. Two consultants with broad experience in banking inspection, auditing and portfolio valuation would be hired to assist in the training of inspectors and to provide advice on conducting the inspections. The consultants would assist inspectors in developing expertise in the valuation of loan collateral, and in the analysis of financial statements and business position of client companies. The consultants would be hired for 24 months at a cost of US$ 6,000 per month each, totalling US$ 288,000.

5. Financial Analyst Training. In order to further assist in the training of off-sight bank financial analysts, an experienced consultant would be hired for a period of two years at a cost of US$ 5,000 per month, totalling US$ 120,000. Such a consultant would assist analysts in analyzing bank financial statements, assessing bank management, developing projections of banks' financial position, and in establishing proactive problem-solving strategies for banks.

6. External Audits The credit would support special portfolio evaluations by external auditors, to assist the SBEF in its own portfolio evaluation. Auditors are contracted to evaluate individual credits as well as to provide an integrated evaluation of internal banking control systems. Possible dates for these audits would be December 31, 1991, December 31, 1992, and possible intermediate dates. Based on the costs of prior audits (financed under the FSAC), it is estimated that this component of the program will cost approximately US$ 800,000.

7. Computerization The SBEF currently uses independent, free-standing personal computers to undertake most of its analysis. It has a small main-frame computer to operate the Central de Riesgos system, process monthly

balance sheet data from banks and other intermediaries and reconcile reserve requirement information. Such information is downloaded to diskettes for further analysis on PCs. The capacity of the mainframe has been reached and much of the data transformation needs for the Central de Riesgos cannot be undertaken because of its limited capacity. The SBEF would like to integrate its information system through another mainframe computer and a database management system. Such a system could facilitate speedy access to data. A local area network could integrate the current free-standing computer processing capabilities of financial analysts and inspectors.

8. The SBEF's strategy would be to: (i) define its precise information system needs, (ii) accept bids for the development and introduction of new systems, including the incorporation of existing equipment into the design proposal, (iii) sign a single contract for hardware and software applications and therefore ensure the success or failure of the system in the hands of one firm only.

9. The new system could be designed and established in a one-year term and the estimated cost is US$ 1.25 million. This includes computer hardware ($500,000), operating software ($250,000) and application software ($500,000). Training of both computer staff as well as SBEF analysts and inspectors in use of the system is estimated at $100,000. In addition, advisory services in information systems would be required (1 consultant x 7 months x $5,000 = US$ 35,000).

10. <u>Managing Bank Crises</u>. An external consultant with a broad experience in managing bank crises and deposit insurance would assist the Gerencia del Sistema Financiero (GSF) in carrying out its responsibilities in thess areas, according to the program described in Annex V. The consultant would work for a two-year term, would be paid US$ 6,000 per month, totalling US$ 144,000. The consultant would be assisted by a local consultant paid US$ 3,000 per month, totalling US$ 72,000.

11. <u>Training</u> The SBEF would complement the on-the-job training of inspectors and analysts provided by on-sight consultants with training courses provided outside of Bolivia. Such courses enable SBEF staff to be trained in more sophisticated and potentially innovative financing techniques as well as to learn from the successes and failures of regulation in other countries. Such training proved very successful under the FSAC. Cost under this item is estimated at US$ 100,000, equivalent to 40 trips at an average of US$ 2,500 per trip.

12. External training of GSF staff in bank crisis management also is necessary to establish an effective system for handling bank crises. Cost of this item is estimated at US$ 17,500 equivalent to 7 trips abroad at an average of US$ 2,500 per trip.

13. <u>Capital Market Development</u> Annexes VIII-XII describe a program to assist the Government in the development of Bolivia's capital markets. The program would be financed, in part, through a trust fund arrangement with USAID, and in part directly by the Credit. As outlined in the policy letter prepared by the Government, emphasis is being placed on preparing legal and regulatory reforms to improve the efficiency and competitiveness of capital markets while strengthening supervision. These reforms will be consistent

with government efforts to privatize companies and to reform Bolivia's existing system of contractual savings(e.g. Social Security, Pensions, and Insurance). The program of technical assistance will consist of five complementary components: (i) a legal study; (ii) an economic study of the contractual savings system; (iii) financing of audits and assessment of the financial condition of insurance companies and pension funds; and (iv) assistance to improve the commercial and other forms of public registries (e.g. CNV) for securities or loans that will permit greater use of secured transactions especially by corporations; and (V) assistance to strengthen supervision by Bolivia's securities exchange commission (CNV), the Superintendency of Insurance and Reinsurance (SNSR), and to support greater capacity to supervise the pension funds (e.g., complementary pension funds).

14. Legal Study: This study (see Annex VIII for Terms of Reference) will be undertaken in two distinct phases.

15. The first phase will provide legal support to the Government in order to implement specific changes in laws and regulations that have created barriers to the competitiveness of Bolivia's credit and nascent securities markets. The specific objectives of this part of the study reflect agreements with the government in a letter of development policy. Recommendations will be made in regard to the exact process needed to achieve various objectives (i.e. issuance of a new law, supreme decree, resolution, circular etc.).

16. The second phase of the study will have as its ultimate goal providing support to the Government in the drafting of a new capital markets law. It will focus on a broader set of objectives that relate to economic reforms of the contractual savings system, further improvements in efficiency through removal of legal ambiguities, and strengthening of supervision authority.

17. The legal study is estimated to cost $US 301,500. The first phase will begin immediately while the second phase will begin once the economic study of the contractual savings system is complete. In this way drafting of the new capital markets law will incorporate relevant changes in other complementary bodies of law relating to the Securities Markets, Insurance, Pensions and the Social Security System. A team of Bolivian lawyers representing the major regulatory agencies and lawyers from private firms (e.g. external and internal consultants) with appropriate specializations will work with the government team.

18. Economic Study of Contractual Savings: The primary objective of this study will be to analyze the options for reforming the contractual savings system by building on work that has already been undertaken (see Annex IX for details). The Government has indicated that this study should result in a consistent set of reforms for the contractual savings system that could involve (i) the partial privatization of the component of the Social Security System that provides retirement benefits; (ii) reforms to the system of compulsory complementary pension funds now organized by sector (e.g. mining, petroleum) to permit greater competition in the management of assets and mobility of payees across plans; (iii) reforms to permit private voluntary pension plans offered by insurance companies or other institutions; and (iv) measures to improve the efficiency and competitiveness of the insurance industry through deregulation of the setting of premia, permitting insurance companies to issue debt, permitting greater diversification of asset

portfolios including offshore investments, and permitting insurance companies to act as managers of complementary pension fund assets. The cost of this study is estimated at $204,000.

19. External Audits: In order to ascertain their financial condition external audits will be financed for insurance companies, insurance brokers and adjusters as well as for private and public pension funds . Having conducted these audits, assistance will be provided in evaluating their results and in developing an action plan for resolving the problems found in the insurance industry and public and private pension systems. Annex X outlines the coverage of institutions and costs of this study as well as the procedures to be followed in resolving financial problems found through the audit. The cost of this assistance is estimated at $U.S. 802,500.

20. Improvements in Registration Systems for Securities and Loans: Assistance to improve certain key public registries (e.g. the commercial registry, the CNV's registration system for public offered securities) will be provided. At present these registries do not permit participants in lending contracts guaranteed with collateral other than real estate to assure themselves that they are the only claimants on the underlying real collateral (e.g., machines, cars, etc.). Lenders have no assurance that borrowers have not double-pledged collateral creating disincentives for the use of private non-banking lending contracts. The costs of providing assistance in this area, involving training, purchase of computer hardware and software will be about US$160,000.

21. Strengthening Capital Market Supervision: Assistance will be provided to support government efforts to restructure and improve supervision by the Bolivian Securities and Exchanges Commission (CNV) and Superintendent of Insurance (SNSR) through a merger of these two Superintendents. Also, should supervision of the pension system be reformed through transferring this function from the Social Security Institute (IBSS) to a new Superintendency of securities and insurance assistance would also be provided. Assistance will involve retention of external consultants, financing of training programs and financing acquisition of computer software and hardware. Annex XII outlines this program of technical assistance. The cost of this component of the assistance will be US$ 416,000.

22. The above assistance program will be complemented by actions to allocate local counterpart funds under the SAC to aid in the restructuring of insurance companies and the Superintendency of Insurance. The funds can be used to meet severance payments and other expenses associated with releasing employees. In addition, some local counterpart funds will be used to finance retention of local consultants involved in undertaking some of the activities noted.

Public Enterprise Reform

23. Privatization. Technical assistance is required to finance staff managing the privatization program. A technical secretariat composed of 4 consultants will be responsible for coordinating the program, reviewing the proposals prepared by ministries and regional development corporations, and making recommendations to the inter-ministerial committee overseeing the program. Staff required would by an economist, a financial analyst, a lawyer

and a management consultant/engineer. These would be local consultants with an estimated salary of US$1500 per month for 24 months, totalling US$144,000.

24. In addition to the secretariat, technical assistance will be required for the preparation and implementation of specific privatization proposals. This will include: (i) preparation of privatization plans, financial audits and valuations of specific companies or groups of companies; (ii) preparation of sales memoranda, prospectuses and other tender or bidding documents; and (iii) analysis of legal issues and preparation of legislation necessary for privatization. We estimate that 20 international consultant months (US$10,000 per month each) and 30 local consultant months (US$1,500 per month each) will be required for a period of 24 months, totalling US$245,000.

25. Restructuring of State Enterprises. Much of the restructuring work underway is being financed by other sources, either other Bank projects or USAID. However, some assistance is required to finance a master plan for improving competition in the telecommunications sector (see Annex XIII). Estimated costs are 15 months of an international consultant at US$10,000 per month, totalling US$150,000.

Trade and Registration Procedures

26. As described in Annex XIV, two consultants will be hired to propose a system for streamlining export approvals and for simplifying firm registration and control procedures. Each task would require two months at an estimated salary of US$10,000 per month.

Financing

27. The technical assistance component would be financed by the IDA credit and by expected cofinancing from the United States Agency for International Development (USAID) and the Government of Switzerland. Discussions are underway with these and other bilateral donors, and we expect to reach a final agreement in the near future. In any event, sufficient funds will be provided from the IDA credit to finance those elements of the technical assistance program which are essential to the Government's program.

Table 1: Technical Assistance Expenditures
(US$)

Banking Supervision	2,574,500
Consultants	
Norms and Regulations (24 person months x $8,000)	192,000
Inspection (48 person months x $6,000)	144,000
Financial Analysis (24 person months x $5,000)	120,000
Establishment of Mechanisms for Preparing for and Managing Bank Crises	
(24 person months x $6,000)	144,000
(24 person months x $3,000)	72,000
External Audits of Banks (14 person months x $57,000)	400,000
Computer Equipment and Training	
Hardware (Expanded Mainframe)	500,000
Operating Software	250,000
Application Software	500,000
Training of Computer Personnel and Staff Use	100,000
Consultant (7 person months x $5,000)	35,000
Training of Financial Analysts and Inspectors	
Training Abroad (47 trips x US$ 2,500/trip)	117,500
Capital Market Development	1,884,000
Legal Study	301,500
Internal Consultants (27 person months x US$4,000)	108,000
External Consultants (15 person months x US$7,500)	112,500
Travel (11 trips x US$6,000)	66,000
Advisory Group	15,000
Contractual Savings Study	204,000
Internal Consultants (15 months x US$3,000)	45,000
External Consultants (15 months x US$7,000)	105,000
Travel (9 trips x US$6,000)	54,000
Registration	160,000
Computer Systems	100,000
External Consultant (10 person months x US$10,000)	60,000
Supervision	416,000
Information Systems	40,000
Internal Consultant (1 person month x US$4,500)	4,500
External Consultant (24 person months x US$8,000)	192,000
Training (30 trips x US$6,000)	180,000

External Audits	802,500
Insurance Comanies (16 companies x US$20,000)	320,000
Insurance Brokers (13 companies x US$5,000)	65,000
Adjusters (17 x US$3,000)	51,000
Pension Funds (29 funds x US$10,000)	290,000
Attestor (60 days x US$200)	12,000
Financial Analyst (90 days x US$250)	22,500
General Coordinator (120 days x US$350)	42,000
Public Enterprise Reform	439,000
Consultants	
Technical Secretariat (96 person months x US$1,500)	144,000
Advisory Services	
Internal Consultants (30 person months x US$1,500)	45,000
External Consultants (15 person months x US$10,000)	150,000
Enterprise Restructuring (10 person months x US$10,000)	100,000
Trade and Registration Procedures	40,000
Consultants	
Export Approvals (2 person months x US$10,000)	20,000
Firm Registration (2 person months x US$10,000)	20,000
Administration	100,000
TOTAL	5,037,500
Financed by IDA	3,623,000
Financed by USAID	650,000
Financed by Switzerland	764,500

Supplementary Loan Data Sheet

Timetable of Key Events

1.	(a)	Identification Mission	May 1990
	(b)	Preparation Mission	July 1990
	(c)	Preparation Mission	September 1990
	(d)	Appraisal Mission	January 1991
	(e)	Post-Appraisal Mission	March 1991
	(f)	Negotiations	May 1991
	(g)	Planned Effectiveness	October 1991
	(h)	Expected Time of Second Tranche Release	December 1992
	(i)	Expected Time of Third Tranche Release	December 1993

Special Conditions of Effectiveness

2. None

Conditions of Disbursement of Second Tranche

3. Conditions of release of the second tranche of the proposed loan would include the maintenance of actions already taken, continued satisfactory macroeconomic policies consistent with the goals of the program, satisfactory performance of the program described in the Government's Letter of Development Policy, and compliance with specific conditions included in the policy matrix. The specific conditions for second tranche release include:

(a) for BAB, BAMIN and FONEM, either: (i) closure of the institution, dismissal of employees not involved in loan recuperation or liquidation and compliance with the program for the sale, legal adjudication and liquidation of their financial and fixed assets; or (ii) sale to the private sector with no remaining Government participation;

(b) completion of either: (i) closure of branches of BANEST which are not found to be cost effective or justifiable, transfer of its functions which can be handled efficiently by the private sector and compliance with the program for the recovery, sale or liquidation of BANEST's financial and fixed assets; or (ii) sale of BANEST to the private sector with no remaining Government participation;

(c) evidence of implementation of eligibility criteria for access of banks and non-banks to development credit and supervision of these intermediaries consistent with sound regulatory practices;

(d) passage of the Banking Law by Congress and implementation of the regulations;

(e) implementation of the action plan to improve supervision and regulation of the banking system;

(f) completion of a plan for the reorganization of COMIBOL and closure of unprofitable mines;

(g) approval for privatization, completion of asset valuations and sales documentation and offer for sale of at least 51% of the voting shares held by the Government have been made in respect of either: (i) Lloyd Aereo Boliviano, 2 large enterprises and 3 small enterprises, or (ii) 3 large enterprises and 5 small enterprises;

(h) an approved privatization agenda setting out enterprises to be brought to point of sale, sufficient to meet the conditions for disbursement of the third tranche.

Conditions of Disbursement of Third Tranche

4. Conditions of release of the third tranche of the proposed loan would include the maintenance of actions already taken, continued satisfactory macroeconomic policies consistent with the goals of the program, satisfactory performance of the program described in the Government's Letter of Development Policy, and specific conditions included in the policy matrix. The specific conditions for third tranche release include:

(a) compliance with the program for the sale, legal adjudication and liquidation of the financial and fixed assets of BAB, BAMIN and FONEM;

(b) compliance with the program for the recovery, sale and liquidation of BANEST's financial and fixed assets;

(c) continued implementation of the regulations for the Banking Law;

(d) elimination of transfers from the Treasury to public enterprises (except those made for agreed public services) and elimination of arrears in the payment of debts among public enterprises;

(e) implementation of a requirement that commercial banks make provisions in amounts equivalent to 10% of their Class 3 loans;

(f) approval for privatization, completion of asset valuations and sales documentation and offer for sale of at least 51% of the voting shares held by the Government have been made in respect of either (a) Lloyd Aero Boliviano, 4 large enterprises and 5 small enterprises, or (b) 5 large enterprises and 6 small enterprises.

THE WORLD BANK INTERNATIONAL FINANCE CORPORATION MIGA

Office Memorandum

① RK
② BBG o/r

DATE: June 3, 1991

TO: Mr. Moeen A. Qureshi, Senior Vice President, Operations

Mr. S. Shahid Husain, Vice President, LAC

FROM: Koji Kashiwaya, Vice President, CFS

EXT.: 80809

SUBJECT: **Japan's Cofinancing to Bolivia**

(Official Debt Relief and New Money)

1. Since late January 1991, the Government of Japan (GOJ) has suspended new comitments and even negotiations for financing to Toronto-Term eligible countries until the Paris Club agrees to a diversified menu of official debt reduction that is acceptable to GOJ. Thus GOJ and JEXIM informed the Bank and the Government of Bolivia (GOB) that they would suspend negotiations for cofinancing for the time being.

2. I have asked the Ministry of Finance (MOF), Japan, to consider whether it might relax its attitude toward new financing in view of the recent developments in the Paris Club. According to Mr. Ljung, it is anticipated that the Paris Club will reach an agreement on a diversified approach before the Summit meeting. MOF has agreed to proceed with cofinancing in the near future assuming that (i) the debt service of this cofinancing is backed by the security package; and (ii) the Paris Club agrees to various modalities for the new Toronto terms e.g.interest reduction, lengthening maturities and capitalization of interest.

3. I conveyed a message from MOF to Mr. Garcia, Economic Minister and Mr. David Blanco, Finance Minister on the occasion of their visit to my office on May 31, 1991, arranged by Mr. Loh. GOB was very pleased to hear of the possible relaxation, and promised to start negotiations with JExIm, in parallel with the movement of the Paris Club. Mr. Garcia said that the GOB does not intend to ask for Paris Club rescheduling of debt after the cut-off date of 1985, and therefore JExIm's cofinancing would not be subject to any rescheduling. In response to my questions, GOB said they wished to proceed with privatization of the Electricity Company (ENDE) at some time in the future, and that they wished to keep open the possibility of privatization of the Electricity Company (ENDE) in their loan agreement with the Bank.

cc: Messrs. Sandstrom, Abe, Loh, Niehuss, Chaffey, Elwan

KKashiwaya:jed

Bolivia

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

May 31, 1991

Mr. Lynn A. Greenwalt
Vice President
International Affairs
National Wildlife Federation
1400 Sixteenth St., N.W.
Washington, D.C. 20036-2266

Mr. Stewart J. Hudson
Legislative Representative
International Division
National Wildlife Federation
1400 Sixteenth St., N.W.
Washington, D.C. 20036-2266

Dear Messrs. Greenwalt and Hudson:

Thank you for your letter of May 9, 1991, regarding the Eastern Lowlands Project in Bolivia and, specifically, its indigenous peoples component.

As you know, I visited the project during my visit to Bolivia and was impressed by the way the indigenous community had been integrated in the project and their concerns addressed. I agree with you that this aspect of the project should not be compromised and we shall continue to emphasize this to the Bolivian authorities. The local people must be represented in decisions that affect them. However, the sociology and the politics of the issue are complex and the question of representation and implementation should be resolved locally.

We have agreed with the Government that in June 1991, Bank staff will visit Bolivia specifically to address the issues affecting the indigenous groups component. We will continue to urge the Government of Bolivia to resolve this matter, so that the Eastern Lowlands project will prove to be an effective vehicle to improve the welfare and social position of the indigenous peoples of Bolivia.

Thank you for your interest in the project.

