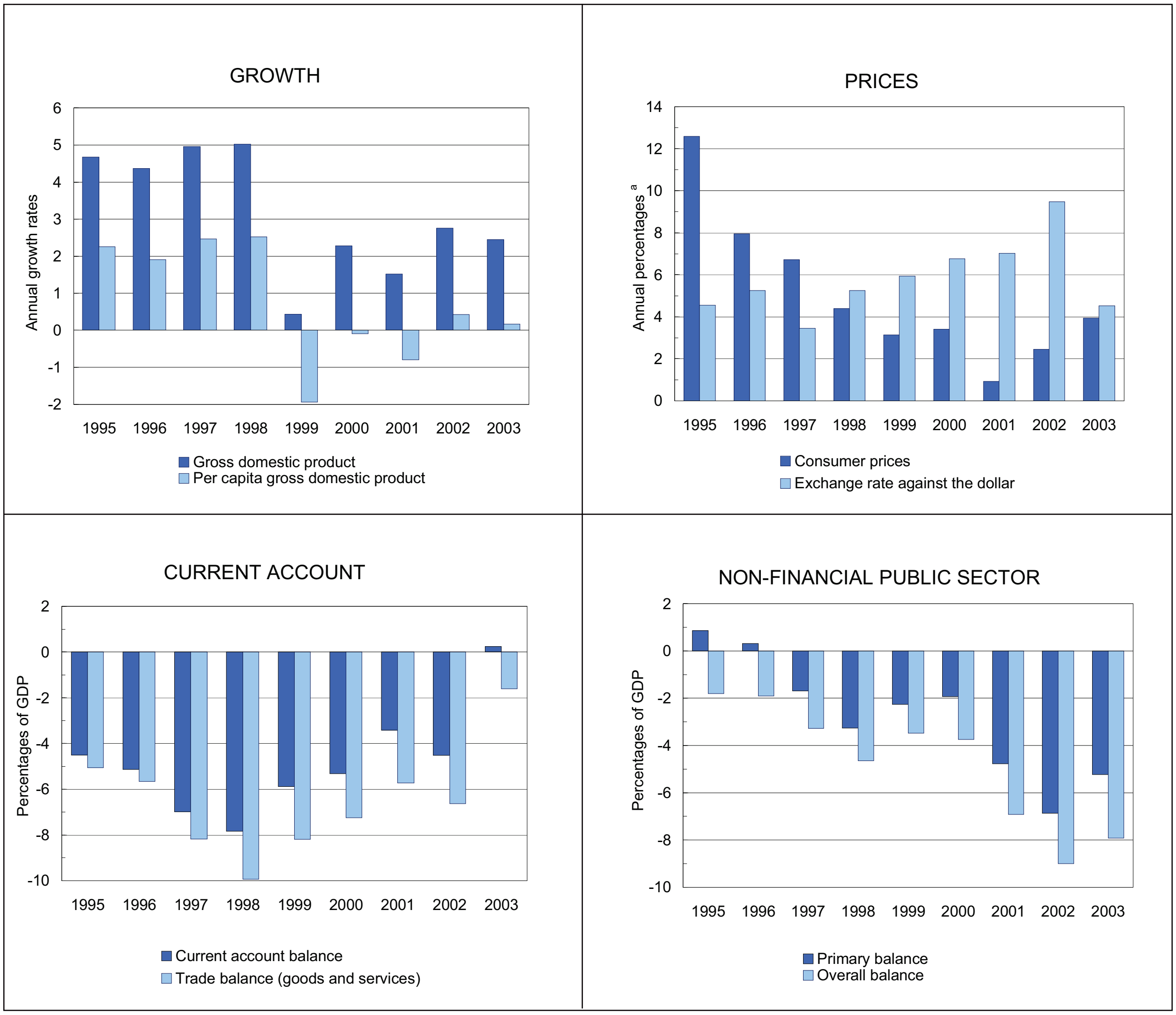
Bolivia

1. General trends

In 2003 a project to export natural gas to the United States triggered a political upheaval that led, in October, to the President's resignation and constitutional replacement by the Vice-President. Earlier, a serious conflict had arisen in February over the government's attempt to introduce a new tax, among other issues. Both events had repercussions on the economic situation and resulted in a new political and economic agenda that entailed the revision of hydrocarbon-sector regulations (reform of the Hydrocarbons Act and a referendum on gas exports) and the review of certain aspects of the political structure (including a call for a constituent assembly).