Sincerely,

Barber Conable

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

April 19, 1991

Mr. Felix A. Camarasa

In your letter of April 8, 1991, you requested a quotation from me on Bolivia to be used by the Government for promoting foreign investment. Please find below a statement which may be useful for this purpose.

"In my recent trip to Bolivia, I was impressed with the conviction of the Government to maintain a stable and open economy, and its commitment to accelerate the development of the country through private sector initiatives. The World Bank supported Bolivia during its courageous and successful stabilization effort, and we will continue to support their efforts to maintain an economic environment conducive to private sector led economic growth."

Barber Conable

SS
KM

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. M. Qureshi (E-1241)	4/11/91

SUBJECT:

Document From: Felix Camarasa
To: bbc
Dated: 4/08/91 Reference No.: EXC910411003

Topic: BOLIVIA: Asking if BBC could provide a quotation to be includ
as an American thought on advertisement adds to promote invest

ACTION INSTRUCTIONS: | DUE DATE:

_______ HANDLE
_______ REVIEW AND RECOMMEND
_______ FOR YOUR INFORMATION
_______ DISCUSS WITH ______________________
_______ AS WE DISCUSSED
__XXX__ PREPARE RESPONSE FOR _BBC'S SIGNATURE 4/18/91
_______ FOR YOUR FILES
_______ RETURN TO ______________________
_______ OTHER: ______________________

Remarks: cc: Mr. Shakow

EXPEDITE

Record Removal Notice

The World Bank Group
Archives
& Records Management

File Title	**Barcode No.**
Bakhrabad Gas Development Project - Bangladesh - Credit 1091 - P009415 - Correspondence - Volume 13	30466346

Document Date	**Document Type**
02 August, 1983	Letter

Correspondents / Participants
From: Mosharraf Hossain, Director Planning, Petrobangla
To: V. Nayyar, WB Energy Dept.

Subject / Title
Reimbursement of tour expenses of Mr. Emdadul Haque

Exception(s)
Financial Information iv

Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	**Date**
A.May	January 29, 2024

SOME AMERICANS' THOUGHTS ON BOLIVIA...

"I agree with you completely that Bolivia's efforts to reform its economy merit strong support."

Vice President Dan Quayle
January 8, 1991

"I agree with the International Monetary Fund officials' view that your government is to be applauded for its new economic policies and the strength it has shown to adhere to them."

Ambassador Carla Hills - USTR
December 27, 1990

"Five years ago, Bolivia faced a 25,000% inflation rate; today, its inflation is lower than ours - a testament to Bolivia's steadfast commitment to sound economic policy."

Mr. Bernard Aronson - Assistant Secretary
U.S. State Department
March 5, 1991

"Bolivia's continuing sound economic policy framework makes it a prime candidate to be one of the early beneficiaries under the President's [Enterprise for the Americas] Initiative,..."

Ambassador James H. Michel - USAID
November 16, 1990

"Doing business in Bolivia is both enjoyable and profitable. We have been involved [in the country] for 65 years. Bolivia is a land of friendly people, a stable government, and virtually limitless economic opportunities."

Mr. Ian Cumming - Chairman
Leucadia National Corporation
March 18, 1991

Other quote requests:

Mr. Michel Camdessus - Managing Director - IMF
Mr. Barber Conable - President, World Bank Group
Mr. Robert Gelbard - U.S. Ambassador to Bolivia
Mr. Enrique Iglesias - President, Inter-American Development Bank
Mr. David Mulford - Undersecretary, International Affairs, Treasury
Mr. David Miller - N.S.C. - Former Presidential Advisor
Mr. David Rockefeller - President, Americas Society
Mr. Paul Tierney - Chairman, TW Holdings, Inc.

OFFICE MEMORANDUM

BBC
Bolivia

DATE: March 6, 1991

TO: Mr. Shahid S. Husain, LACVP

FROM: Ping-Cheung Loh, LA3DR

EXTENSION: 38692

SUBJECT: BOLIVIA: Meeting with Minister of Energy and Hydrocarbons

1. Minister Angel Zannier, Bolivian minister for Energy and Hydrocarbons, will visit you on March 8 at 10:00 am. He is visiting Washington to discuss the financing of the Power/Gas Pipeline Project with us and the IDB.

2. As you know, during Minister Garcia's visit to Washington in early February, we advised him of the position of the Japanese Government regarding Japanese Export-Import Bank's financial participation in this project. We also advised him that since J-EXIM will not be in a position to commit to financing this project for several months, that the Government of Bolivia should now actively seek private sector financing for the pipeline component of the project. We had written an aide memoire to this effect for Minister Garcia to discuss with the President and the Cabinet (the aide memoire is attached).

3. I understand that the aide memoire has been discussed in detail. The message which we have received from Minister Zannier is that he would like the Bank to consider going ahead with the project with 100% public financing with a proviso that the whole operation would be privatized once completed. They have also brought a technical proposal to reduce, although not significantly, the cost of the project by drawing out the timetable for installation of generators.

4. In your meeting with Minister Zannier, we would like for you to emphasize to him the following points:

- given that the debt service requirement of this project ($70 million per annum) exposes Bolivia to a major creditworthiness risk (25% increase in debt service obligation), all out effort must be made to minimize the risk element of the project

- we will need to seriously explore the private investment option for the pipeline component of the project (the recently enacted hydrocarbon law now allows private investments/operation in gas transportation and distribution)

- since it is unlikely for the Trinidad Terms discussion of the Japanese Government to be resolved over the next six month, the process of exploring the private sector option, by no means, will delay the cofinancing process

- we need to agree on a fast timetable for convening an investors' conference to explain the project and to set dates for prequalifying investors and for bids to be received. Technical details of pre-qualification and bid evaluation, etc. will need to be worked out. The Bank, through CFSPS, could assist Bolivian Government in preparing the pre-qualification documents and the investors' conference. IFC has also been contacted recently to solicit their interest

Biographical Information **Angel Humberto Zannier Claros.** He was Chief of Program, Electricity OLADE and worked as consultant on several projects for GTZ and UNDP. He is an electrical engineer by training with an undergraduate degree from the Universidad Nacional de la Plata, Argentina and a masters degree from Queen Mary College in England. He is married and has two children.

cc: Messrs. G. Smith, J. Page, A. Covarrubias

MKonishi/mof

Feb. 11
10:30 am

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. B. Conable (E-1227)	2/11/91

SUBJECT:

Document From: M. Qureshi
To: bbc
Dated: 2/08/91
Reference No.: EXC910211001

Topic: BOLIVIA: Mtg. with Min. Enrique Garcia (Min. of Planning) on MONDAY, FEBRUARY 11 @ 10:30 am.

ACTION INSTRUCTIONS: | DUE DATE:

_______ HANDLE
_______ REVIEW AND RECOMMEND
_______ FOR YOUR INFORMATION
_______ DISCUSS WITH ___________________
_______ AS WE DISCUSSED
_______ PREPARE RESPONSE FOR ______ SIGNATURE
_______ FOR YOUR FILES
_______ RETURN TO ___________________
_______ OTHER: ___________________

Remarks: cc: Messrs. Sandstrom, Khanna

*IMPORTANT

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: February 8, 1991

TO: Mr. Barber B. Conable, EXC

THROUGH: Mr. Moeen A. Qureshi, OPNSV

FROM: Rainer B. Steckhan, Acting LACVP

EXTENSION: 38074

SUBJECT: BOLIVIA - Meeting with Minister Enrique Garcia (Minister for Planning)

1. Mr. Enrique Garcia, the Bolivian Minister of Planning, will meet with you at 10:30 a.m., on Monday, February 11. Mr. Garcia will be accompanied by the acting Ambassador Fernando Gonzales and Mr. Jorge Quiroga, Subsecretary for Planning and Coordination. Messrs. Loh and Page from LA3 will accompany them and Mr. Gaston Pacheco (EDS) will also attend. A brief bio of Mr. Garcia is attached for information.

2. We felt in view of your forthcoming visit it would be timely to introduce Minister Garcia who will be your host in Bolivia. Mr. Garcia will probably express the Government of Bolivia's pleasure of your upcoming visit, and may wish briefly to discuss the proposed itinerary (draft itinerary is attached).

3. On a more substantive issue, Mr. Garcia may discuss the situation of the proposed Bolivia-Brazil Power/Gas Pipeline Project. Japanese cofinancing for the project is now uncertain; JEXIM has made its participation ($180 million of a $520 million project) conditional on the outcome of the discussions on official debt relief by G-7 countries and the Paris Club to be held, respectively, by June and October this year. We are exploring various alternatives for financing the project, including private sector participation on the project and additional cofinancing from CAF (Mr. Kashiwaya and his staff have been very helpful). Mr. Garcia will also be meeting with Mr. Kashiwaya and Mr. Shiratori.

Attachments

cc: Messrs/Mesdames. Husain (o/r), LACVP; Sandstrom, Khanna, McLaughlin, Volk, EXC; Butler, OPNSV; Loh, Page, LA3; Pacheco (EDS08)

MK/dc

BOLIVIA

BIOGRAPHICAL NOTE

DR. L. ENRIQUE GARCIA
MINISTER OF PLANNING AND COORDINATION

Dr. Garcia came to this post with an impressive employment record at the Inter-American Development Bank. Since December 1, 1987, he was the Treasurer and Deputy Manager of the Finance Department. He joined the IDB in 1966 as a Young Professional and two years later secured a position as a loan officer in Operations. In 1971 he was assigned to the Office of the President and in 1972 was appointed Area Chief, and later Senior Officer of the Operations Department. In 1973 he returned to Bolivia where he held various positions in both the private and public sectors (Manager of the Industrial Bank, Director of the Central Bank and Undersecretary of the Ministry of Planning and Coordination under Presidnet Banzer). In addition, he served as Advisor and Board Member to various companies. He rejoined the IDB in 1979 as Resident Representative in Argentina and in 1981 returned to headquarters as Division Chief of Industry and Credit Institutions of the Project Analysis Department. Later he was named Assistant Treasurer and Division Chief, Capital and Finance Operations.

Dr. Garcia studied economics and has a Masters degree from the University of St. Louis, Missouri and a Ph.D in economics from American University. He was a professor of economics at two universities in Bolivia and has authored several articles on development themes. He is a member of the Economics Academy of Bolivia. He is 48 years old, married and has two daughters.

DC
2-8-91

BOLIVIA
Itinerary
Mr. and Mrs. Conable's Visit
(February 20-24, 1991)

Wednesday, February 20

9:25a	Arrive Santiago, Chile from Miami
11:00a	Depart Santiago by charter
3:30p	Arrive Santa Cruz
	Met by Minister of Planning and Coordination Enrique Garcia and Resident Representative Connie Bernard. Mr. Garcia will accompany the group during part of the visit. Press will be present for photographs only.
4:30p	Arrive at hotel
6:00p-7:00p	Short briefing meeting outlining plans for visit. Minister Garcia or Subsecretary Quiroga will lead the briefing.
	Dinner -- unscheduled

Thursday, February 21

Themes: Overview of Government economic program and Bank projects with key ministers. Development of Eastern Lowlands area, including agricultural development, transport constraints, gas pipeline development, oil exploration, environmental issues, and impact on indigenous people.

8:00a-8:30a	Breakfast (informal briefing)
8:30a 10:00a	Roundtable meeting with Cabinet members (Ministers of Planning, Finance, Agriculture, Industry, Mining, Energy, Health and Education, President of Central Bank) at offices of CORDECRUZ (simultaneous translation available)
10:00a	Leave for Airport
10:30a-11:30a	Fly to San Jose de Chiquitos Region in eastern Santa Cruz (Twin Otter seating approximately 20 provided by CORDECRUZ)
11:30a-1:30p	Visit indigenous settlements in Chiquitano and Ayoreo Indians (A component under the Eastern Lowlands Project provides assistance to these groups.)
1:30p-2:30p	Informal lunch

2:30p- 3:30p	Return to Santa Cruz area
3:30p- 4:15p	Overfly Eastern Lowlands project area to NE of Santa Cruz, Amboro National Park
5:00p	Return to hotel
8:00p	Reception hosted by Government (at hotel)

Friday, February 22

Themes: Meeting with President, development of altiplano region, poverty and social sectors

8:30a 9:00a	Breakfast briefing
9:00a	Leave for a/p
9:30a- 11:00a	Fly to La Paz (see altiplano and NE agricultrual/ forestry region from air on the way) (two jets provided by Government seating approximately 6 each)
11:30a- 12:30p	Meeting with President (Palace)
12:30p 2:00p	Lunch hosted by President (at the Palace)
2:00p 2:45p	Visit Resident Mission
3:00p- 4:00p	Visit community health center, ESF projects (including PRODEM) in La Paz, El Alto (optional)
4:00p- 5:30p	Fly to Cochabamba
7:00p	Meeting with members of Grupo del Rio (senior legistators from Bolivia, Peru, Chile, Argentina and Brazil)
	Dinner -- unscheduled

If Mrs. Conable would rather not accompany her husband on Friday, she might remain in Santa Cruz, accompanied by Ms. VanDomelen, with the following schedule:

9:00a- 9:30a	Briefing at the ESF office
9:30a- 12:30p	Visit ESF projects (women's coop., daycare center, health center)
12:30p- 2:00p	Informal lunch with representatives of ESF

3:00p	Women's World Banking
4:30p	Leave for airport
5:00p	Fly to Cochabamba with Ms. VanDomelen in plane provided by CORDECRUZ

Saturday, February 23

Themes: Water supply, poverty and agricultural development, private sector issues

8:30a-9:00a	Breakfast briefing
9:00a-12:00p	Visit rose, cochinilla, and rabbit farms and ESF projects in West/NW part of Cochabamba. Agricultural developments represent activities likely to be supported by the Agricultural Development Project currently in preparation.
1:00p-2:00p	Informal lunch
2:00p-4:00p	Meet with Alan Carroll and SEMAPA at hotel on water supply issues and role of Bank in sector. Short field trip to see affected areas.
5:30p-7:00p	Roundtable meeting with national representatives of private sector (approximately 24 participants) at hotel (simultaneous translation available)
7:30p	Press Conference
	Dinner -- unscheduled
8:30p	Cocktail hosted by private sector

In Cochabamba, if Mrs. Conable would rather not participate in the afternoon meetings, there are a number of ESF projects, an interesting open air market which is typical of the region, and the museum Portales, formerly the home of the wealthy Patino mining family.

Sunday, February 24

7:30a	Leave for Cochabamba airport (charter to Ecuador)
8:00a	Fly to Santa Cruz
9:00a	Arrive at Santa Cruz airport
9:45a	Depart for Brazil

AK/SS/ Mr. Conable
Co. file

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: April 29, 1991

TO: Mr. S. Shahid Husain, LACVP

FROM: Ping-Cheung Loh, LA3DR

EXTENSION: 38692

SUBJECT: BOLIVIA - Letter of Reply to ASOBAN (Bolivia Bankers' Association)

1. Please find attached for your signature a reply letter to Dr. Calvo (President) and Mr. Antezana (Executive Secretary) of Asociacion de Bancos e Instituciones Financieras de Bolivia (ASOBAN). Their letter to Mr. Conable is attached for your reference.

2. The letter from ASOBAN thanks Mr. Conable and yourself for the recent visit to Bolivia and for the frank exchange of ideas during the meeting with the private sector in Cochabamba. In the letter, they raise some concerns about comments made by the Bank delegation and also some complaints about the management of the financial sector. These include, the Bank's comment on the necessity of increasing the repatriation of capital; the impact of the liberalization of interest rates on credit; and problems of the auction system for development credit. Also, they asked that Aide Memoires of Bank missions concerning the financial sector be shared with ASOBAN in the future (e.g. Aide Memoires of SAC preparation mission). The reply letter addresses these issues.

cc: Messrs.\Mmes. Conable, Khanna (EXC); Qureshi (SVPOP); Selowsky, Fleisig, Aiyer (LACVP); Garcia-Zamor, Vasiliades (LA3DR), Page, Morrow, Mierau, Shaw, Konishi, Albert (LA3C1); Challa (LA3TF); Glaessner, Dorfman (LATTF); Bernard, Aguilar (LA3BO); Pacheco (EDS)

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

S. SHAHID HUSAIN
Vice President, Latin America and the Caribbean

April 30, 1991

Dr. Fernando Calvo U., President
Lic. Guido Antezana V., Executive Secretary
Asociación de Bancos e Instituciones Financieras de Bolivia
Edificio Cámara Nacional de Comercio
Av. Mariscal Santa Cruz 1392
La Paz, Bolivia

Dear Dr. Calvo and Lic. Antezana:

Thank you for your letter of March 5, which Mr. Conable has asked me to respond.

We all greatly enjoyed our visit to Bolivia. It was an excellent opportunity to learn more about the country and to further the Bank's relationship with the Bolivian Government and people. Mr. Conable remarked particularly on the usefulness of our discussions with private sector businessmen in Cochabamba.

Let me assure you that my remarks concerning the necessity of increasing the repatriation of capital were in no way meant as a criticism of the private sector. I stressed the need to raise capital inflows to Bolivia for two reasons. First, it is crucial to increase private sector confidence through continuing to maintain prudent fiscal and monetary policies and through establishing an appropriate legal and regulatory framework for investment. The Government has made remarkable progress in both of these areas, and continued commitment to the program is essential to recovery. Second, as you note in your letter, interest rates are too high in Bolivia. While a considerable inflow of private capital has occurred since the 1985 stabilization, the risk premium necessary to attract that capital has resulted in real interest rates well in excess of international levels. Further increases in capital repatriation would assist in lowering interest rates and permit a more rapid expansion of economic activity.

This leads me to your discussion of the impact of the liberalization of interest rates on credit financed by official donors. The removal of limits on the interest rate charged final borrowers will provide the appropriate incentives for the market to allocate this credit more efficiently, while the auctioning of credit will facilitate the overall management of monetary policy. It is true that the increase in the interest rate on development credit will result in some borrowers paying higher interest charges than they did under the former system. However, the resulting improvement in the balance sheet of the Central Bank should permit, over time, an easier credit policy than otherwise would have occurred, thus lowering interest rates for the economy as a whole.

It is true that the initial implementation of the auction system has encountered some problems. The level of funds auctioned has been somewhat lower than the amount lent before the system was implemented, although that is to be expected given the unfamiliarity of the system and the rise in rates. The World Bank and the Inter-American Development Bank will continue to assist the Government in reviewing the operation of the auction system and effecting any changes necessary.

I appreciate your interest in the reports of World Bank missions to the Government. Unfortunately, we are not in a position to provide these documents directly, as they are prepared solely for use by the Government and World Bank staff. Confidentiality is important in facilitating a frank and useful discussion of the many difficult policy choices confronting the Government. Of course, the Bank has no objection if the Government wishes to circulate these reports more widely.

I hope this letter is helpful in clarifying the Bank's views on the questions raised in your letter. I understand that members of your association have been very generous in providing time for discussions with World Bank staff in Bolivia concerning the Bolivian financial system. We should continue to work together to resolve the difficult problems facing the sector, and I urge you to stay in touch with our Resident Representative and the staff working on these issues.