Bolivia's GDP grew by 2.5% in 2003, essentially on the strength of gas and soybean exports, while domestic demand (particularly investment) slumped. Exports climbed to a record level of over US$ 1.5 billion, which, in conjunction with grants received, contributed to a small current account surplus on the balance of payments. Inflation remained low, although social conflicts gave rise to temporary shortages and price hikes. The boliviano's increased competitiveness during the year helped to stimulate non-traditional exports. The growth profile for 2004 is expected to be similar to the pattern in 2003, with booming exports but weak domestic demand. In the first few months of the year the government implemented an austerity programme, introduced a temporary tax and began to deregulate fuel prices. It also attempted to boost domestic demand through initiatives such as the "Buy Bolivian" programme aimed at steering State demand towards local enterprises. In June the Executive Board of the International Monetary Fund (IMF) released the final tranche of the standby arrangement approved in April 2003, and the agreement was extended to December. This resulted in a US$ 79 million disbursement, which freed up other lines of financing needed to cover the fiscal deficit, estimated at 6.5% of GDP. Still pending, however, is the negotiation of a loan under the Poverty Reduction and Growth Facility (PRGF). On 18 July a referendum on natural gas exports revealed strong support for the hydrocarbons policy stance taken by the current administration.

Figure 1
BOLIVIA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

2. Economic policy

The country's two key macroeconomic vulnerabilities are its large fiscal deficit (4.9% of GDP in 2003), which is largely the result of a 1996 pension reform, and its fragile banking system, which has been undermined by deposit withdrawals and a high loan delinquency rate.

(a) Fiscal policy

The non-financial public sector's fiscal deficit eased to 7.9% of GDP (US$ 616 million) in 2003, compared to 9% in 2002; nonetheless, the deficit still overshot the target of 6.5% of GDP set in the agreement reached with IMF in April 2003. Excluding pensions, the shortfall narrowed from 4% to 3% of GDP between 2002 and 2003, whereas the target for that period was 1.5%.

Although the authorities planned, in early 2003, to boost tax receipts by adopting a new tax code, eliminating exemptions and increasing hydrocarbon revenues, the complex political situation made it impossible to carry out these initiatives and left the current government in a critical fiscal situation that seemed headed for a deficit similar to the one posted in 2002. In December the shortfall stood at US$ 96 million, which could have prevented the payment of wages and bonuses.

The outlook improved somewhat, however, as income rose and efforts were made to curb expenditure. Spending on goods and services and on public investment was trimmed from 8.7% to 8.2% of GDP, although interest payments (2.7% of GDP in 2003) and payments for personal services were up in relation to their 2002 levels. Income growth was mainly attributable to international cooperation grants, which represented 3% of GDP in 2003 (2.7% in 2002). Tax revenue also climbed as a result of the tax amnesty ("perdonazo") approved in September, the positive effects of which lasted up to May 2004. In addition, fiscal income was boosted by an increase in gas exports to Brazil after the political crisis had ended.

Concessional external credit covered 69% of the deficit (5.5 points of GDP), while 31% (2.5 points) was financed by domestic credit, mainly in the form of bond purchases by private pension fund companies (1.6 points of GDP). In 2003 the public debt amounted to 86.9% of GDP, or US$ 6.75 billion, comprising US$ 5.04 billion in external debt and US$ 1.71 billion in domestic debt. Between 1999 and 2004 the domestic debt doubled as a result of the larger fiscal deficit, and its financing on the local market is pushing up interest rates. The treasury has turned to the central bank for liquidity, with the result that lending to the public sector has accounted for nearly half the monetary base since 2002. The government and the central bank imposed upper limits on debts contracted by the treasury, linked to the credit balance maintained in the central bank by other State institutions.