Sincerely,

S. Shahid Husain
Vice President
Latin America and the Caribbean

cc: Messrs.\Mmes. Conable, Khanna (EXC); Qureshi (SVPOP); Selowsky, Fleisig, Aiyer (LACVP); Loh, Garcia-Zamor, Vasiliades (LA3DR); Page, Morrow, Mierau, Shaw, Konishi, Albert (LA3C1); Challa (LA3TF); Glaessner, Dorfman (LATTF); Bernard, Aguilar (LA3BO); Pacheco (EDS), LAC Files

WShaw

5/7

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 90/05/01 DUE DATE : 00/00/00
LOG NUMBER : 900502003 FROM : Mr. Husain (MAQ)
SUBJECT : BRIEFING: mtg. with President Paz-Zamora of Bolivia, on Monday at
4:30 ~~4:00p~~ at the Blair House. May 7
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
__✓__ FOR YOUR INFORMATION
_____ FOR YOUR REVIEW AND RECOMMENDATION
_____ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :
cc: Mrs. Haug, JWS, AK

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 1, 1990

TO: Mr. Barber B. Conable

THROUGH: Mr. Mooen A. Qureshi MAQ

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: **BOLIVIA: Your Meeting with President Paz-Zamora**

1. For your meeting with Bolivian President Paz-Zamora at Blair House on May 7, at 4:30 p.m., the following may be useful.

2. Bolivia faces severe and intractable poverty problems. Per capita income is US$580, infant mortality ranges from 80 to almost 300 per 1,000, and maternal mortality is the highest in the hemisphere at 48 per 10,000. Bolivia was an economy in total chaos in 1985, inflation was running at 24,000% a year and GDP/capita had contracted more than 20% over four years. The Government of Dr. Paz-Estenssoro introduced an orthodox stabilization program which included freeing of prices (including wages and the exchange rate); liberalizing foreign trade and international capital movements, increasing taxation; and raising energy prices to international levels. This stabilized the economy and positive growth returned in 1987. Since then inflation has been under control and growth has averaged about 2.5%. Two heterodox elements in the package were the efforts to buy back commercial debt at a substantial discount (89%), and protect the poor through the Emergency Social Fund (ESF) Program. Both programs have been successful; Bolivia has bought back about two thirds of its commercial debt, and the ESF has implemented about 3,000 small projects with a cost of $180 million.

3. The present Government came to power in August 1989. It is a fragile coalition of a center-right and a center-left party. The Government excludes the party in power between 1985 and 1989. Mr. Paz-Zamora is the leader of the left-leaning party. This Government has confirmed its commitment to the liberal policies implemented under the previous Government and moved quickly to contain fiscal pressures by raising public sector prices in August of 1989. Bolivia was given access to a second year of the IMF's Enhanced Structural Adjustment Facility in November 1989. Recently Bolivia received debt rescheduling of its bilateral debt from the Paris Club on similar terms to those awarded to Sub-Saharan African countries.

4. The Government wants to put more emphasis on poverty alleviation. So far little action has been taken but a very good Maternal Health and Child Survival Program was introduced, and the Government is looking at badly needed education reform. The Bank is preparing a poverty report to help the Government in the analysis of poverty issues and definition of action plans. A mission is presently in the field to discuss education reform. Two of the three credits approved this fiscal year are in the social sectors: Integrated Health Development and Social Investment Fund (the successor of ESF in health

and education) and the third (for development of the Eastern Lowlands) contains important poverty related components.

5. While Bolivia's program generally is on track, we have raised several concerns in recent months:

(1) Some planned investments in the public investment program appear unjustified, and some should be undertaken by the private sector.

(2) The public sector deficit of 1989 was higher (5.5% of GDP) than agreed with the IMF (5.0% of GDP). Recent increases in the public sector wage bill appear excessive.

(3) It appears that there is a lack of total conviction in the Government on the need for continued reform. Structural adjustment takes time, and not all members of the Government appear to be on board.

6. Issues likely to be brought up by the Bolivians:

(1) Request for Bank assistance for a US$600 million project to sell power to Brazil. Your response to a letter from the President on the matter is attached. Because the project is designed to benefit Brazil, we are considering an IBRD loan on an enclave basis rather than an IDA credit. The prospective cofinanciers, IDB and Japan, are likewise considering loans on hard terms. To protect the rest of the economy from the project's financial risks, the loans will need to be guaranteed by a creditworthy third party; Bolivia has asked Brazil to be the guarantor. You may wish to emphasize the importance of this guarantee and our support for it. You may also want to emphasize the importance of private sector participation in the scheme.

(2) Request for Bank assistance to eliminate the remaining commercial debt. The Board has discussed on March 13 a preliminary note indicating IDA's willingness to allocate $10 million for this purpose if a successful buyback is arranged. The final approval awaits a new agreement between Bolivia and the banks.

Attachment

cc: Messrs./Mmes. Selowsky, Quijano, Duer, Segura (LACVP); Loh (LA3DR); Garcia-Zamor (LA3DR); Page (LA3TF); Marshall, Miovic, Shaw, Albert, McGinnis, Ardila, Rodriguez (LA3C1)

Cleared w/&cc: Messrs. Drysdale (LA3HR); Forno (LA3AG); Smith (LA3IE)

SJorgensen/dc

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

February 6, 1990

His Excellency
Mr. Jaime Paz Zamora
President of the Republic of Bolivia
La Paz, Bolivia

Dear Mr. President:

Thank you for your recent letter on your Energy Integration Program with the Federal Republic of Brazil. The authorities and technicians of your country have been working closely with our staff on the analysis of the related projects.

I agree with you that commercialization, transformation and use of Bolivian natural gas could contribute to strengthening the economic, financial and political ties at the level of La Plata River Basin and its subregions. At the same time, it would support Bolivia's economic and social development. Given the size of the Program, private sector participation will be crucial to keep the public sector financial burden within affordable margins and to share the risks inherent in the projects.

Provided that each project is justified economically and environmentally, and the financing mechanisms and guarantees required for their implementation are designed in a manner that duly safeguards the economy and finances of your country, the World Bank would be prepared to consider providing support to the projects arising from the Energy Integration Program.

Your Excellency, please accept the renewed assurances of my highest esteem.

Sincerely,

/s/
Barber B. Conable

Record Removal Notice

The World Bank Group
Archives
& Records Management

File Title	Barcode No.
Country Files - Bolivia - Correspondence	1779621

Document Date	Document Type
October 31, 1989	Letter

Correspondents / Participants
To: Mr. Barber Conable, President, The World Bank
From: Fernando Kempff, Director Ejecutivo, Banco Santa Cruz de la Sierra

Subject / Title
End of tenure

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Shiri Alon	November 15, 2023

X

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

August 29, 1989

Dear Mr. President:

I have learned of your appointment as Alternate Governor for Bolivia on the Boards of Governors of The World Bank Group. I realize this is incident to your responsibilities in your own Government, but I hope you will be in a position actively to participate in the affairs of the Bank Group, as well.

The Executive Directors, Officers and Staff of The World Bank Group believe very strongly in its development mission and in the battle against poverty. We look forward to working with you to make the Bank Group even more effective during the coming years. Congratulations on your appointment and thank you for your willingness to take on this additional responsibility.

I look forward to meeting you here in Washington at the time of the Annual Meetings, and send my best personal wishes.

Sincerely,

(Signed) Barber B. Conable

Senor Raul Boada
Presidente
Banco Central de Bolivia
Cajon Postal No. 3118
La Paz, Bolivia

cc: Mr. Morales
Mr. Loh
Mr. Santos

ETS
/ETSanidad

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

29 de agosto de 1989

Señor Presidente:

Me he enterado de que ha sido nombrado para ocupar el cargo de Gobernador Suplente por Bolivia en las Juntas de Gobernadores del Grupo del Banco Mundial. Estoy consciente de que ésta es sólo una de las importantes responsabilidades inherentes al cargo que ocupa usted en el Gobierno de su país, pero confío en que pueda participar activamente en los asuntos del Grupo del Banco.

Los Directores Ejecutivos, los altos funcionarios y el personal del Grupo del Banco Mundial están firmemente convencidos de que a esta institución le corresponde una importante misión en lo que respecta al desarrollo y a la lucha contra la pobreza. Espero que podamos trabajar en colaboración en la tarea de hacer que el Grupo del Banco sea aún más eficaz en los años venideros. Me complace felicitarlo por su nombramiento y deseo expresarle mi agradecimiento por su disposición a asumir esta responsabilidad adicional.

En espera de verlo aquí en Washington con ocasión de las Reuniones Anuales, le envío mis mejores deseos personales.

Atentamente,

Señor
Raúl Boada
Presidente
Banco Central de Bolivia
Cajón Postal No. 3118
La Paz, Bolivia

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Country Files - Bolivia - Correspondence	1779621

Document Date	Document Type
August 10, 1989	Memorandum

Correspondents / Participants
To: Timothy Thahane
From: Raymundo Morales, EDS08

Subject / Title
Governors - Bolivia

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Shiri Alon	November 16, 2023

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

August 29, 1989

Dear Mr. Minister:

I have learned of your appointment as Governor for Bolivia on the Boards of Governors of The World Bank Group. I realize this is incident to your responsibilities in your own Government, but I hope you will be in a position actively to participate in the affairs of the Bank Group, as well.

The Executive Directors, Officers and Staff of The World Bank Group believe very strongly in its development mission and in the battle against poverty. We look forward to working with you to make the Bank Group even more effective during the coming years. Congratulations on your appointment and thank you for your willingness to take on this additional responsibility.

I look forward to meeting you here in Washington at the time of the Annual Meetings, and send my best personal wishes.

Sincerely,

(Signed) Barber B. Conable

Su Excelencia
Senor Enrique Garcia
Ministro de Planeamiento y Coordinacion
Avenida Arce 2147
Cajon Postal No. 3116
La Paz, Bolivia

cc: Mr. Morales
Mr. Loh
Mr. Santos

/ETSanidad

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

29 de agosto de 1989

Señor Ministro:

Me he enterado de que ha sido nombrado para ocupar el cargo de Gobernador por Bolivia en las Juntas de Gobernadores del Grupo del Banco Mundial. Estoy consciente de que ésta es sólo una de las importantes responsabilidades inherentes al cargo que ocupa usted en el Gobierno de su país, pero confío en que pueda participar activamente en los asuntos del Grupo del Banco.

Los Directores Ejecutivos, los altos funcionarios y el personal del Grupo del Banco Mundial están firmemente convencidos de que a esta institución le corresponde una importante misión en lo que respecta al desarrollo y a la lucha contra la pobreza. Espero que podamos trabajar en colaboración en la tarea de hacer que el Grupo del Banco sea aún más eficaz en los años venideros. Me complace felicitarlo por su nombramiento y deseo expresarle mi agradecimiento por su disposición a asumir esta responsabilidad adicional.

En espera de verlo aquí en Washington con ocasión de las Reuniones Anuales, le envío mis mejores deseos personales.

Atentamente,

Señor
Enrique García
Ministro de Planeamiento y Coordinación
Avenida Arce 2147
Cajón Postal No. 3116
La Paz, Bolivia

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Country Files - Bolivia - Correspondence	1779621

Document Date	Document Type
August 10, 1989	Memorandum

Correspondents / Participants
To: Timothy Thahane
From: Raymundo Morales, EDS08

Subject / Title
Governors - Bolivia

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Shiri Alon	November 16, 2023

#11

Bolivia

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/01/30 DUE DATE : 00/00/00
LOG NUMBER : 890131017 FROM : Mr. S. Husain (Thalwitz)
SUBJECT : BRIEFING: Meeting with Minister of Planning & Coordination of Bolivia, Mr. Fernando Romero on Feb. 1, 1989 at 2:15 p.m.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

- ______ APPROVED
- ______ PLEASE HANDLE
- ___✓___ FOR YOUR INFORMATION
- ______ FOR YOUR REVIEW AND RECOMMENDATION
- ______ FOR THE FILES
- ______ PLEASE DISCUSS WITH ______
- ______ PLEASE PREPARE RESPONSE FOR ______ SIGNATURE
- ______ AS WE DISCUSSED
- ______ RETURN TO ______

COMMENTS :cc: Mrs. Haug, JV (follow file)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: January 30, 1989

TO: Mr. Barber Conable

THROUGH: Wilfred P. Thalwitz, Acting SVPOP

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: **BOLIVIA - Visit of the Minister of Planning and Coordination**

1. Mr. Fernando Romero, Bolivia's Minister of Planning and Coordination, will be in Washington from January 30 to February 2 to meet with World Bank, IMF, and U.S. Government Officials. His primary objective is to seek solutions, notably a US bridge loan to Bolivia's most immediate economic problems; there are largely, in Bolivia's view, due to the accumulated arrears and delays in Argentine payments for Bolivian natural gas exports. Mr. Romero will also press Bolivia's cause on other issues, notably the commercial bank buyback scheme and Bolivia's bilateral debt. In his meeting with you he is likely to seek your support vis-a-vis the US Government on the bridge loan proposal, and vis-a-vis Argentina in solving the payment problems. He will also press for sustained Bank support for Bolivia's program, particularly in this critical period leading to Presidential elections in May 1989.

2. Mr. Romero to meet you on February 1 at 2:15 p.m. Prior to his meeting with you he will see me at 11:30 a.m. He will also hold discussions at the technical level with Bank staff. Mr. Romero will be accompanied by Mr. Trigo, Central Bank President, and Mr. Kempff (EDs). Mr. Loh and Ms. Marshall from LA3 will attend your meeting.

3. Mr. Romero has been Minister of Planning since mid-September, 1988. He was previously Executive Director of Emergency Social Fund, which we have assisted with two IDA credits. Most of his career has been in the private sector, as a successful businessman, operating both in Bolivia and in the US. He holds a masters degree from MIT. While Mr. Romero only joined the Cabinet last September, he has been a key architect of Bolivia's economic program since President Paz Estenssoro took office in August 1985.

The Gas Payment Problem

4. Although Bolivia registered 2.5% growth in GDP in 1988, its economic recovery program is now threatened by deteriorating balance of payments situation and declining reserves. A major part of the problem has been a deadly game of brinksmanship by Argentina in paying for Bolivia's natural gas exports: for over two years these payments have been erratic and unpredictable, obviously in large part because of Argentina's economic difficulties. A long series of bilateral negotiations at all levels and international interventions (including pleas from the UN

Secretary General and my December 1988 letter to the Minister of Finance urging payment) have yielded only partial and temporary solutions and the Bolivia Government fears that worse lies ahead. This, they fear, will bring the Government and the hard fought economic program to its knees just as elections approach.

5. Delayed payments from Argentina for gas shipments have been extremely costly to the Bolivian economy. Bolivia's exports of gas to Argentina (assuming payments were made on schedule) were valued at US$213 million in 1988 or nearly 40% of Bolivia's total merchandise exports receipts. Further, the level of arrears alone (approximately US$130 million) is now equivalent to more than 23% of Bolivia's annual export revenues. A September 1987 agreement stipulated that Argentina would pay US$20 million per month to Bolivia, about US$17 million to cover payments for current gas shipments and the remainder to retire past arrears. Despite this framework and the prior negotiation on which it was based, Argentina's payments during 1988 were extremely erratic; there were a number of 2-3 month delays and continuing uncertainty throughout as to whether Bolivia was going to be paid for either current shipments or the mounting arrears. It was only after considerable effort by Mr. Romero and others that by the end of 1988 Argentina had almost caught up on the 1988 payments. Further payment of US$12 million was made in mid-January, but it is unclear whether this is the entire amount which Argentina plans to pay this month.

6. The Bank has sought to assist to Bolivia on this matter in the past, most recently, via my December 1988 letter urging Mr. Sourrouille's personal attention in resolving the gas payment issue. This letter appears to have helped the Bolivian Government to convince the Argentine Government to pay up most of its arrears for 1988 gas shipments.

7. Mr. Romero is likely to underscore the gravity of the situation and ask your support in obtaining a bridging loan from the United States Government to help Bolivia through the next several months, in the event Argentina does not make the projected payments. He would also like to explore ways to accelerate disbursements of IDA funds, which we intend to pursue with him at the working level. Finally, he will urge further efforts by the Bank to persuade Argentina to meet its obligations. We believe the bridging loan would be helpful to take pressure off the Government and give it a greater ability to manage its foreign exchange reserves at this critical juncture. Bolivia is in the midst of Presidential elections (as is Argentina) and these elections can be expected to result in some instability and uncertainty in economic and financial affairs. In terms of direct IDA assistance, evidently it is problematic even to discuss IDA support in filling a gap caused by Argentina's failure to pay its bills. Nonetheless, solving this problems is clearly vital to the sustainability of Bolivia's program and the outcome could well affect the election.

Commercial Bank Debt

8. Mr. Romero may also seek your support in the Government's efforts to raise funds for a further (and hopefully final) buyback of its commercial bank debt; you will recall that in 1988 Bolivia completed

successfully a buyback of about half of its commercial bank debt which stood at US$650 million (face value), using funds granted by seven countries, for 11 cents on the dollar. Now the Government is negotiating with the commercial bank steering committee (headed by Bank of America) a further operation which would result in the elimination of the remaining commercial bank debt of about US$350 million. We support this scheme, but could not at this stage support it directly with IDA funds, which is what the Government has in mind.

Bank Operations

9. Since 1986 the Bank has provided extensive assistance to Bolivia, both financial (IDA assistance of about US$70 million a year) and other support, including aid coordination and mobilization through the Consultative Group. The FY89 program includes three operations: the Economic Management Technical Assistance Project (US$11.5 million), approved in December, a Mining Sector Project and a Transport Project. In addition, a supplemental Credit under the IDA reflows program is planned (US$11.3 million). For FY90 we plan four operations, an Agricultural Development Project, a Health Project, and a further credit to support the Emergency Social Fund.

cc: Messrs./Mmes.: Qureshi (o/r), Bock, Selowsky, Quijano, Bottelier, Bery, Loh, Flood, Marshall, Miovic, Mendoza, Potashnik.

MP/KM:dc

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: January 30, 1989

NAME	ROOM NO.
Mr. Conable	
Through Mr. Thalwitz	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
XX	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS:

BOLIVIA : Visit of the Minister of Planning and Coordination (Brief)

February 1, 1989, at 2:15 p.m.

FROM:	ROOM NO.:	EXTENSION:
S. Shahid Husain		39001

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 26, 1988

TO: Mr. Michel Camdessus

FROM: Barber B. Conable

EXTENSION: 72001

SUBJECT: BOLIVIA - Policy Framework Paper

The Committee of the Whole of the Executive Directors of the Bank and IDA discussed the paper entitled "Bolivia: Policy Framework Paper" on July 21, 1988. Attached, for your information, is a summary of the main points.

Barber B. Conable

Attachment

FROM: Vice President and Secretary

July 26, 1988

COMMITTEE OF THE WHOLE, July 21, 1988

Summary of Discussion on

BOLIVIA: Policy Framework Paper

Attached is a copy of the summary of discussion of the Committee of the Whole on July 21, 1988, on the above subject. This summary is being transmitted to the Managing Director of the IMF.

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council

Summary of Discussion of the Committee of the Whole, July 21, 1988

BOLIVIA: POLICY FRAMEWORK PAPER

1. The Executive Directors of the Bank and IDA discussed in a meeting of the Committee of the Whole, the paper entitled "Bolivia: Policy Framework Paper 1988-91". This paper updates and extends by two years the Policy Framework Paper for 1987-89.

2. Speakers complimented the Government of Bolivia for its continued progress in reorienting its economy and achieving structural reforms since 1985. The meeting noted that despite mixed results in implementing its 1987-89 program, the Government had made significant adjustments and showed renewed determination to proceed with its reform program under very difficult circumstances.

3. Speakers stressed the importance of several measures in the program such as controlling inflation, strengthening public finances by raising revenues and limiting public sector deficits, and continuing reforms of the trade sector and financial system to give confidence. They underlined the need to increase saving levels in order to increase investment, public and private. They emphasized the importance of increased investment in key sectors, notably mining, hydrocarbons, agriculture, and transport.

4. The staff reported on the measures being taken by the Government itself, and with Bank assistance, to strengthen public sector management overall, including the state enterprises, and to improve the management of the public investment program. These measures include strengthening of the Central Bank and the Ministries of Finance and Taxation, and assisting sectoral ministries in undertaking reviews of their public investment programs and in project preparation.

5. There were also questions about Bolivia's debt and the measures being taken to manage it. In this connection, it was noted that Bolivia's debt buy-back and conversion scheme will result in the cancellation of close to 50% of Bolivia's commercial bank debt of US$680 million. Staff pointed out that rescheduling of official bilateral debt is essential for the success of the medium-term adjustment program. In addition, Bolivia will continue to require substantial external support, in the form of concessionary assistance for an extended period of time.

6. Speakers raised questions about the social objectives of the medium term program and expressed the hope that through the Emergency Social Fund and other initiatives, the Government will be able to give more assistance in the social sectors, housing, and nutrition. Bank staff reported on government and Bank activities to address social sector issues through the ESF, technical assistance for decentralization and strengthening management of sector institutions, and lending operations in health and education.

7. Several speakers recommended that future PFPs provide a more explicit and comprehensive assessment of progress and constraints to the achievement of objectives set forth in previous PFPs.

August 28, 1987

Dear Mr. Minister:

It is indeed good to know that you have been appointed Governor for Bolivia on the Board of Governors of The World Bank. Congratulations!

The Executive Directors, Officers and Staff join me in extending to you a warm welcome. We look forward to your participation in the affairs of the Bank.

On a personal note, I hope to have the opportunity of greeting you here in Washington at the time of the Annual Meetings.

Sincerely,

(Signed) Barber B. Conable

Barber B. Conable

Su Excelencia
Senor Gonzalo Sanchez de Lozada
Ministro de Planeamiento y Coordinacion
Cajon Postal No. 3116
La Paz, Bolivia

cc: Mr. Camarasa
Mr. Loh
Mr. Schultz

ETSanidad:jlk

Record Removal Notice

File Title	Barcode No.
Country Files - Bolivia - Correspondence	1779621

Document Date	Document Type
August 21, 1987	Memorandum

Correspondents / Participants
To: Mr.Timothy T. Thahane
From: Fernando Scelza, EDS

Subject / Title
Governor of Bolivia

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

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Shiri Alon	November 16, 2023

Record Removal Notice

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File Title	Barcode No.
Country Files - Bolivia - Correspondence	1779621

Document Date	Document Type
10 August, 1987	Telex

Correspondents / Participants
From: Dr. Jaime Escobar, Presidente A.I.
To: Felix Alberto Camarasa, Executive Director

Subject / Title
Representation

Exception(s)
Communications of Executive Directors' Offices

Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
A.May	January 23, 2024

Archives 01 (March 2017)

*IMPORTANT

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDANCE DATE : 87/05/20 DUE DATE : 00/00/00
LOG NUMBER : 870520016 FROM : Andre Guy, Karaosman
SUBJECT : My Message on Bolivia during Board Meeting of 5/19

OFFICE ASSIGNED TO FOR ACTION : Mr. Barber Conable E1227

ACTION:

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COMMENTS : Mr. Conable read this quickly before it was logged.
Isaac should see and provide bfg. before Board, if
bfg. is necessary

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

CONFIDENTIAL

DATE: May 20, 1987

TO: Mr. Barber B. Conable BBC
(Through: Messrs. Karasmanoglu AK and Knox) AML

FROM: Andre Ryrie AR

EXTENSION: 72011

SUBJECT: My Messsage on Bolivia during yesterday's Board meeting

1. While we were sitting in the anteroom before the Argentina presentation yesterday afternoon, Ms. Moira Paz Estenssoro took me aside to say that Minister Cariaga had asked her to raise the stalemate on the gas contract between Bolivia and Argentina during the Argentine discussion. I asked her whether she had spoken to Mr. Camarasa and told her I did not think it was a good idea to do this at this time and in this forum. Mr. Camarasa came by and I asked him to join us. He was very upset. Mr. Malan also joined us. Ms. Paz however persisted and wanted to raise the issue. This is when I sent you the message. A little later Mr. Malan told me that Mr. Arlman might also raise the issue.

2. A few minutes later Ms. Estenssoro joined me again. I explained to her in more detail why I thought she should not do this because she would embarrass everyone. I told her that she had made her point. I reminded her that you had told the Minister that we would try to help and that she should not embarrass you either. After that, she said that she would think it over and probably not raise it in this way but write a memo instead.

3. A little later I discussed this with Isaac Sam who told me that the issue had in fact been raised that same morning but appeared to have been resolved. I did not know about that.

cc: Mr. Stern (o/r)
Mr. Picciotto
Mr. Scherer
Ms. Marshall

JV(AP)

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDANCE DATE : 87/05/08 DUE DATE : 00/00/00
LOG NUMBER : 870513013 FROM : David Knox
SUBJECT : BOLIVIA: Brief for the Meeting with Mr. Juan Cariaga, MOF on Monday, May 18 at 2:30 pm.
OFFICE ASSIGNED TO FOR ACTION : Mr. Barber Conable E1227

ACTION:

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COMMENTS : Copy given to Isaac for info.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 8, 1987

TO: Mr. Barber Conable

THROUGH: Mr. Ernest Stern

FROM: A. David Knox

EXT.: 75901

SUBJECT: BOLIVIA - Brief for the Meeting with Mr. Juan Cariaga, Minister of Finance

1. You will meet the Bolivian Minister of Finance on Monday, May 18 at 2:30 p.m. Ms. Marshall will attend the meeting from the LAC Region. The primary purpose of Mr. Cariaga's visit to Washington is to negotiate a US$55 million Reconstruction Import Credit (RIC II); he has asked to see you to pursue your discussions at the time of the 1986 Annual Meeting and to renew his appeal for Bank Group support for Bolivia at this critical juncture.

Economic Background and Bank Group Strategy

2. Bolivia's Government took office in August 1985 in the face of a chaotic economic situation. Within a month, the Government adopted far-ranging economic reforms to stabilize the economy and address the root causes of Bolivia's economic problems-notably a very large and unwieldy public sector, public spending out of control, and a dwindling, patently inadequate tax base, and controls on prices, interest rates and exchange rates. The economic program has been applied with vigor and, barring a few temporary lapses, consistency. Key achievements are freeing of prices, smooth functioning of foreign exchange auctions, sharp staff cutbacks in the public mining company, and hard won passage by Congress of a comprehensive new tax law. Results have been encouraging - a dramatic reduction in the inflation rate (from some 24,000% to less than 15% over the past twelve months), a free and competitive exchange rate, and a sharply reduced fiscal deficit. This record is particularly striking as Bolivia's economy faced severe terms of trade shocks as tin prices collapsed and natural gas prices declined during the same period. Disappointing export revenues (despite an increase in export volumes) largely explain the continuing recession; preliminary data for 1986 indicate a negative growth of about 3%. We are hopeful that 1987 will see a resumption of growth. The Bolivian program is widely viewed as one of the boldest and, to date, most successful in Latin America. Bolivia's economic team, and particularly Mr. Cariaga, feel the pressure of events very keenly and often express their impatience to see promises of support translated into concrete results. In fact, a remarkable level of support has been forthcoming so we are counseling patience and sustained effort. A special dimension of Bolivia's situation is the enormous importance of cocaine in the economy. The Government is tackling this problem boldly, working closely with the US. The Bank participated in an April meeting in Vienna on the proposed anti-narcotics program.

3. Mr. Cariaga may underline Bolivia's serious debt problems. Over the past year, Bolivia has moved actively to regularize relations with external creditors (Paris Club Agreement June 1986). Of particular interest is a Bolivian initiative to buy back the commercial bank debt at a deep discount. The Government may ask us to provide technical support and we are exploring how we might assist.

4. The challenges ahead for Bolivia are unquestionably enormous, despite the sterling record of the past 19 months. We are focusing on these major issues:

(a) We are urging the Government to sharpen the medium to long-term policy framework, which, as yet, provides little concrete hope that expected economic imbalances in the 1990s can be addressed, nor a clear vision of how growth can be achieved. There is no substitute here for sector by sector planning and preparation of new investments;

(b) Bolivia's future financial viability depends on making the new tax law work. This will take time and sustained effort;

(c) Urgent action is needed to boost public and private investment, as low investment levels largely explain the continuing economic recession. Existing projects must be implemented and the very weak public investment programming process strengthened, as a basis for mobilizing more external financing. The Government in partnership with the private sector is engaged in a promising effort to improve the investment climate and identify policy measures and investments which promise to restore growth;

(d) Across the board, implementation problems (as distinguished from the design and articulation of broad policies) stymie economic management. This applies at both the macro-economic and sectoral levels. The theme of implementation is the counterpoint of our dialogue;

(e) Bolivia's economic stabilization and adjustment program has to date paid little explicit attention to social issues. The Government is now keenly aware that it must act to address social problems if it is to survive and succeed. We are working with the Government to launch an Emergency Social Fund program primarily aimed at generating employment.

5. Bolivia's relations with the IMF are good. A one-year standby arrangement, approved in June 1986, is well on track. In December 1986 the IMF Board approved access to the Compensatory Financing Facility (SDR 64.1 million). The joint World Bank/IMF/Government Policy Framework Paper was discussed by the Bank's Board (November 25, 1986) and the IMF Board (December 15, 1986) (the first year SAF is SDR 18.1 million). Discussions with the IMF on an Extended Fund Facility (EFF) or a second standby arrangement beyond June 1987 are expected to begin in late May 1987. We are working closely with the IMF on many issues, notably financial sector reform, tax reform, and the ongoing overhaul of the Central Bank.

6. The Bank has responded to the Government's program with a sharp increase in our operations. During FY86 two IDA-financed operations--the Reconstruction Import Credit for US$55 million and the Vuelta Grande Gas Recycling Project for US$15 million - were approved. We launched an ambitious program of project preparation and economic and sector work including support for public investment planning and for revival of private investment. We are specifically focussing in Bolivia on the issue of the role of women and families, and are working to develop a strategy on environmental issues. The Resident Mission in Bolivia, long without an incumbent, was reactivated in October 1986. Finally, the Bank chairs the Bolivia Consultative Group which we see as a key vehicle for mobilizing international support. Particularly encouraging is a very likely Japanese Government decision to cofinance the RIC II with US$50 million (they participated in the appraisal mission). We plan to present three operations for Bolivia to the Board this fiscal year; the RIC II (US$55 million), a Power Rehabilitation Project (US$6.5 million) and a Public Sector Financial Management Project (US$11.5 million). Three other operations are at appraisal stage: a Financial Sector Operation, an Urban project, and a project to support the Emergency Social Fund. This program is striking when seen in contrast to the Bank's inability to lend to Bolivia from 1980 to 1985 because of the terrible economic situation. Bolivia is an IDA only country at present (per capita income $470).

Issues Likely to be Raised by Mr. Cariaga

7. Mr. Cariaga is likely to stress the great need for IDA support and the urgency of providing funds quickly. He may also point out that resource transfers from the Bank Group to Bolivia have been negative for the past 5 years, including 1986. You may wish to point out that the pipeline has now almost been rebuilt and that the resource transfer is about to turn strongly positive. You may also wish to reiterate our strong and continuing support but stress the severe constraints on IDA resources and the need for Bolivia to demonstrate its ability to use resources effectively.

Issues you might Raise

8. You may wish to stress our support and admiration for the vision and tenacity of the Bolivian authorities. The Bank Group is making an extraordinary effort for Bolivia which reflects our appreciation for the magnitude and urgency of the problems the Government faces. We are confident that the Consultative Group mechanism will be of material support in mobilizing and coordinating international support; Japanese support for RIC II is a good example of what can be achieved.

Cleared with and cc: Mr. Scherer, LC2AR

cc: Messrs. Pfeffermann, Quijano, LCNVP; Gue (o/r), Nankani, LC2DR;
Miovic, Zea, LC2PB

KMarshall:vv

Biographical Information on Mr. Juan Cariaga, Minister of Finance

Appointed Minister in January 1985, Mr. Cariaga is a key figure in the economic team and the individual who stands most firm on the tight fiscal policies and efforts to reduce sharply the Government's role in the economy. He has a B.A. in Economics from Dartmouth College and Masters in Economics from Rutgers University. He was coordinator for the Musgrave Mission which conducted a Tax Reform Study for Bolivia in 1975-77. In 1980 he became first Vice President of the Association of Banks and Financial Institutions of Bolivia (ASOBAN). From 1979 to January 1986, he was General Manager of Banco de Santa Cruz, La Paz Branch. Mr. Cariaga also served as president of the Bolivian Academy of Economic Sciences and is a member of the National Academy of Science of Bolivia and Professor of Economics, Universidad Mayor de San Andres and Universidad Catolica Boliviana. He has published several papers and articles on macroeconomic issues.

Mr. Cariaga was born in May 1945. He is married and has one child by his current marriage; children of a former marriage live in Canada.

①IS

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

RECEIVED DATE : 87/01/07 DUE DATE : 00/00/00
LOG NUMBER : EXC870107001
SUBJECT : Bolivia - Divisional Country Brief (DCB)

OFFICE ASSIGNED TO FOR ACTION : ② Mr. Barber Conable E1227

ACTION:

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COMMENTS :

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Barber Conable

January 6, 1987

FROM: Ernest Stern ES.

SUBJECT: BOLIVIA - Divisional Country Brief (DCB)

Attached is the Bolivia Divisional Country Brief (DCB), which was discussed by the OPC on November 25, 1986. Attached also are the Agenda for the meeting and the Postscript to the DCB, recording the conclusions of the OPC discussion. Pending a full review of IDA allocations after IDA-8 availabilities are set, the Committee approved a level of SDR 50 million a year of IDA lending for FY87-90 as an upper limit for the Region's planning purposes.

The proposed strategy involves no major policy issues. Given the still very unsettled situation in Bolivia, I do not believe that this document warrants a meeting with your senior staff.

Unless you advise me otherwise, we will proceed as agreed in the Operations Policy Committee.

Attachments

CONFIDENTIAL

BOLIVIA

DIVISIONAL COUNTRY BRIEF

Postscript

49. A meeting of the Operations Policy Committee was held on November 25, 1986 to consider the Divisional Country Brief (DCB). The discussion focussed on the following issues: (a) the outlook for economic recovery and for debt reconstructing; (b) the level of the IDA lending program and creditworthiness for IBRD lending; (c) the extent of sector coverage and role of the IDB; and (d) the policy content of the next adjustment lending operation.

Economic Prospects

50. The Region said that despite the virtually ideal macroeconomic policies followed during the past year, growth had not resumed and private investment remained disappointingly low. However, there were signs of a good recovery of exports other than tin and natural gas. The level as had actually been achieved in 1990, so they did not seem excessively optimistic. An important unknown in the outlook concerned the impact of current efforts to discourage cocaine production. The Region said that a significant decline in production was likely only if profitable alternatives could be provided to Bolivia's farmers. Overall, the Chairman indicated that the country's prospects were highly uncertain, but that so long as the Government maintained sound adjustment policies, the Bank should continue to provide support.

51. Some progress was reported on Bolivian plans to purchase, at a heavy discount, its external debt held by commercial banks.

The Level of Bank Group Lending

52. The Chairman noted that the level of IDA lending proposed by the DCB appeared very high. He indicated that an annual average of about SDR 50 million represented the maximum that should be used for present planning purposes. It was considered unlikely that the country could become creditworthy for normal IBRD borrowing in the foreseeable future, although IBRD lending on an enclave basis might be feasible. However, it was pointed out that difficult legal issues could be raised by enclave lending if there were still substantial unsettled claims by past commercial lenders.

Diversity of Sectors and the Role of the DCB

53. The Region indicated that its tentative plans for wide sector involvement were in response to the Government's wishes to obtain Bank assistance in dealing with a wide range of sector problems -- in agriculture, energy, transport, finance, urban development, and the social sectors. The question was raised whether there should not be some division of labor with the Inter-American Development Bank (IDB). The Region noted that the IDB had a large pipeline of committed but undisbursed loans in several sectors, but that Bank

staff was concerned that IDB had been reluctant to address policy issues directly. The Chairman suggested that the Bank intensify its efforts to persuade the IDB to tackle such issues.

54. Another problem with the IDB was that more than half of its lending to Bolivia is expected to be at terms comparable to IBRD lending, even though Bolivia's creditworthiness was very weak. It was suggested that the Region stress to the Bolivian Government the desirability of limiting the amount of its borrowing on such terms.

Content of the Next RIC and the Emergency Reconstruction Operation

55. The Region indicated that the next RIC would be intended to support a continuation of the macroeconomic reforms already underway and in addition, would be used to develop an approach to alleviating the social costs of adjustment, through longer term measures in health and education and through more immediate actions to help meet the problem of finding employment for workers displaced by the closure of tin mines and retrenchment in other parts of the public sector. The latter area might be the focus of an emergency reconstruction operation tentatively scheduled for FY88. The emphasis would be on creating productive employment, perhaps in road rehabilitation and reforestation.

January 5, 1987

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: November 24, 1986

TO: Operations Policy Committee

FROM: Basil Kavalsky, Acting Director, CPD

EXT.: 60063

SUBJECT: BOLIVIA DCB: OPC Review

1. Attached is an agenda and comments on major policy issues identified by CPD and PBD for consideration by the Committee. The suggested agenda items are:

(a) The Economic Prospects.

(b) The Bank's Assistance Strategy.

2. The Review Meeting will be held on Tuesday, November 25, 1986, at 4:30 p.m. in Room E-1208. The meeting has been requested now because the Regional Office wants guidance for its position in the Consultative Group Meeting which will take place next week.

Attachments

cc: Regional Office: Messrs. Gue
Picciotto
Pfeffermann
Ms. Marshall (3)
Nankani
Tyler
Gregory

Messrs. Ryrie
Jansen

BOLIVIA

DIVISIONAL COUNTRY BRIEF

Topics for Discussion

The Economic Prospects

1. A crucial determinant of Bolivia's economic prospects is a very substantial expansion of merchandise exports other than tin and natural gas -- from $108 million in 1985 to $350 million in 1990 and $855 million in 1995.[1] This increase would come mainly from private enterprise in agriculture, mining, and manufacturing. However, while the DCB underscores the importance of achieving a rejuvenation of private initiative, private investment is projected to recover from 4.0 percent of GDP in 1985 to only 6.0 percent in 1995 (this compares with 7.3 percent in 1980). Are the relatively modest ratios of private investment consistent with the recovery of exports and GDP that is being projected? What are the main sources of potential private investment, and what are the conditions (political and economic) required to achieve a strong recovery?

Differences in IMF and IBRD Projections

2. At the discussion of the Bolivia Policy Framework Paper (PFP) on October 22, there was a consensus that import growth would have to be higher than projected in order to be consistent with GDP growth of 3.5 percent, and that in the absence of agreement by the commercial banks to a reduction in interest charges, the full amount of the amounts due needed to be included. These changes are reflected in the DCB, with the consequence that the current account deficit rises as a share of GDP from 9 percent in 1985 to 12 percent in 1989. They are also included in the Economic Report which has been distributed to the Consultative Group. However, the IMF did not accept these changes. Thus, the final version of the PFP which is to be discussed by the Board tomorrow, still shows a current account deficit at 8 percent of GDP in both 1985 and 1989. Are these differences in the projections likely to create any problems in practice?

The Bank's Assistance Strategy

3. The policy performance by the Bolivian Government over the past year has been very impressive. The Bank has responded with a substantial increase in economic and sector work and with two IDA operations totalling $70 million in FY86. On the assumption that the Government's performance will stay on course, the DCB recommends a further increase in staff resources for ESW and an expansion of IDA lending to between $70 and $95 million a year during FY87-91. One of the main objectives of the Region in seeking the present OPC review is to obtain guidance prior to the Consultative Group Meeting on the magnitude of IDA resources it can plan on for the next few years. While any judgments on IDA allocations must be very tentative at this stage pending the outcome of the

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1/ These figures are from the Economic Report.