In May 2004 the government announced that the overall deficit was set to reach 6.5% of GDP for the year as a whole (about US$ 530 million), or 1.7% excluding pensions, and would be financed largely through concessional external credits. The authorities have been implementing initiatives to control the troublesome fiscal situation since the beginning of the year. Initially, there was a failed attempt to obtain exceptional financing through the Bolivia Support Group, and in February the government presented a fiscal adjustment plan that included measures to increase income and reduce expenditure. Originally, the authorities planned to introduce two new taxes –one on net assets and the other on financial transactions– but pressures from the business sector prompted the government to withdraw the first of those proposals. The second, with various amendments, entered into force in July and provides for an annual tax rate of 0.3% on all financial operations except those relating to savings accounts in bolivianos, operations for less than US$ 1,000 and payments for services. The government also proposed to cut current expenditure by 5% and to streamline public administration. In February the authorities partially deregulated hydrocarbon prices, which are now set using a formula that tracks the performance of the dollar and of a basket of international oil prices. In 2003 subsidies on liquefied petroleum gas and gasoline amounted to US$ 40 million and US$ 51 million, respectively.[1] In June the price of a cylinder of liquefied gas rose by 2.4% (more than cumulative inflation at that time), while the price of gasoline rose by 1.5%. Given the steep increases in oil prices on the world market, the government extended the range of international prices that affect domestic prices. The formula for calculating the special tax on hydrocarbons and petroleum products was corrected to include variations in the exchange rate (whereas previously the