IDA-8 replenishment exercise, it can be pointed out that the Region's proposal would represent a very high level on a per capita basis. The mid-point of the proposed range ($82.5 million or SDR 68.8 million) corresponds to SDR 11.1 per capita per annum. Among countries over one million population, only Zambia has a higher program over a three year period, even counting the SFA funds (see Attachment). For planning purposes, a program corresponding to the level now in the MIS of SDR 8.2 per capita per annum might be more appropriate, although even this would require a significant reallocation away from other countries for FY87.

4. If substantial amounts of cofinancing were available, there might well be justification for the Bank to maintain a program of 3-4 operations a year even if the average size of the IDA contribution were constrained to amounts lower than proposed. It would be useful for the Region to have some guidance on this point prior to the Consultative Group Meeting.

5. The DCB proposes two more adjustment operations, another RIC in FY87 and a financial sector operation in FY88. A SAL is in reserve for FY89. With respect to the first of these, the paper mentions several objectives: reactivation of private investment, restructuring the energy sector, improvement in transport and the design of an effective social program (para. 34). This is a broad agenda. It would be useful for the Region to elaborate on the key areas of Government policy action on which such as RIC should be conditioned. Given that foreign exchange reserves are equal to about 6 months of goods and services (including interest due), is there a balance of payments need for a quick disbursing operations at this stage?

6. The DCB proposes to devote substantial resources to the social sectors in the form of manpower for ESW in FY87 and FY88 and for lending in FY90 and FY91. It also proposes an emergency reconstruction operation, mainly to help with employment generation in FY88. Given the substantial unemployment being created by the closure of tin mines and other reductions in the public sector, the latter seems like a commendable initiative. However, this is a difficult area. Does the Region have ideas on the content of such an operation and on safeguards to prevent it from becoming an open-ended vehicle for income transfers?

Attachment

A Comparison of IDA and SFA Lending for Selected Countries/a
SDR Per Capita Per Annum

	FY85	FY86	FY87	Average FY85-87	Average FY88-89
LAC					
Bolivia MIS	-	9.9	9.8	6.6	8.2
DCB	-	9.9	11.1/b	7.0	11.1/b
Haiti	6.0	-	9.8	5.3	4.3
EMENA					
Yemen AR/c	3.0	5.5	3.9	4.1	3.4
Yemen PDR/c	9.7	-	7.0	5.6	5.0
Sub-Saharan Africa					
Benin/c	1.3	2.7	7.4	3.8	5.3
Burkina Faso/c	9.5	-	3.2	4.2	4.8
Burundi					
IDA Only	6.9	7.8	4.6	6.4	5.4
Inc. SFA		14.7	8.2	10.0	
Ghana					
IDA Only	9.3	6.6	4.7	6.9	6.5
Inc. SFA		12.0	10.8	10.7	
Madagascar					
IDA Only	7.0	4.9	5.7	5.8	5.2
Inc. SFA		10.5	10.8	9.4	
Malawi					
IDA Only	5.7	5.8	5.2	5.6	7.1
Inc. SFA		16.2	8.8	10.2	
Niger					
IDA Only	2.7	9.0	6.6	6.1	9.4
Inc. SFA		20.2	6.6	9.8	
Senegal					
IDA Only	3.8	9.5	5.7	6.3	6.1
Inc. SFA		16.6	8.9	9.8	
Zambia					
IDA Only	8.1	12.8	8.2	9.7	8.1
Inc. SFA		23.5	16.5	16.0	
South Asia					
Bangladesh	2.8	4.5	3.5	3.6	4.5
Bhutan/c	7.7	-	5.0	4.3	4.5
Nepal	5.5	1.9	5.8	4.4	3.1

/a IDA Lending data are from the MIS as of end October unless otherwise specified.
/b Assumes a lending program of $82.5 million (SDR 68.8 million) a year, the mid-point of the range recommended in the DCB.
/c Countries without adjustment lending in the current program.

CONFIDENTIAL

BOLIVIA - DIVISION COUNTRY BRIEF

A. Introduction and Background

1. The Bank's management last reviewed a CPP for Bolivia in December 1976. Bolivia's program has been discussed since then on several occasions, notably an OPSC review of a Bolivia strategy paper in August 1983. Within the past year, several papers proposing a new approach have been discussed, most in conjunction with the Reconstruction Import Credit approved in May 1986, and a joint Bank/IMF Framework Policy Paper was reviewed by the OPC on October 22, 1986. The objectives of this brief are to highlight major strategic issues for Bank operations in Bolivia for the next two-year period, with a focus on proposals for lending and ESW programs, issues for Bolivia's medium- and long-term development which underlie the operational proposals, and suggestions on ways to manage the very real risk that the Government policy direction could change, calling for a shift in the Bank Group role.

2. The setting for the present review is the sharp change in Bolivia's fortunes and the direction of economic management since August 1985. The new democratic Government led by President Paz Estenssoro has followed an extraordinary economic stabilization and adjustment program. As recently as six months ago this program was expected to spur growth in the economy this year. However, several unexpected external shocks have undermined short-term growth prospects; the collapse of the world tin market and drop in hydrocarbon prices have delayed Bolivia's recovery and accentuated the medium and long-term dilemma presented by Bolivia's heavy dependence on export commodities which face major uncertainties. At present, the economy is still in a recession and, while the Government remains committed to maintaining its tight stabilization program, the resumption of economic growth is now the paramount objective.

3. The Government is seeking large scale Bank Group assistance to support its adjustment and development programs. They wish us to play a central role in resource mobilization and aid coordination, lending for new programs, and economic and sector work in support of economic policy reforms. We have already increased markedly our activities in Bolivia, notably with approval of a total of US$70 million in IDA credits for the Reconstruction Import program and a Gas Recycling Project in FY86 and increases in staff resources devoted to Bolivia (the work program calls for 680 staffweeks in FY87 compared to 447 staffweeks in FY86 and 316 staffweeks in FY85). We are far advanced with preparation of a Consultative Group meeting (the first since 1977) in December 1986. However, if we are to respond to the challenge to assist the Government in its programs, still higher levels will be required, as we must rebuild our lending programs almost from scratch and greatly expand our economic and sector work. Specifically, Bolivia cannot be considered creditworthy for Bank lending now and a sharp increase in IDA resources is justified by Bolivia's poverty and excellent economic management performance under the Paz Estenssoro Government. We recommend in this paper a lending program of

US$70 increasing to $95 million in IDA credits a year for the FY87-91 period. Management of this program will require particular care as it is based on an optimistic scenario which assumes continued momentum in introducing further economic reforms. The alternative scenario would be sharply reduced lending for recovery of productive capacity and institution-building support. Given the volatility of the situation in Bolivia we recommend a review by Regional Management of the strategy and related programs in one year's time.

B. Political and Social Context

4. The most marked feature of Bolivia's political background is the extraordinary record of political instability: over 180 governments have held office since independence in 1825 and six presidents (military and civilian) have held office since 1979. Wide swings in ideology from far left to far right have characterized these governments. Results have been a high measure of uncertainty, the erosion in confidence in the Government, very high levels of corruption, and a breakdown in basic Government services and in law and order. Unions throughout the economy are active and strikes are endemic, a symptom of the adversary relationships between government and workers which are most striking for the troubled mining sector.

5. The present government of President Paz Estenssoro, elected in July 1985, took office in a period of unprecedented economic crisis with inflation running at what may have been 28,000% a year. The new President emerged as a leader of Bolivia in the 1940s and has served twice before as president, notably presiding over the 1952 revolution which nationalized many enterprises (including the mines) and introduced agrarian reform. Now 78 years old, the President has set about to create a "new Bolivia". He has set a path of reform totally at odds with his previous record. The population or at least the political leadership has to date supported him in his reform efforts: the argument is that having reached the depths of economic chaos there is wide recognition that far-reaching changes must come about and a willingness to weather the consequences, at least for a time.

6. Behind this general facade of strong leadership and support there are intense internal debate and many tensions. The President is highly skillful in playing off internal political alliances against each other and has shown himself willing and able to tackle frontally vested interests, including the powerful drug barons. The two major parties - the MNR of President Paz Estenssoro and the ADN, led by General Banzer, have struck a somewhat uneasy truce. Within the MNR, however, tensions are becoming increasingly apparent, and are presently reflected in different approaches to handling the social dimensions of the adjustment program. If the MNR wing which advocates more expansionary policies gains ascendence, there is considerable risk that the rigor behind the economic reform program will flag. In addition to these major party struggles large numbers of left and right wing parties are active in the Congress and outside. There is active and open debate on policy issues in Bolivia now, with a free and vocal

press and constant questioning of policies and results. The political situation is thus difficult, with continual challenges to government policies and possibilities of changes in government. Nonetheless, the Government has weathered 15 months since taking office and has shown its ability to stay the course on economic policy and to win major victories in the Congress, notably the passage in May 1986 of a new tax reform law.

7. In sum, the President has showed great vision and courage in launching and pursuing a new economic policy and he, as a long-standing nationalistic leader, is uniquely positioned to introduce the far reaching changes Bolivia needs. He has assembled a cabinet, mostly from the private sector, of extraordinarily able and principled individuals to pursue the stabilization program. The situation is fragile, however, with challenges from all sides. External support is essential and is seen as a key element in the equation of sustaining the present policy stance.

8. Bolivia faces deep-seated social problems, with an essentially dual society and wide disparities in incomes. The majority of the population is Indian in origin and, despite universal adult suffrage, a large part of the population is effectively estranged from Bolivia's socio-political life. One half of the population does not speak Spanish fluently and Bolivia's government has traditionally been run by the 'white' Spanish speaking and western oriented elite. This situation presents long term issues and challenges for Bolivia. In the immediate future, it accentuates the importance of effective action to address the social impact of economic programs and to launch efforts to remedy the weak social services (health, education) which contribute to the dismal social statistics on Bolivia - highest infant mortality rate in Latin America, lowest access to piped water, etc. In the longer term, issues of social policy should figure prominently in our operational program and we plan to start work on social sector reviews to provide a basis for long term action plans. Bolivia will be one of the LAC Region's countries where the role of women in development will be emphasized. This work will focus on monitoring the poverty impact of adjustment programs and on defining social action programs. It may also offer a vehicle for defining approaches to the more fundamental social issues facing Bolivia.

9. Bolivia's rapid population growth rate raises important issues. Statistics are particularly poor but best estimates indicate that the population of about 6.5 million is increasing at about 2.8% a year. The official Government stance is that Bolivia has ample land resources to support a much larger population; underlying this position is the racial dimension of population policy issues and an unwillingness to broach the topic which is very sensitive. We do see population as an important issue because of its impact on prospects for employment, development of human capital and poverty alleviation. We propose that the most effective approach to the problem at this stage would be the proposed initiatives to define social action programs, with a focus on health care and the role of women. The problems posed by rapid population growth should remain an important theme in our policy dialogue.

10. The growth of the cocaine industry in Bolivia over the past six years has had far-ranging effects on the economy and society. These issues have come to the forefront in recent months with a strong Government commitment to curtail the trade and joint US-Bolivia military intervention

during the summer of 1986. The problem is enormous as coca accounts for a large part of Bolivia's economy and legal exports are well below earnings from cocaine. The drug interests are powerful and play an increasingly pervasive role in the economy and in politics. The Government sees also an alarming incidence of social problems in Bolivia linked to drugs (addiction, crimes, alienation of large groups, disruption of traditional agriculture). The Government has therefore decided to address the problem frontally with a program designed to eradicate coca production and processing (except for traditional uses). Following an international appeal by the Government launched through the U.N. in October 1986, an agreement was signed with an American Government team in La Paz in late October to implement a comprehensive program, whose cost over three years is about US$300 million. Whether the Government has the capacity to implement this program fully is doubtful. A number of senior officials are strongly rumored to have coca-industry links and the large amounts, estimated between US$200 and 600 million, of coca dollars repatriated each year have been strategically invested to support trade union organizations, key private sector industries, prestige ranches, and social infrastructure supporting the growing areas. A number of towns are well-endowed with good schools and infrastructure support for a captive local work force e.g. Santa Ana. The American troop presence over a period of 120 days this summer and autumn temporarily dislocated the market price of coca leaves by frightening away the middle men but within ten days of troop departure coca leaf prices compatible with early 1986 levels were restored. This issue is likely to figure prominently in discussions of Bolivia's problems and prospects in the immediate future. We consider it important that we make special efforts to understand the situation - notably the economic impact of the cocaine industry and its possible sharp reduction, and the specific development consequences of the proposed eradication schemes.

C. Economic Background

11. Bolivia's precarious economic situation is described in two recent documents: Updating Economic Memorandum for Bolivia (November 3, 1986), and the joint Bank/IMF/Government Policy Framework Paper (November 6, 1986). This section summarizes briefly the Paz Estenssoro Government's economic legacy, the Government's economic program, the record of performance to date, projections for future growth and resource needs, what we see as underlying adjustment issues, and prospects and needs for external resource flows.

12. The Legacy. The chaos of Bolivia's economy in July-August 1985 is well documented but the salient features were the hyperinflation, which ran at some 24,000% over the one year period ending September 1985, an exchange rate system where the parallel rate exceeded the official rate by 20 times, Government deficits approaching 30% of GDP, a large unmanageable debt, and a tax effort which declined to about 3% of GDP, making it one of the lowest in the world. Bolivia had run up a debt of some US$4 billion, most of which was not being serviced; arrears stood at about US$1 billion in August 1985. GDP fell by 30% over 1981-85 and the situation of Bolivia's population was notably worse than it was 20 years earlier.

Behind these figures was a state apparatus running out of control, a far-ranging breakdown in Government services including those responsible for economic management, and a sharp decline in investment, public (because it could not be managed or financed) and private (because confidence in the economy was almost nil). Bolivia's export earnings were heavily dependent on tin and gas, both of which have had heavy state intervention. Bolivia's mining industry, in particular, was exceptionally vulnerable to external shocks as it was high cost with virtually no effective measures to explore new resources or to put the industry on a sound, modern footing.

13. The Government's Economic Program, introduced in August 1985 with important additional measures over the coming year, is a far-ranging, ambitious effort to achieve stabilization and bring about fundamental adjustment in the economy. The program is, for the short term, centered on sharply reducing deficits of the non-financial public sector, and more broadly, curtailing the state's role so as to encourage a free market economy. Noteworthy features are the absence of controls on prices and wages (outside the public sector) and a free exchange rate system based on a daily public auction. Important measures include laws on public employment which eased restrictions on firing, passage of a far-ranging tax law, and reforms in the trade regime, including a uniform 20% import tariff. The economic program includes in outline and in some instances very specifically, plans for fundamental structural adjustment, with a strong focus on addressing the problems of the public enterprises. The aim behind these measures is to bring about a sharp reduction in the public sector, including employment, and to put public enterprises on a sound financial and economic footing. A comprehensive program to introduce an integrated financial management system for the Government is at an advanced planning stage. Bolivia aims to reestablish normal relations with its debtors, starting with the Paris Club and including commercial banks. It also sought quickly to reestablish relations with the IMF.

14. Record of Performance. The record of the Government's first 15 months in office should be viewed as extraordinary. The stabilization policies introduced in August 1985 have been implemented with vigor, despite many challenges to them, internal and external. Perhaps most notable is that the lid has been kept on public sector wages and on government spending. Inflation has run at some 2% a month since early 1986. The exchange rate is free and stable. Major progress has been made in freeing prices and in raising tariffs. The Government has made significant progress in regularizing relations with creditors, notably the Paris Club Agreement in June 1986. The problems the economic team have faced have been far worse than anticipated because of the sharp reverses in market prospects for Bolivia's two major exports - tin and natural gas. Nonetheless they have sustained a coherent policy stance taking these new developments into account.

15. The major weaknesses in policy can be seen in the areas of public investment and general government administration, and in the absence of explicit measures to address the social consequences of adjustment. For public investment, the Government has only recently started the full-scale review of ongoing and planned programs required to boost investment levels and ensure that they are efficiently managed and geared towards the Government's recovery objectives. If international support is to be mobilized and used well, a disciplined effort to improve the management of public resources is urgently required. More broadly, despite important

measures already underway to cut back public sector employment and to improve key services, the administrative apparatus which must implement policy change is still extremely weak and decision-making across the board is slow and uncertain. Carefully targeted efforts to build key services and cut some red tape are essential if the Government is to follow through on the policy initiatives already taken. The Government is well aware of this critical problem of implementation - a Government powerful with the policy pen but much less so in following through on its decisions. The problem is that, to date, only a small part of the changes introduced can be seen as truly "institutionalized". This conundrum underscores the importance of vigorous institution-building efforts targeted in the first instance to the key areas of economic policy management (Ministries of Finance and Planning, Central Bank, and Contraloria General) which manage the financial control system. We see a strong focus of Bank assistance on the implementation of policy reforms. Another area where priority attention is needed is in monitoring and acting to alleviate the social impact of adjustment policies. To date, virtually no systematic action has been taken in this domain. The strong response of the miners to lay-offs has seriously cramped reforms of COMIBOL, the mining public enterprise. It has brought home the need to design an effective social action program to ensure that social issues are understood and that the Government responds, within the severe constraints upon its administrative and fiscal capacity, to the most urgent social needs. During an October meeting convened by the UN Secretary General, the Government appealed for international support for a Social Emergency Fund. However, this remains little more than an idea and much work is needed to prepare sound proposals for putting it into effect.

16. Economic Projections. Our projections on future macroeconomic developments are detailed in the Updating Economic Memorandum. Tables 1, 2, 3 and 4 present a summary. The projections are admittedly based on optimistic assumptions: they presume the continuation of the Government's current macroeconomic policies - including the maintenance of stabilization programs and continued structural adjustment measures at the macroeconomic and sector levels. It assumes an increasing level of investment, public and private, within the period. With this scenario, GDP growth of about 3-1/2% a year should be achieved. Even with this rate of growth, per capita incomes in 1995 will be the same as 1985. This scenario suggests broadly that with strong external support Bolivia can maintain equilibrium in internal and external accounts through the early 1990s. Thereafter the present scenario shows a sharp deterioration in the external accounts as repayments to the Paris Club and to the IMF fall due and the important natural gas contract with Argentina expires. Longer-term growth and financial equilibrium will depend on Bolivia's ability to: (a) restructure its debt in a radical manner; (b) maintain what must be seen as high levels of growth and investment; and (c) develop major new sources of export earnings. Under present assumptions, therefore, Bolivia clearly cannot be considered creditworthy for Bank lending; it stands, rather, in urgent need of a sharp increase in financing on highly concessional terms.

17. We have reviewed several less optimistic scenarios. The "worst case" involves a return to the types of policies followed before August 1985 and the consequences are clear from that history. With intermediate scenarios which are based on less vigorous adherence to present adjustment policies Bolivia cannot achieve any significant level of growth and the

prospect is for a continued or worsening recession. The gaps in the external account widen, and per capita incomes fall. In sum, unless there is sustained commitment to the reform program coupled with high levels of external support, the substantial achievements to date will founder.

18. We consider the most critical variables for future growth, tied to Government policy, to be: (i) maintenance of a free and competitive exchange rate, (ii) maintaining free prices within the economy, (iii) active measures to promote export growth and diversification, notably a favorable trade regime based on low import tariffs and no re-introduction of restrictions on exports, (iv) effective measures to bring about further reductions in direct public sector involvement in productive activities, (v) progress in stimulating private investment, and (vi) an increase in the amount and efficiency of public investment.

19. Major Economic Adjustment and Issues. The major adjustment issues for the medium-term for Bolivia may be briefly summarized as follows:

(a) Redefinition of the Role of the State. A central tenet of the Government's new economic policy is a sharp reduction in public sector intervention in and management of the economy. The issue now is how to carry this into practice by sustaining and enlarging measures taken already to free prices and dismantle the complex web of controls which has been created over the past 30 years, to reduce the scope and sheer size of the public sector, and to make public services more effective and efficient, geared to supporting a free market economy. This constitutes an enormous challenge for Bolivia as the public sector is one of the biggest and probably most inefficient in Latin America. Large numbers of public entities operates in a confused policy environment and public sector employment is around 200,000 or about 30% of total wage employment. Public enterprises dominate key sectors, notably mining, energy and transport. The objectives for the medium-term are thus to restrict further the public sector role by reducing the number and size of institutions (including large reductions in public sector employment), to redefine administrative procedures to reduce and simplify them dramatically, and to rebuild basic public services starting with those central to management of the economy (Ministries of Finance and Planning, Central Bank, Controller General). In the medium- to long-term, far-ranging civil service reforms including adjustments in salary scales will be required.

(b) Financial Equilibrium. Bolivia faces three imperatives to achieve lasting adjustments to bring its internal and external accounts into balance: first, tax revenues must be increased by implementing the Tax Law passed in May 1986. This effort is just now beginning but needs to be pursued with vigor; second (and related to the redefinition of the role of the State) public sector spending must be reduced and redirected to productive ends, notably investment; and third, Bolivia, with external support, must seek a restructuring of its external debt as this cannot be serviced with present foreign exchange resources.

Reschedulings of debt offer a very partial solution because of the financial difficulties foreseen for the early 1990s. Bolivia offers features, notably the exemplary policy performance, poverty of the country, and relatively small size of the debt in international terms, which suggest that radical solutions to the problems of commercial bank and possibly bilateral debt should be explored.

(c) Export Diversification and Promotion. Bolivia has seen the virtual collapse of markets for its two major exports, tin and natural gas, over the past year. While prospects may improve, especially if a project to export gas to Brazil proves viable, these developments underscore the need to diversify exports and to promote actively exports other than tin. The most favorable prospects are development of commercial agriculture in the Santa Cruz Department (which should be stimulated by the opening of the waterway to the Atlantic via the Paraguay River) and exploitation of a range of metals other than tin. What is needed is an active policy stance promoting exports, translating President Paz' statement "Either we export or we die" into practice.

(d) Public Investment. Major efforts are needed to boost levels of public investment and direct it to productive ends. This is feasible because there is a large pipeline of financed but undisbursed projects (around US$1 billion) but difficult because management of this portfolio is poor and responsibilities highly fragmented. Lack of counterpart funds and the acute administrative weakness of implementing agencies have slowed implementation severely. High priority must go to speeding implementation of the portfolio which for the most part consists of reasonably sound investments, followed by measures to establish a decent investment preparation, screening and programming process. In the interim a challenge will be to avoid bad investment decisions, as several "white elephants" with strong sponsors are waiting in the wings. Although some of these ideas have been around for many years, neither we nor the Government now has adequate up to date information on them. This underscores the importance of an early focus on the public investment review. This effort has barely begun and much work remains.

(e) Private Investment and the Financial Sector. The motor for future growth is to be the private sector but it has been very slow to resume investment despite the favorable policy environment. The structure of the private sector (geared to trading and quick return ventures), decades and even centuries of bad habits, and an understandable concern with political and economic policy stability present a particularly difficult problem in efforts to reactivate investment. One area is susceptible to immediate action: restructuring the troubled financial sector. Work is underway to prepare proposals that would put the banking system back on a sound footing and thus ensure that financing for private investment is available. Other policy objectives should be special efforts to convince private operators of the Government's commitment to continuity in economic policies, improve information flows and, for the public and private sectors, to prepare and, in appropriate instances, participate in promising investment ventures.

(f) Social Sectors. Bolivia's deep-seated social problems suggest that during the adjustment period priority should be given to preparing actionable social service programs in critical areas, notably health and primary education.

(g) Environment. Bolivia faces important long-term ecological issues both on the Altiplano (land degradation) and in the lowlands. It would be prudent to initiate soon a careful review of issues with a view to presenting a strategy for addressing environmental issues in the medium- to long-term.

20. Prospects and Needs for External Resource Flows. Bolivia will require substantial transfers of external resources to close the balance of payments gap and allow growth. Given the difficult medium and long term prognosis for the external account, it is important that this assistance be on highly concessional terms. The Bank's economic projections assume that these needs are met primarily by bilateral and multilateral disbursements and direct foreign investment (Table 4). For 1987, the estimates are as follows: multilateral gross disbursements US$282 million (including IMF), bilateral gross disbursements on loans US$132 million, official assistance on grant terms US$95 million, and net direct foreign investment US$20 million. No new financing from commercial banks is assumed with the exception of capitalization of interest. The solutions worked out for the commercial bank and Paris Club debt will have a major impact on actual financial requirements in the ensuing years, but the projections indicate increasing needs for external financing through the early 1990s.

D. Past Bank Group Operations and Bolivia's Relations with Other Agencies

21. The Bank Group has been actively involved in Bolivia since 1964. Total lending to date stands at about US$460 million; 16 credits, 15 loans, and one blend operation have been approved. Of this, US$295 million is outstanding and, as of September 30, 1986, US$86.5 million was undisbursed. Bolivia was an IDA country until 1975 (except for the Gas Pipeline loan), then borrowed for several years on Bank terms until the economic situation begun to deteriorate around 1978. An ill-fated structural adjustment loan was made in 1980 and its failure combined with worsening creditworthiness for the country and deterioration of economic management led to the cessation of Bank and IDA lending between FY81 and FY86. As a result our present portfolio (leaving aside the two operations approved in late FY86) is very small, consisting essentially of small remaining parts of old projects, most of which have had a troubled history. They were designed in a different era and were implemented during a period of economic turmoil with Bank/IDA disbursements stopped several times as Bolivia failed to service its obligations. The undisbursed balance on this portfolio stood at US$15 million as of October 31, 1986, and a large part is likely to be cancelled before the end of this fiscal year. By FY88, none of these older projects will remain alive.

22. Past Bank lending has been quite far-ranging and diverse, with an active involvement in several sectors, notably transportation (26% of total lending) and hydrocarbons, where the Bank played a key role in developing Bolivia's gas export potential. Other sectors where the Bank has been actively involved are power, mining (largely credit operations for the private sector), water supply, and urban. Our record in agriculture has been mixed, with some successful operations in earlier years focussed on the livestock sector; three more recent (two still ongoing) rural development projects have, however, faced serious implementation problems. Execution of many on-going projects was affected adversely by the shortage of local funds, changes in Government personnel, and periodic suspension of Bank disbursements and as a result the conclusions of recent PPARs have been quite negative, notably for the 1980 Structural Adjustment Loan. The current Government has made praiseworthy efforts to improve portfolio performance but faces a difficult, and in some instances, virtually impossible task in trying to resuscitate flawed or outmoded operations. Recent economic reforms and the appointment of qualified project managers by the current Government are expected to improve project execution in several cases.

23. While no new operations were approved between 1980 and May 1986, the Bank provided substantial technical assistance through its economic and sector work which was focussed on critical impediments to Bolivia's development. Many recommendations resulting from these efforts provided the basis for the current Government's stabilization and structural reform program and underpin specific programs now under active preparation; on the other hand, many reports remain on the shelf and events have largely bypassed them. Specific efforts included a comprehensive study on COMIBOL rehabilitation in 1981, proposals for mining tax reform, analyses of mining investment laws and fiscal reserve, a proposed reorganization of the troubled Agricultural Credit Bank (BAB), studies on pricing issues for agriculture, a sector paper on transport, an energy assessment, and a program proposing a full overhaul of auditing and procurement practices. These provide a fairly good base for our present efforts to support the Government's adjustment program and start to rebuild a lending program. Nonetheless, the very small size of the current portfolio and of our recent operational program plainly presents important disadvantages, and calls for special efforts to rebuild our knowledge of various sectors and to move quickly in preparing new lending operations in what remains a difficult operational environment. Our limited recent involvement is particularly apparent as we seek to review the public investment and expenditure programs. This work will require, in many sectors, a heavy initial investment in reconstituting knowledge of the sector.

24. The Bank response to the new policy initiatives launched in August 1985 was rapid and during that fiscal year two IDA-financed operations - the Reconstruction Import Credit for US$55 million to finance imports for key sectors, and the Vuelta Grande Project for US$15 million - were approved. The Bolivia country team was retailored with the creation of a new division in the Bank and an ambitious program of project preparation (supported by five new PPFs) and economic and sector work was launched. The Resident Mission in Bolivia has been reactivated with the appointment of a new Resident Representative in October 1986. Finally, the Bank has agreed to resurrect the Bolivian Consultative Group (dormant since 1977) with a first meeting in December 1986.

25. During the period of limited Bank involvement (1980-85) the IDB maintained an active presence in Bolivia, reflected in their current large project portfolio which stands at about US$460 million in undisbursed commitments. IDB has lent largely for transport and energy investment but also has important technical assistance efforts ongoing. The UN system also remained actively involved and the Secretary General himself, and other senior UN officials, have taken a lead in appealing for international support for Bolivia in recent years. IFAD has a relatively strong involvement in the agriculture sector, mostly for relatively small but quite soundly-conceived projects. The Fondo Financiero para el Desarrollo de la Cuenca del Plata (FONPLATA) and the Corporacion Andina de Fomento (CAF) provide some financing, although their terms are not very concessional. Among the bilateral agencies, Argentina and Brazil have been by far the most important, reflected in their current 50% share of Bolivia's bilateral debt. Most support has been supplier credits with some technical assistance and, in the case of Argentina, an important role for countertrade. The USA has a longstanding special interest in Bolivia, which has taken on special significance with the increasing prominence of issues around the cocaine trade. Other bilateral agencies with significant programs are the UK, Germany, and Japan, and, to a lesser extent, Switzerland, Holland, and Denmark. These latter countries have followed the developments of the past year closely and have expressed interest in supporting Bolivia's development efforts. Other important actors are non-governmental organizations, which are very active in Bolivia (some 197 operate there) but there are important problems in coordinating these activities. In sum, Bolivia has long been a country where external assistance plays an important role and there is evidence of particular interest in supporting Bolivia's program now. Aid coordination is poor, however, with information exchange limited and considerable overlapping in activity and even contradictory programs. This gives special importance to the Consultative Group as a vehicle for improving aid coordination by improving information flows and supporting the Government in presenting to donors and carrying through a coherent development program.

26. Original commercial bank debt in Bolivia stands at about US$650 million in principal but would total at least US$900 million if unpaid interest, penalties, etc. were added in (the latter figure is subject to dispute as there is, no legal agreement as of yet). It is held by some 140 banks, with US banks holding the lion's share. Bank of America chairs the Bolivia Advisory Committee. Bolivia has not serviced its commercial bank debt since March 1984. Several meetings have been held within the past year (most recently in September) and progress is being made. There is recognition on both sides that innovative solutions will be required and possibilities under discussion include debt equity swaps, interest subsidies, and buyback of Bolivia's debt at a deep discount. Recourse to new commercial bank lending in the short- and medium-term seems unlikely.

27. Bolivia's relations with the IMF over the past year have been good. A one-year Standby agreement was approved in June 1986 and Bolivia has met virtually all performance targets by comfortable margins. The Fund staff is now preparing to present proposals for access to the Compensatory Financing Facility and the Structural Adjustment Facility in December. Discussions on a further Standby are likely to begin in the spring of 1987.

E. Bank Assistance Strategy and Operational Program

28. The Government's stabilization program and medium-term strategy for economic reconstruction, recovery, and growth provide a good framework for an expansion of our operations in Bolivia. Our proposed assistance program, including economic and sector work, should allow us to be an active partner in the Government's efforts to rehabilitate the economy's productive capacity and play a central role in monitoring and supporting the implementation of policy reforms. Specifically, our strategy will focus on assisting the Government to: (i) sustain the implementation of the macroeconomic stabilization program and carry through structural adjustment reforms including specifically a change in the role of the state; (ii) rehabilitate and restructure the agriculture, mining, and hydrocarbon sectors with the view to diversifying exports and achieving efficient import substitution; (iii) reconstruct and rehabilitate essential infrastructure to minimize bottlenecks to increased production and to support increases in private investment; (iv) support major increases in public and private investment notably through strengthening the public investment program, enhancing the investment climate through appropriate policy measures, and reforming the financial sector; (v) alleviate the direct social impact of the stabilization programs especially on lower income groups; and (vi) reintroduce discipline in public sector management and administration to support the effective execution of the economic reforms and management of the economy. We also expect, in collaboration with the IMF, to support the Government in its efforts to restructure its commercial bank and bilateral debt.

29. In line with the above strategy, we will endeavor to (i) increase the quantity and quality of our economic and sector work program; (ii) strike a balance between policy-based and regular project lending with substantial institution-building components; (iii) to the extent possible, increase the size and number operations of IDA lending to increase the transfer of resources and rebuild our operational portfolio; and (iv) help to coordinate aid flows to Bolivia and participate in working out Bolivia's indebtedness problems including participation in commercial bank and Paris Club discussions.

Economic and Sector Work Program (ESW)

30. Through our proposed ESW program (FY87-89) we aim to continue a productive policy dialogue with the Government and assist in elaborating a realistic and actionable medium-term policy framework and a sound medium-term public expenditure program. Further, some planned studies would help rebuild, update, and fill in gaps in our knowledge of key sectors and could become the basis for policy-based and project lending and enable us to establish parameters and indicators for monitoring the performance of Government adjustment policies and programs.

31. The proposed ESW program for FY87-89 is as follows:

(a) an Updating Economic Memorandum has been prepared for the December 1986 Consultative Group Meeting. It provides a review of the new economic policies and performance in implementing them, and presents medium-term economic projections.

(b) the first stage of a Public Investment Program (PIP) Review has been completed, focusing on the analysis of the composition, level, and implementation constraints of the Government's 1986 and 1987 investment programs and a preliminary review of the agency project proposals for future years. A summary of findings has been circulated to the CG. A second stage in-depth Public Sector Expenditure Review (PSER) will be undertaken in the second half of FY87 (i.e. after the CG Meeting). The PSER will aim to provide advice and support to the Government in improving resource allocation and management as Bolivia moves from short-term stabilization to medium-term growth. It will entail in-depth reviews of sector strategies and investment and expenditure programs, criteria and means for developing investment programs and projects, and institutional mechanisms for project identification, screening, monitoring and implementation. A key objective is to ensure that investments are focused on the Government's strategic priorities within the macro-economic framework, including resource availability. We expect to undertake more limited public expenditure reviews on an annual basis in FY88 and FY89.

(c) Medium-Term Policy Framework. A joint Bank/IMF/Government Medium-Term Policy Framework Paper for the Structural Adjustment Facility has been completed (November 6, 1986) which outlines major macroeconomic and sectoral objectives in the medium-term. The FY87 work program (which did not include the SAF paper) includes a medium-term work-out paper to be prepared at the end of the fiscal year. If discussions during the CG meeting with multilateral and bilateral donors indicate that an elaboration of the medium-term scenario would be useful, we will update the PFP at the end of FY87-early FY88. In conjunction with the medium-term policy framework we plan to assist the Government with the analysis of the social impact of adjustment programs (with an emphasis on families) and of employment issues including specifically handling of redundant labor.

(d) Export Prospects. In preparation for the medium-term policy review we undertook a consultant review of export prospects which is being issued as a divisional working paper. This document provides a commodity-by-commodity review of past and proposed exports and a review of policy issues and institutional mechanisms needed to promote growth and a rapid, far-ranging diversification of exports. A major conclusion is that Bolivia's strategic focus for the medium-term should shift to Santa Cruz and agriculture geared to the Brazilian market and export via the Paraguay river system.

(e) Private Sector Investment Issues. Also in conjunction with the medium-term framework a working paper on private investment issues is being prepared. It provides an analysis of the Bolivian private sector and its present approach to investment and makes proposals on improving the investment climate and stimulating private investment.

(f) Country Economic Memorandum (CEM). We plan to prepare a full CEM in FY88 to provide an in-depth analysis of the Government's economic policies and performance and thus to underpin our dialogue with the Government on economic adjustment issues.

(g) A regional study of the Santa Cruz Department is planned for FY88 to provide a basis for development programs aimed at tapping the region's agricultural potential. The Review would address major strategic issues (assessing the Brazilian market, for example) and identify major bottlenecks to development (transport, land titling, services, credit, and agricultural research, for example). This study is urgent and should be advanced to FY87 if resources are available.

(h) A Financial Sector Study has started in FY87 and will be completed in FY88, to analyze the major problems and key policy constraints afflicting the Central Bank and the private banking sector and recommend measures for the system's rapid rehabilitation and restructuring to avoid a financial crisis that could set back the rehabilitation. This effort will be linked closely with the preparation of a possible policy-based financial sector loan (FY88) and will draw from the analyses and recommended actions under the proposed institutional development project for Public Sector Financial Management (FY87).

(i) Sector studies in agriculture, transport, health and nutrition and education are programmed in FY87 through FY89 to provide a comprehensive view of the status, problems and strategies for rehabilitation and development of these sectors. In addition, supervisory assistance will be provided to the Government in developing a UNDP-financed Energy Master Plan which will be a follow-up to the work carried out by the Energy Assessment of April 1983. Among the objectives of the exercise will be to propose energy sector strategies, identify investment possibilities and priorities, improve the financial viability of key energy institutions and improve the coordination of the energy sector.

(j) A study of employment problems and prospects will be initiated in FY88 and completed in FY89 which will examine the employment implications of the economic reform programs. A Poverty Study with a comprehensive analysis of basic needs, social indicators, the impact of the stabilization and adjustment programs on the poverty groups will be undertaken in FY89 and completed in FY90 as part of a Bank-wide effort on poverty analysis.

(k) A strategy statement on the role of women-in-development is planned for FY88 to review the results of analysis initiated in FY87 (monitoring of impact of adjustment programs, social services review) and make proposals on future action.

(1) A number of additional areas for such analysis have been identified and could be considered if resources are available. A first is a review of data sources and availability with a view to defining a program to improve information. A second possibility would be a full review of ecological issues to prepare an action plan. Third, given the active presence of NGO's in Bolivia a review of their activities with a view to defining better coordination mechanisms and areas for joint approach would be useful.

Proposed Lending Program

32. Bolivia's needs for assistance are enormous and areas where the Bank Group could provide effective support are myriad. This is particularly true because of the hiatus in lending from 1980-86 so that virtually all older projects are closed or near closing. Thus we need to rebuild and expand our program simultaneously. Our ability to expand our lending program will be determined first, by the Government's success in sustaining the economic program, second by IDA availability, third by staff resources allocated for Bolivia, and fourth by the Government's absorptive capacity for policy and institutional reform and investment. Our strategy is to build as rapidly as possible towards an effective lending program in the sectors which are critical for economic recovery and adjustment and to use our project preparation and appraisal work as a vehicle for assisting the Government in resource mobilization; thus cofinancing would be sought actively in all appropriate cases. Given the need to reactivate operations in many sectors, this suggests that the very limited IDA resources will tend to be distributed quite thinly among different operations. However, there are strong arguments for a wide involvement across sectors--notably the potential catalytic role we can play in mobilizing external resources, and the demand for broad knowledge of investment programs dictated by our own role in assessing the public sector expenditure program.