1 Fundación Milenio, *Informe de Milenio sobre la economía en el año 2003,* p. 28.

Table 1
BOLIVIA: MAIN ECONOMIC INDICATORS

	1995	1996	1997	1998	1999	2000	2001	2002	2003 [a]
	Annual growth rates [b]								
Gross domestic product	4.7	4.4	5.0	5.0	0.4	2.3	1.5	2.8	2.5
Per capita gross domestic product	2.3	1.9	2.5	2.5	-1.9	-0.1	-0.8	0.4	0.2
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	1.4	6.7	4.6	-4.4	2.5	2.7	3.8	0.6	6.0
Mining	7.3	-2.0	6.1	5.6	-4.6	6.4	-1.4	3.6	6.4
Manufacturing	6.8	4.9	2.0	2.5	2.9	1.8	1.8	2.2	2.7
Electricity, gas and water	8.7	3.4	4.7	2.5	4.7	2.8	0.6	1.8	0.9
Construction	6.0	9.0	5.0	35.7	-16.8	-6.9	-6.1	14.3	-18.4
Wholesale and retail commerce, restaurants and hotels	2.8	5.1	4.1	2.0	0.8	2.3	2.0	2.1	2.0
Transport, storage and communications	5.9	6.9	9.2	7.0	-0.8	2.5	2.1	5.1	3.7
Financial institutions, insurance, real estate and business services	3.7	8.5	12.6	12.5	13.3	-0.5	0.2	-1.5	-1.3
Community, social and personal services	2.9	2.5	4.9	3.6	2.9	2.2	2.6	3.4	4.5
Gross domestic product, by type of expenditure									
Consumption	3.4	3.2	5.1	5.1	2.8	2.6	1.8	1.7	1.2
General government	6.6	2.6	3.4	3.8	3.2	2.1	2.5	3.3	3.2
Private	2.9	3.3	5.4	5.3	2.8	2.7	1.7	1.5	0.9
Gross domestic investment	12.3	18.8	30.2	28.5	-18.8	-5.3	-23.4	0.5	-17.1
Exports (goods and services)	9.1	4.1	-2.1	6.5	-12.8	12.9	11.4	12.4	10.1
Imports (goods and services)	8.9	7.9	13.5	22.3	-17.1	6.4	-4.8	7.7	-2.7
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	15.2	16.2	19.6	23.6	18.8	18.3	14.2	14.7	11.1
National saving	10.2	11.9	12.6	12.7	9.8	11.4	9.8	8.9	11.4
External saving	5.1	4.4	7.0	10.9	8.9	6.9	4.4	5.8	-0.3
	Millions of dollars								
Balance of payments									
Current account balance	-303	-380	-554	-666	-488	-446	-274	-352	19
Merchandise trade balance	-182	-236	-477	-656	-488	-364	-193	-340	54
Exports, f.o.b.	1 041	1 132	1 167	1 104	1 051	1 246	1 285	1 299	1 573
Imports, f.o.b.	1 224	1 368	1 644	1 760	1 539	1 610	1 477	1 639	1 519
Services trade balance	-158	-182	-172	-189	-190	-244	-267	-177	-180
Income balance	-207	-208	-197	-162	-196	-225	-211	-205	-302
Net current transfers	244	247	292	341	386	387	396	369	447
Capital and financial balance [d]	395	648	654	791	515	407	237	50	120
Net foreign direct investment	391	472	728	947	1 008	734	660	674	160
Financial capital [e]	4	176	-74	-156	-493	-327	-423	-624	-40
Overall balance	92	268	101	125	27	-39	-37	-302	139
Variation in reserve assets [f]	-147	-310	-90	-133	-32	39	34	303	-152
Other financing [g]	55	42	-11	8	5	1	4	-1	13
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	110.7	105.9	103.7	99.9	99.1	100.0	101.4	99.1	108.3
Terms of trade for goods (index: 1997=100)	86.5	96.6	100.0	95.1	95.0	96.9	95.6	95.1	101.6
Net resource transfer (% of GDP)	3.6	6.5	5.6	7.5	3.9	2.2	0.4	-2.0	-2.1
Gross external public debt (millions of dollars)	4 523	4 366	4 234	4 655	4 574	4 461	4 412	4 300	5 042
Gross external public debt (% of GDP)	67.4	59.0	53.4	54.8	55.2	53.2	55.0	55.1	64.1
Net profits and interest (% of exports) [i]	-16.5	-15.7	-14.7	-13.4	-16.3	-16.7	-15.3	-14.7	-17.4

Table 1 (concluded)