33. Our proposed lending program is based on two scenarios: (i) a high case of US$70-95 million (for three to four operations) per year through FY91 if the Government stays on track and keeps up the momentum of reforms (see Attachment I); and (ii) a low case of about US$20-30 million a year focussed on recovery of productive capacity and institution-building. The high case scenario gives priority to (i) policy-based lending for short-term recovery and rehabilitation, specifically programs linked to private sector investments and sector based policy reforms; (ii) institution-building support to assist in rebuilding priority public services and support improvements in the public expenditure management processes; and (iii) investment projects for the agriculture, transportation, energy, and mining sectors with emphasis on reduction of bottlenecks to production and processing. Modest resources are allocated for the social sectors; our aim would be to maximize cofinancing from other donor agencies. Social components (education and training, health, water supply and sanitation and urban development) in production-oriented and regional development projects will be encouraged, as appropriate. We have already launched an intensive program of project preparation supported by five project preparation facility advances for mining, energy (2 PPFs),

urban development, and the public sector financial management project. Work in cooperation with the UNDP is currently underway in several sectors, notably agriculture, energy and public sector management, to prepare investment proposals. We recommend work on a relatively large reserve program given the numerous project possibilities identified and uncertainties associated with projects in the regular lending program. Work on these operations should also be seen as part of the effort to strengthen public investment programming and resource mobilization.

34. The objectives for policy-based lending will be to provide quick-disbursing assistance to support the recovery and rehabilitation effort. Such lending will be based on the Government's economic program and include specific conditionality, within the medium-term policy framework. For the first two operations (the first and second Reconstruction Import Credits - FY86 and FY87), the most effective mechanism for assistance is direct financing for imports, linked specifically to recovery programs and key policy changes in the major sectors of activity. The first Reconstruction Credit is effective and, while it has taken longer than expected to start disbursements, the operation is soundly conceived and will provide support to clearly defined sector programs which contribute directly to economic recovery. The second operation, which should be appraised shortly, will be similar in conception, although efforts will be made to simplify implementation mechanisms. The major focus will be on promoting a reactivation of private investment, restructuring the energy sector, urgent improvements in transport, and design of an effective social action program; for the latter, the objective would be to agree with the Government on specific action measures to monitor the impact of adjustment programs and to address their major consequences, notably unemployment. These operations have great urgency and there is thus a premium on moving quickly with design and implementation. Looking ahead, we have included a Structural Adjustment Credit as an FY89 reserve; it would be based on a more comprehensive, well articulated medium-term adjustment program. We will review in one year's time whether a structural adjustment operation is the most appropriate vehicle for ensuring clear agreement on the macro-economic policy framework with the Government, or whether sector-based operations are better suited to Bolivia's circumstances.

35. The FY87-91 lending program includes sectoral adjustment operations in the financial, mining, and transport sectors and agriculture projects which would be based squarely on a medium-term policy framework for that sector. An energy sector adjustment operation is also a possibility but urgent needs would be addressed under RIC II and it is therefore carried in reserve. The proposed Financial Sector Credit (FY88) will be linked to policy adjustment measures in the financial sector and to strengthening of public and private financial institutions. The rehabilitation of financial institutions should improve resource mobilization and ultimately, increase the availability of credit to the private sector on reasonable terms, while minimizing direct costs to the Government arising from insolvent financial institutions. A Mining Sector Rehabilitation operation is planned for FY89(S) which will focus on the policy and institutional changes required to streamline and reestablish a viable COMIBOL operation and stimulate public and private mining diversification. This operation is urgent and should be advanced if work

progresses more quickly than expected. A Transport Sector Rehabilitation operation in FY89 will aim to support major maintenance and some reconstruction works in the road and railway systems and, if appropriate, include the construction of priority feeder roads nationwide. The operation would build on measures included in the RIC I and II operations.

36. A major objective of our operational program will be to support the Government's objective of redefining the role of the state, specifically by supporting institution-building programs for the core ministries and agencies. A first operation in FY87 will focus on financial management and specifically support development of new and better management systems for the Ministry of Finance, the Central Bank (in its role vis-a-vis the financial sector) and the Controller General. Support will be provided for implementation of the tax reform. We expect this to be the first of a series of similar projects aimed to reinforce the Government's economic management capacity. A second operation in FY88 would support improvements in public investment programs including specifically rebuilding the Ministry of Planning on a sound basis and providing resources to support professional reviews of investment proposals, joint financing with UNDP is being explored.

37. Project lending for agriculture, energy and power, and social services will focus primarily on rehabilitation, reestablishing the foundation for growth, and strengthening the sectors' absorptive capacity for future assistance. We expect that all projects will have important policy content and support the broader sector investment and expenditure programs. For the current fiscal year (FY87) we plan a small power rehabilitation project, which includes important studies to prepare a sector investment program, and institutional strengthening measures. For FY88, an urban project will follow on from the successful first project and will be focused on institutional strengthening of the La Paz Municipality and low-cost infrastructure development. In FY88 and 91 we plan two agricultural projects which are tentatively designed to address the development needs of the very different regions of Santa Cruz (commercial agriculture largely for export) and the Altiplano (smallholders subsistence agriculture). Other possible project ideas to explore are support for agricultural services, including credit, and development in the San Buenaventura area; these are carried as reserve projects. An energy sector project to develop LPG exports is included in FY89. The largest potential project investment during the program period is the Bolivian/Brazil gas pipeline (programmed as a reserve project for about US$50 million in FY90). This project, whose total cost could be as high as US$1 billion, has considerable potential for increasing gas export revenues, making Brazil the biggest market for Bolivian exports when the Argentine gas contract expires in 1992. We would propose that this project be considered for IBRD financing set up as an enclave operation with Brazil providing a guarantee based on gas receipts. There are good possibilities for further lending in the energy sector (hydrocarbons) but they are not yet included in the regular program because of uncertainties on future strategy (including unresolved issues on the role of the national oil companies) and limited IDA resources. If concrete proposals are prepared we should consider adding them to the regular lending program. We have included in the FY88 program a special operation for emergency reconstruction and rehabilitation geared towards employing displaced miners and other

laborers. It would specifically address the problems resulting from the stabilization programs and the collapse of Bolivia's major export markets. This operation would support the social action program which the Government is now preparing as a framework for its response to the social consequences of adjustment programs (paras. 15, 34). It would involve the Bank in a catalytic role in mobilizing and coordinating external support for this effort. In the outer years we plan continuing lending for the sectors outlined above, with new lending focussed on the social sectors. The program should be seen as fairly tentative still given the intensive efforts planned over the year ahead by the Bolivian Government to redefine sector strategies, and prepare coherent investment programs.

38. In the design and implementation of the lending program, special attention is needed on implementation arrangements, as this is proving to be the number one constraint to achieving Bolivia's policy objectives. Specifically, program and project design must recognize explicitly the limited implementation capacity of most agencies. Project design should be simple and clearly set out, and intensive supervision efforts will be essential. Given the acute shortage of budget resources and strict ceilings on public expenditures agreed upon with the Fund, we need to consider a high financing share: we propose a 75% share for IDA financing and 90% of total costs in most instances; an exception being institution building projects where we would propose a higher share.

39. If a low-case scenario must prevail, we will plan for one or at most two projects a year. Likely candidates would be export generating and rehabilitation projects in the agriculture and hydrocarbon sectors and very limited involvement in small enclave projects less directly affected by general economic policy problems and preferably with strong cost-recovery components (e.g. Santa Cruz agricultural development; Bolivia-Brazil gas pipeline; La Paz Municipal Development). If an intermediate scenario were to prevail (say US$55-60 million IDA a year) we would plan on reducing the current allocations for individual operations and seek to increase cofinancing in the first instance, but clearly our involvement in several sections would need to be curtailed or delayed. Specific proposed reductions for FY88 and FY89 would be in power/energy sectors and in the emergency program.

Bolivia Consultative Group and Aid Coordination

40. We anticipate an active role for the Bolivia Consultative Group, given the importance of resource mobilization needs for Bolivia. It is likely to occupy a central position in our operational strategy and demand substantial resources to prepare and conduct meetings. The first Consultative Group meeting since 1977 will take place on December 3-4, and will focus on the Government's medium-term strategy, and overall resource needs. The case will be presented for active measures to accelerate existing investment programs, financing for imports, and participation in the ongoing process of redefining sector strategies and investment programs with priority to mining, energy, transport, agriculture, and the social emergency program. It is likely that specific working group meetings on these sectors will be recommended as a result of the meeting and, possibly,

informal coordination meetings to review the Government's cocaine eradication proposals and the urgent appeal for support for the Emergency Social Program. A second formal meeting of the Consultative Group is planned for October-November 1987, at which time a full public investment program for 1988-90 and a review of priorities and issues by the Bank should be completed. We plan to hold a formal Consultative Group meeting each year.

41. Relations with the Fund. Close collaboration between the Bank and IMF staff has been established and efforts will be made to maintain this relationship without sacrificing each institution's independent judgement and interests. Close collaboration will continue in the months ahead in connection with the Bank's Second Reconstruction Credit, the Public Sector Financial Management Project, and Financial Sector Credit, which entail overlapping concerns with the IMF, and annual updates of the policy framework for the structural adjustment facility.

42. Relations with IDB. Special efforts will be needed to maintain close coordination with the IDB, which is at present the largest donor for Bolivia. In general relations between the Bank and IDB are cordial and information is exchanged regularly. However, better coordination on our policy stance in some areas should be our objective. Notably the IDB is proceeding with a large agricultural credit program in the absence of an agreed financial sector restructuring program which needs careful monitoring. IDB staff will participate in our financial sector mission as a first step in working towards a common approach to such lending. Likewise, differences in approach are evident in the energy sector.

43. Relations with Commercial Banks and the Paris Club. Bank staff attended the June 1986 Paris Club meeting and we plan to continue to monitor closely Bolivia's future negotiations in that forum. It appears likely that, given close linkage between aid and debt issue for Bolivia, issues for both bilateral and multilateral debt will arise in the context of the Consultative Group. The Government's most recent plan is to issue an invitation to all commercial banks to buy Bolivia's commercial bank debt at a very deep discount on the face value. The buy back period will be 90 days and the Government will undertake to renegotiate the remaining debt thereafter, on terms including interest rates below LIBOR and long pay back periods. We plan to keep closely in touch with Government-commercial bank negotiations in the future. At the request of the Coordinating Committee, the Bank has attended most commercial bank meetings with the Government and on some occasions has provided assistance in the form of an independent analysis of Bolivia's situation. We intend to continue assisting the Government in elaborating concrete proposals and expect this to become an important exercise for Bolivia.

IFC Program/MIGA

43. IFC should play a central role in the Bank Group's operational program for Bolivia given the vital role of private investment. IFC has not been active in recent years, but has recently started to reactivate its operations in Bolivia with the approval of a US$800,000 loan and US$400,000 equity convertible loan for a silver recovery project in the Cerro Rico de Potosi mines. IFC plans to continue its promotion efforts and has so far

identified a number of potential mining projects. Other priority areas include: hydrocarbons, in particular oil and gas exploration and associated activities such as transport and downstream processing facilities (an oil and gas production project with Tesoro Petroleum has been preappraised); industry, with emphasis on export-oriented projects; and development banks. It will also explore possible use of innovative investment approaches that would particularly benefit medium size investors, e.g. a package investment in three to five medium-size projects with BISA. If economic conditions continue to improve IFC currently plans to commit about US$15.0 million in Bolivia in the next four years. Between 1973 and 1981 IFC invested about US$3.3 million in mining and industrial projects. We plan to explore whether a larger role might be feasible.

45. MIGA. The Multilateral Investment Guarantee Agency's (MIGA) insurance coverage could play a useful role in enhancing the Government's efforts to attract foreign investment in Bolivia. The MIGA convention, which was signed by Bolivia on May 5, 1986, still awaits ratification of about 15 countries, with ratification expected around October 1987. Once ratified, MIGA could offer guarantees to interested foreign investors, provide technical assistance to promote investment opportunities in Bolivia. We will liaise closely with the staff responsible for the MIGA start-up operation to determine the opportune time for Bolivia to benefit from its facilities and services.

Other Issues

46. Our operational program will aim to achieve five additional objectives:

(a) Enhanced Trade with Brazil. A major area of hope for Bolivia could be strengthening of trade relations with Brazil which offers by far the best market for many potential products. We should explore ways in which we could support the negotiation of an agreement or set of agreements to facilitate this development. An immediate objective is to get the rail line to Corumba working well.

(b) Cocaine. Issues for cocaine will figure prominently in debate on Bolivia's future and the industry has vital, if murky, economic importance. Our strategy is in the first instance to learn what we can of the economic aspects and social impact of the cocaine industry and specifically prepare ourselves to respond to proposals for investment in eradication and particularly crop substitution. In addition, a program on the scale being discussed (US$300 million), will have important macro and development implications. We will work with the Government to ensure that these aspects are taken into account.

(c) Private Investment. Following our preliminary review of private sector issues, leaders in the Bolivian private sector have launched an initiative to prepare policy proposals and investment schemes for the short and medium term. The outline will be presented at the CG meeting. We plan to follow and, as appropriate, support this effort. More broadly, we will aim to support the recovery and development of private sector activities throughout our operational program.

(d) Ecological Review. Because we see serious ecological issues for Bolivia (notably forest destruction and uncontrolled settlement in the lowlands, soil erosion, endangered species, endemic diseases) we intend to explore ways in which a review to prepare an environmental strategy could be undertaken to set the stage for action programs in the future. A first stage might be accomplished through agricultural sector work.

(e) Women in Development. We will aim to define a practical strategy for addressing issues for women in development through our lending and economic and sector work programs.

F. Conclusions

47. The challenge to the Bank presented by Bolivia's program is enormous and calls for a sharp increase in both lending and staff resources. We believe that the increases proposed in this brief are justified because of the bold and visionary economic program which Bolivia's economic team is implementing and the extraordinarily difficult development challenges which the country faces. Donor interest in Bolivia is great and thus intensive Bank involvement could have an important catalytic effect for resource mobilization. We must recognize clearly, nonetheless, that the proposed program is difficult, demanding, and risky. The political situation remains volatile, decision-making and administration are exceptionally weak, and information and data are fragmented and frequently incomplete and contradictory. Implementation of any proposal is exceptionally difficult and extensive assistance is often required. Nonetheless, we recommend an effort at the level proposed, to be sustained as long as the economic program remains fully on track.

48. Any major departure from the economic program must, given the special efforts entailed, call for an immediate and careful review of the Bank's role and program. If the basic validity is threatened, then the program can and should be cut back. If this rather dramatic strategy is agreed upon, it should be clearly conveyed to the Government to ensure that the parameters and conditions of our support are clearly understood.

Table 1: GROWTH OF GDP AND THE MAJOR DEMAND AGGREGATES

	1985 Levels in US Dollar Terms /a ($)	Projected Real Rates of Growth (in %) 1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
GDP	3,781.6	-2.9	3.2	3.4	4.2	4.0	4.0	0.0	4.0	4.0	4.0
Total Consumption	3,488.7	-5.5	1.8	3.3	3.3	3.7	3.6	3.3	3.3	3.1	3.0
Private Consumption	2,899.0	-0.4	0.2	3.8	3.8	3.7	3.5	3.5	3.2	3.0	2.8
Public Consumption	589.7	-30.4	12.9	0.0	0.0	4.0	4.0	2.0	4.0	4.0	4.0
Total Investment	244.6	31.3	33.8	8.5	10.1	9.9	7.0	4.4	5.6	5.0	5.0
Private Fixed Investment	151.3	6.0	8.1	10.0	10.0	10.0	7.0	5.0	5.0	5.0	5.0
Public Fixed Investment	124.2	52.2	34.3	7.5	10.0	10.0	7.0	5.0	5.0	5.0	5.0
Inventory Accumulation	-30.9	-	-	-	-	-	-	-	-	-	-
Exports of Goods and Non-Factor Services	712.7	-1.4	1.6	2.5	6.4	3.4	4.8	-16.4	6.7	8.0	8.4
Less: Imports of Goods and Non-Factor Services	664.4	-2.3	9.3	5.0	6.0	6.0	4.9	1.9	4.2	4.2	4.2
Memo: Public Fixed Investment in Current Dollar Terms /b (in millions)	124.2	197.3	274.5	306.5	350.0	400.2	444.8	485.3	529.5	577.5	630.1

/a Converted to US dollars at real exchange rate of 1986. Units are millions.
/b Obtained by applying a world dollar inflation index to the Public Fixed Investment level expressed in real terms.

Table 2: SAVINGS/INVESTMENT BALANCE

	Shares of GDP (in %)			Change in Percentage Shares	
	1985	1990	1995	1995-90	1990-95
A. Total Investment	6.5	13.3	14.8	6.8	1.5
1. Private Fixed Investment	4.0	5.4	6.0	1.4	0.6
2. Public Fixed Investment	3.3	7.8	8.6	4.5	0.8
3. Inventory Accumulation	-0.8	0.1	0.1	0.9	0.0
B. Total Savings	6.5	13.3	14.8	6.8	1.5
1. Gross Domestic Savings	7.7	12.5	12.1	4.8	-0.4
A. Private	15.4	8.0	7.7	-7.4	-0.3
B. Public	-7.7	4.5	4.4	12.2	-0.1
2. Foreign Savings (Trade Deficit)	-1.3	0.7	2.6	2.1	1.9

Note: Totals may not add due to rounding.

Table 3: BALANCE OF PAYMENTS

	Flows in U.S. Dollar Millions											Growth Rates In Nominal Terms	
	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1985-90	1990-95
1. Resource Balance	48.5	-77.8	-190.7	-214.0	-225.9	-255.0	-270.7	-382.5	-381.0	-364.3	-334.8		
A. Exports of Goods & NFS	712.9	611.2	591.9	639.4	714.2	780.1	857.5	812.2	912.3	1035.4	1180.3	1.8%	8.6%
B. Imports of Goods & NFS	664.4	689.0	782.6	853.5	940.1	1035.1	1128.2	1194.8	1293.2	1399.8	1515.2	9.3%	7.9%
2. Factor Service Receipts	24.5	26.8	34.3	34.0	32.0	34.0	35.0	36.0	38.0	40.0	42.0		
3. Factor Service Payments	434.9	356.6	368.2	392.5	420.5	451.7	469.2	507.1	557.2	612.2	668.6		
A. Total Interest	336.6	271.6	286.2	307.5	332.4	360.6	375.2	410.8	457.2	508.2	560.7		
Paid	142.1	135.6	199.0	211.2	226.5	244.1	266.3	291.9	329.0	369.1	409.7		
Capitalized	194.5	136.0	87.2	96.3	105.9	116.5	108.9	118.9	128.2	139.1	151.0		
B. Other Factor Service Payments	98.3	85.0	82.0	85.0	88.0	91.0	94.0	97.0	100.0	104.0	108.0		
4. Private Transfers - Net	14.5	18.0	20.0	22.0	24.0	26.0	28.0	30.0	32.0	34.0	36.0		
Current Account Balance	-347.4	-389.6	-504.6	-550.5	-590.4	-646.6	-677.0	-823.6	-868.1	-902.5	-925.5		
Memo: Ratio of Current Account Balance to GDP (%)	-9.2	-10.2	-12.3	-12.5	-12.4	-12.6	-12.2	-14.3	-13.9	-13.4	-12.7		

Table 4: NET FINANCING REQUIREMENTS

	In millions of US Dollars						
	1986	1987	1988	1989	1990	1986-90	1991-95
Current Account Balance	-389.6	-504.6	-550.5	-590.4	-646.6	-2681.7	-4196.7
1. Net Official Transfers	77.0	95.0	101.0	106.0	111.0	490.0	646.0
2. Net Direct Foreign Investment	10.0	20.0	35.0	45.0	50.0	160.0	325.0
3. Net Disbursements on MLT Debt	295.3	352.1	374.3	388.2	336.5	1746.4	1263.2
a. IBRD and IDA: Net	2.9	55.8	30.5	19.1	14.6	122.9	316.0
(i) Gross Disbursements	20.2	73.4	48.7	37.7	33.7	213.7	406.3
(ii) Amortization	-17.3	-17.6	-18.2	-18.6	-19.1	-90.8	-90.3
b. IDB: Net	60.3	87.4	105.1	105.5	114.1	472.4	391.9
(i) Gross Disbursements	73.0	109.8	130.0	133.8	424.4	589.0	656.7
(ii) Amortization	-12.7	-22.4	-24.9	-28.3	-28.3	116.6	-264.8
c. IMF Trust Fund and SAF: Net	13.7	6.2	6.2	-4.6	-2.3	19.2	-31.4
(i) Gross Disbursments	21.7	14.2	14.2	0	0	50.1	0
(ii) Amortization	-8.0	-8.0	-8.0	-4.6	-2.3	-30.9	-31.4
d. Other Multilateral: Net	5.8	21.7	13.0	21.2	9.3	71.0	-18.8
(i) Gross Disbursements	31.0	42.9	26.9	35.6	29.5	165.9	144.5
(ii) Amortization	-25.2	-21.2	-13.9	-14.4	-20.2	-94.9	-163.3
(Sub-total: All Multilateral): Net	82.7	171.1	154.8	141.2	135.7	685.5	657.7
e. Bilateral (incl. Suppliers Cr.): Net	138.6	132.4	123.2	141.1	84.4	619.7	-40.1
(i) Gross Disbursements	138.6	132.4	123.2	141.1	149.7	685.0	850.4
a) Project Disbursements	76.5	93.9	123.2	141.1	149.7	584.4	850.4
b) Capitalized Interest	62.1	38.5	0	0	0	100.6	0
(ii) Amortization (after rescheduling)	0	0	0	0	-65.3	-65.3	-890.5
g. Financial Institutions: Net	73.9	48.7	96.3	105.9	116.5	441.3	645.4
(i) Gross Disbursements	73.9	48.7	96.3	105.9	116.5	441.3	645.4
(ii) Amortization	0	0	0	0	0	0	0
4. Net Short-term Debt	0.0	13.8	11.8	15.0	15.0	55.6	75.0
5. IMF Upper Tranches	86.2	18.6	39.4	14.9	-64.5	94.6	-149.6
(i) Purchases	116.0	41.6	41.6	20.8	0	220.0	0
(ii) Repurchases	-29.8	-23.0	-2.2	-5.9	-64.5	-125.4	-149.6
6. Change in Reserves (- = increase)	-174.5	5.0	-11.0	-9.0	-20.0	-209.5	-100.0
7. Errors and Omissions	95.6	0	0	0	0	95.6	0.0
8. Remaining Unfinanced Gap	0	0	0	30.3	218.6	248.9	2137.2

BOLIVIA

Proposed Lending Program 1987-91 (High Scenario)

Sector	Project	Status	Actual FY86	Current FY87	FY88	FY89	FY90	FY91
I. Non-Project								
A. Policy-based	(i) Reconstruction Import Credit I	-	55.0					
	(ii) RIC II	L		56.0				
	(iii) Financial Sector Credit	L			30.0			
B. Institutional Development	(i) Public Sector Financial Management I	M		8.0				
	(ii) Public Investment Programming	M			5.0			
	(iii) Public Sector Financial Management II	M				5.0		
II. Agriculture								
	(i) Agriculture I (lowlands)	S				15.0*		
	(ii) Agriculture II (Altiplano)	S						30.0
III. Energy and Power								
	(i) Vuelta Grande Gas Recycling	-	15.0					
	(ii) Power Rehabilitation	L		6.0				
	(iii) Power Distribution	S						25.0*
	(iv) Gas Utilization & Export	L					25.0	
IV. Mining								
	(i) Mining Sector Rehabilitation	S				20.0*		
V. Infrastructure								
	(i) Emergency Reconstruction -Special Operation	L			25.0			
	(ii) Transport Sector Rehabilitation	L				40.0		
VI. Industry and IDF								
	(i) Industrial Credit (DFC)	L						25.0
VII. Urban Development								
	(i) La Paz Municipal Development	L			10.0			
VIII. Social Services								
	(i) Education Sector	L					25.0	
	(ii) Water Supply & Sewerage	S					20.0*	
	(iii) Health	S						15.0*
TOTAL			70.0	70.0	70.0	70.0	60.0	95.0
No. of Projects			2	3	4	4	3	4
Reserve								
	(i) Agricultural Credit					20.0		
	(ii) Energy Sector					30.0		
	(iii) SAC I					40.0		
	(iv) San Buenaventura Regional Development						30.0	
	(v) Secondary Cities Development (Urban Development III)						15.0	
	(vi) Bolivia-Brazil Gas Pipeline						50.0 1/	
	(vii) Railway Rehabilitation							15.0
	(viii) Oil and Gas Development							30.0

* Standby.

1/ IBRD-enclave operation.

November 18, 1986

BOLIVIA

Country Summary

Economic and Sector Work by Task, FY86-88

Tasks	Aims and Coverage	Audience	FY86	FY87	FY88
A. Economic Reports					
Economic Update	Review economic policies for CG (completed)	Govt./Bank/CG	5.0	14	
Public Sector Review	Review PIP for 1986-87	Govt./Bank/CG	6.0	20	
Public Sector Expenditre Review	Full review of Public Expenditure Program	Govt./Bank/CG		45	
Public Sector Exp. Review Update	Updating of the Public Expenditure Review	Govt./Bank/CG			25
Country Econ. Memo	Analyze economic developments	Govt./Bank		2	30
Export Prospects Study	Review of export performance prospects and issues	Govt./Bank		10	
Private Sector Rev.	Review investment climate	Govt./Bank		10	
Policy Framework Paper	Joint Bank/IMF Government Medium-Term Framework Paper	Govt./Bank/IMF/CG		5	5
Santa Cruz Regional Study	Review of potential and bottleneck to development of Region	Bank/Govt			40
Employment Study	Review employment implications of the economic reform programs	Govt./Bank			30
Women in Development Strategy	Review issues and propose strategic framework	Bank/Govt.			10
B. Sector Reports					
Agricultural Sector Review	Definition of medium-term strategy and framework for investment program for agric. sector	Govt./Bank	22.0	30	20
Financial Sector	Follow-up of Financial Mgt. Tech. Asst. Project	Govt./Bank	.1	42	
Education Sector Rev.	Review of strategy issues and public expenditure program for sector to proposed bank strategy	Govt./Bank		10	
Transport Sector Memo	Update Transport Sector Strategy Memo	Govt./Bank		8	
Social Sector Rev.	Review of strategy and public expenditure issues to assist in defining social action programs.	Govt./Bank			40
C. Other Economic Work (EWO)		Bank	10.0	20	
D. Other Sector Work (SWO)		Bank	14.0	3	

November 18, 1986

Mr. Southworth
M. Lerdau
E-1227

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

March 26, 1984

His Excellency
Mariano Baptista Gumucio
The Ambassador of Bolivia
Embassy of Bolivia
3014 Massachusetts Avenue, N.W.
Washington, D.C. 20008

Dear Mr. Ambassador:

It was a great pleasure to meet with you on March 9 on the occasion of your delivery of your letter to Mr. Clausen. In his absence, permit me to reply to that letter and to reiterate the points that we covered in our meeting.

My colleagues and I share your concerns that everything possible should be done to help Bolivia in its present difficulties. The Bank's decision to close its Resident Mission in Bolivia in no way alters this position. It was made exclusively on grounds of administrative efficiency and economy because it seems clear that for the time being the scope for Bank activities in Bolivia will be smaller than was hoped when the Mission was established.

But we continue to stand as ready as ever to assist your Government in the formulation of economic reforms and development programs, and to provide financial help for their implementation. Thus, Bank's staff are currently working on a large project for the exploitation of Bolivia's hydrocarbon resources. We hope to bring this operation to fruition as soon as we have agreed with your Government on all the outstanding issues and as soon as Bolivia is current in its debt service payments to the Bank.

In connection with the latter, let me express my appreciation for the efforts that the Government has made already to reduce outstanding arrears. I realize that this represents a significant burden in these difficult times, but I hope that the Government will persevere in these efforts since they are an essential pre-requisite for enabling the Bank to provide financial assistance to Bolivia.

I should also like to confirm that I have agreed, in response to the Government's request, to keep the office open until the end of June 1984.

However, unless by that time there are concrete reasons to expect a sharp upturn in the kind of activities for which the Office is useful, we will definitely have to close it down. I hope that this can then be done without any further misunderstanding about the reasons for this action.

Best regards.

Sincerely,

Ernest Stern

Ernest Stern
Senior Vice President
Operations

cc: Messrs. Zalduendo, Lerdau, Knox, Gonzalez-Cofino, van der Meer, Carter, Bolivia Team

ELerdau:gc

TO: Mr. Ernest Stern, SVPOP March 14, 1984

FROM: Enrique Lerdau, Acting Regional Vice President

SUBJECT: BOLIVIA: Visit of Ambassador Marino Baptista Gumucio

The Ambassador will follow-up on a telex sent to Mr. Clausen by the Minister of Foreign Affairs and Finance in which they request that the Bank reconsider its decision to close the Resident Office in La Paz. The Government argues that closure of the Resident Mission would be a serious blow against Bolivia's fledgling democracy and complicate its efforts to adopt an economic stabilization program. Specifically, the Government wants us to maintain a presence because of the Bank's importance in the forthcoming negotiations for international economic assistance (UN sponsored Round Table Meeting in La Paz).

The Bank already considered closing the Resident Mission in Bolivia in late 1982 when the present government of President Siles came to power. We kept it open in the expectation that the new government would stabilize the economy and that the Bank could resume lending on a significant scale.

During last year's Annual Meeting, we told the Bolivian delegation of the Bank's intention to close the office. The Minister of Finance expressed concern that Bank action on this matter would weaken the cabinet politically and make efforts to reach an agreement with the Fund more difficult. In response, we agreed to delay the departure of the Resident Representative until mid-November 1983 and the closure of the Mission until end March 1984. The Minister expected to have a Fund stand-by in place by that time.

I suggest that you tell the Ambassador that we would consider reopening the office if and when this be justified by improvements in our dialogue with the Government and the size of our lending operations.

Attached is my letter to the Ambassador notifying him of the closure of the Resident Mission.

Attachment

cc: Messrs. Gonzalez Cofino and Carter

PRScherer:gc/mac

EMBAJADA DE BOLIVIA
WASHINGTON, D. C. 20008
EMBO 117/84

March 9, 1984

Mr. A. W. Clausen
President,
The World Bank,
1818 H Street, N. W.
Washington, D.C. 20433

Dear Mr. Clausen:

I wish to write to you at this time to convey to you the deep concern that the news that The World Bank would close down its Mission in Bolivia has caused in my country. I have received instructions from my government to request from you and the Bank's Board of Directors to reconsider this extreme measure.

Despite the severe economic crisis that Bolivia is confronting, the Government is committed to revamp the country's economy through a program of austerity and export incentives. It is also committed to comply with its obligations with the international banking and to negotiate an agreement with the International Monetary Fund.

For the development of this policy, we require naturally the support of The World Bank, an institution which, under its policy of collaboration with the less developed countries, has traditionally afforded Bolivia an effective cooperation. Although it is true that due to political circumstances known to you, from 1980 on, no new loans have been negotiated, Bolivia has several pending projects of great importance for its development, among which are the exploitation of its hydrocarbons, the implementation of which would not be possible without The World Bank's support. The closing down of the Representation of The World Bank in Bolivia would cause a severe impact on the Bolivian people, who, through great economic difficulties, are trying to consolidate their democratic process.

Mr. A. W. Clausen
March 9, 1984
Page two.

Last year Bolivia suffered droughts and floods brought about by the El Niño current which represent a loss of 25 percent of agricultural production. Such a loss is comparable to or even greater than that which a country in war can tolerate.

I would be greatful if you would review the enclosed clippings of the U. S. press on the seriousness of this situation which is bringing famine in several regions of Bolivia.

In such a critical moment, it would be incomprehensible and very painful to the Bolivian public opinion not to count on the traditional solidarity afforded us by The World Bank.

I am sure that the Board of Directors of The World Bank and you, in particular, will understand the great importance to us of having The World Bank representation stationed in Bolivia.

Please accept on this occasion my best regards,

Mariano Baptista Gumucio
Ambassador

Encs.

MBG/mjlv.

CF

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

March 26, 1984

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Best regards.

Sincerely,

Ernest Stern

Ernest Stern
Senior Vice President
Operations

cc: Messrs. Zalduendo, Lerdau, Knox, Gonzalez-Cofino, van der Meer, Carter, Bolivia Team

ELerdau:gc

FORM NO. 89
(2-83)

THE WORLD BANK

ROUTING SLIP

Date: March 9

OFFICE OF THE PRESIDENT

Name	Room No
Mr. Benjenk	E 823
cc: Mr. Lerdau	

	To Handle		Note and File
XX	Appropriate Disposition		Prepare Reply
	Approval		Per Our Conversation
	Information		Recommendation

Remarks

Roy Southworth

From

ZCZC DIST4201 WUI9904 WUI9904
DIST
REF : TCP MC
MR. CLAUSEN

cc: Mr. Stern
Mr. Lerdau

2QU FINANZA BV

216

TO: MR.A.W.CLAUSEN
PRESIDENT OF THE WORLD BANK
WASHINGTON, D.C. U.S.A.

TELEX NO.- 043/84F

ON BEHALF OF THE REPUBLIC OF BOLIVIA,WE KINDLY ASK YOU TO RECONSIDER THE OPTION OF CLOSING DOWN THE WORLD BANK OFFICE IN OUR COUNTRY. AS YOU KNOW IN APRIL 1984 WE WILL BE HOLDING AN INTERNATIONAL COOPERATION MEETING IN ORDER TO SETTLE THE FINANCIAL REQUIREMENTS TO SUPPORT A LARGE INVESTMENT PROGRAM, WHICH WE EXPECT WILL INVOLVE THE PARTICIPATION OF THE WORLD BANK ON A BROADER BASIS. BESIDES,WE WANT TO CALL TO YOUR ATTENTION THAT OUR COUNTRY IS RULED UNDER A DEMOCRATIC GOBERNMENT AND TO REVERSE THE ECONOMIC CRISIS WE ARE GOING THROUGH IS WHEN WE NEED THE MOST THE SUPPORT OF THE WORLD BANK.

HIGHEST CONSIDERATION,

FERNANDO BAPTISTA GUMUCIO
MINSTER OF FINANCE OF BOLIVIA
AND GOVERNOR TO THE WORLD BANK

JOSE ORTIZ MERCADO
MINISTER OF FOREING AFFAIRS
OF BOLIVIA

LA PAZ/BOLIVIA
8/MAR/1984

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FORM NO. 89
(2-83)

THE WORLD BANK

ROUTING SLIP	Date March 9

OFFICE OF THE PRESIDENT

Name	Room No.
Mr. Benjenk	E 823
cc: Mr. Lerdau	

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XX	Appropriate Disposition		Prepare Reply
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Remarks

Roy Southworth

From

MISION PERMANENTE DE BOLIVIA
ANTE LAS NACIONES UNIDAS

231

Nueva York, 6 de marzo de 1984
ONU-12/84

Señor Presidente:

Me es grato remitir adjunta a la presente, la nota de 29 de febrero que le dirige el Señor Ministro de Relaciones Exteriores de Bolivia, Lic. José Ortíz Mercado en la cual lo invita a honrarnos con su presencia en la Segunda Fase de la Mesa Redonda de Cooperación Internacional a Bolivia, que tendrá lugar del 2 al 4 de abril próximo en la ciudad de La Paz; reunión que contará con la participación del Secretario General de Naciones Unidas en su calidad de co-auspiciador.

Esperando contar con la valiosa cooperación que brinda su organización a los planes de desarrollo bolivianos, me permito reiterarle que su presencia en la citada reunión será de mucha importancia.

Al agradecer a usted nos haga conocer su decisión sobre el particular, le reitero las seguridades de mi consideración distinguida.

Jorge Gumucio Granier
Embajador,
Representante Permanente

Excelentísimo señor
D. A. W. Clausen
Presidente
Banco Mundial
Washington, D.C.

REPUBLICA DE BOLIVIA

MINISTERIO DE RELACIONES
EXTERIORES Y CULTO

La Paz, 29 de febrero de 1984

231

Excelentísimo Señor:

Como es de su conocimiento del 20 al 22 de abril de 1983 se llevó a cabo en La Paz la Primera Fase de la Mesa Redonda de Cooperación Internacional a Bolivia co-auspiciada por el Gobierno de Bolivia y la Organización de las Naciones Unidas; reunión en la que tuvimos el honor de contar con la participación de su Institución. En esa reunión se informó a los participantes que se celebraría una Segunda Fase de la Mesa Redonda para convocar nuevamente a los países e instituciones amigas y en esa oportunidad presentar el Plan de Desarrollo 1984-87 del Gobierno de Bolivia, acompañado por un conjunto de perfiles de los proyectos que integran dicho Plan, con miras a concretar en forma coherente y considerada la mejor forma en que se nos puede ayudar en nuestro programa de recuperación y desarrollo.

Por este medio tengo el honor de informarle que la Segunda Fase de la Mesa Redonda tendrá lugar del 2 al 4 de abril próximos, en el Hotel Sheraton de La Paz.

Debido a las reiteradas muestras de amistad y cooperación que su Institución ha demostrado hacia el pueblo y Gobierno bolivianos, tengo el agrado de invitarle a que participe en la reunión, de la cual le remito la ayuda memoria y el temario respectivo y en próximos días se le hará llegar una mayor información y documentación sobre los arreglos para la Segunda Fase de la Mesa Redonda Internacional de Cooperación a Bolivia.

Aprovecho la oportunidad para reiterarle las seguridades de mi más distinguida consideración.

José Ortiz M

Excelentísimo señor

D. A.W. Clausen
Presidente
Banco Mundial
1818 H. Street, N.W.

Washington, D.C. 20433

FORM NO. 89
(12-83)

THE WORLD BANK

ROUTING SLIP	Date March 9

OFFICE OF THE PRESIDENT

Name	Room No.
Mr. Benjenk	E 823
cc: Mr. Lerdau	

	To Handle		Note and File
XX	Appropriate Disposition		Prepare Reply
	Approval		Per Our Conversation
	Information		Recommendation

Remarks

Roy Southworth

From

Jane:
Our tracking
File shows
no record
that this
cable was
responded to!
Our system
is leaky so
it may have
been handled
But could you
have someone
follow up for

[illegible]
[illegible]
REF : TCP [illegible]
MR. [illegible]

cc: Mr. Stern
Mr. Lerdau

[illegible] FINANZA BV

[illegible]

TO: MR. A. W. CLAUSEN
PRESIDENT OF THE WORLD BANK
WASHINGTON, D.C. U.S.A.

TELEX NO. - 043/PAF

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[illegible]

[illegible] [illegible] JOSE ORTIZ MERCADO
[illegible] OF BOLIVIA MINISTER OF FOREIGN AFFAIRS
[illegible] THE WORLD BANK OF BOLIVIA

[illegible]
[illegible] MAR 1984

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