	1995	1996	1997	1998	1999	2000	2001	2002	2003[a]
				Average annual rates					
Employment									
Labour force participation rate [j]	55.1	56.5	52.5	49.5	55.9	56.1	60.6	58.0	...
Open unemployment rate [k]	3.6	3.8	4.4	6.1	7.2	7.5	8.5	8.7	9.5
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	12.6	8.0	6.7	4.4	3.1	3.4	0.9	2.4	3.9
Variation in nominal exchange rate (December-December)	4.6	5.3	3.5	5.3	5.9	6.8	7.0	9.5	4.5
Variation in real minimum wage	-2.1	-3.3	2.0	16.1	7.6	2.9	10.8	4.7	0.7
Nominal deposit rate [l]	...	...	...	...	...	...	...	2.7	1.8
Nominal lending rate [l]	...	...	...	...	...	...	...	10.9	9.1
				Percentages of GDP					
Non-financial public sector									
Current income	30.7	28.1	28.1	29.9	30.8	31.5	28.5	25.8	26.8
Current expenditure (including pensions)	26.0	24.2	25.5	28.9	28.9	30.4	29.4	28.5	29.6
Current balance	4.7	3.9	2.5	1.0	1.8	1.1	-0.9	-2.7	-2.8
Net capital expenditure	6.6	5.8	5.8	5.6	5.3	4.9	6.0	6.2	5.2
Primary balance	0.9	0.3	-1.7	-3.3	-2.3	-1.9	-4.8	-6.9	-5.2
Overall balance	-1.8	-1.9	-3.3	-4.7	-3.5	-3.7	-6.9	-9.0	-7.9
Total public debt	84.8	76.4	69.8	68.1	71.3	71.9	79.4	82.0	90.4
Domestic	13.4	13.6	13.2	13.3	16.2	18.8	25.6	26.9	26.2
External	71.3	62.8	56.6	54.8	55.1	53.2	53.9	55.1	64.3
Interest payments (% of current income)	8.7	7.9	5.7	4.7	5.1	5.7	7.5	8.2	10.1
Money and credit [m]									
Domestic credit [n]	49.5	54.1	60.1	65.6	65.1	61.3	58.6	55.1	52.6
To the public sector	1.3	1.1	1.9	1.7	1.1	2.7	2.9	3.7	4.5
To the private sector	48.2	53.1	58.2	63.9	64.0	58.6	55.7	51.3	48.1
Liquidity (M3)	37.4	40.4	47.9	50.0	52.3	50.3	52.7	48.9	47.4
Currency in circulation and local-currency deposits (M2)	6.2	6.2	7.1	7.0	6.5	6.0	6.3	6.3	6.7
Foreign-currency deposits	31.3	34.2	40.9	43.0	45.8	44.3	46.4	42.7	40.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1990 prices. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; urban total, up to 1998, departmental capital cities. [k] Unemployed population as a percentage of the economically active population, urban total; up to 1998, departmental capital cities. [l] Bank operations (61-90 days). [m] The monetary figures are annual averages. [n] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

tax would fall in response to a rise in the international price of oil). These changes should have little effect on the fiscal situation in 2004.

The fiscal accounts improved considerably in the first quarter of 2004 as a result of higher tax receipts (29.1%), which mainly reflected the tax amnesty, and spending cuts.

The high cost of pension reform poses a major challenge; in 2003 the actual cost of pensions was more than double what had originally been expected when the reform was planned. This large discrepancy can be explained by three factors.[2] First, demographic and macroeconomic projections were over-optimistic and based on poor-quality data. Second, the reform was not

2 S. Cueva and others, "Bolivia: selected issues and statistical appendix", *IMF Country Reports*, No. 03/258, August 2003.

Table 2
BOLIVIA: MAIN QUARTERLY INDICATORS

	2002				2003[a]				2004[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	1.6	3.1	3.8	2.4	2.6	3.3	2.1	1.9	3.8	...
Merchandise exports, f.o.b. (millions of dollars)	276	329	358	359	315	397	433	426	453	...
Merchandise imports, c.i.f. (millions of dollars)	393	462	480	497	444	384	406	451	414	...
Net consolidated international reserves (millions of dollars)	1 641	1 464	1 239	1 360	1 205	1 348	1 470	1 489	1 378	1 201
Real effective exchange rate (index: 2000=100) [c]	100.7	101.3	97.4	97.0	101.9	108.9	109.8	112.5	115.3	114.3
Consumer prices (12 month variation %)	0.9	0.2	1.0	2.4	2.8	3.2	3.6	3.9	4.2	4.9
Average nominal exchange rate (bolivianos per dollar)	6.9	7.1	7.3	7.4	7.5	7.6	7.7	7.8	7.9	7.9
Nominal interest rates (annualized percentages)										
Deposit rate [d]	2.0	1.7	3.7	3.5	2.3	1.8	1.6	1.6	1.6	2.1
Lending rate [d]	12.0	10.3	10.7	10.6	9.6	9.7	9.7	7.5	7.4	7.9
Repurchase rate [e]	3.2	3.9	8.5	6.7	6.4	6.7	6.7	7.2	6.4	8.1
Domestic credit [f] (variation from same quarter of preceding year)	-1.7	-0.1	0.3	1.5	1.9	2.7	4.6	3.0	2.0	-0.8
Non-performing loans as a percentage [g] of total loans (%)	15.9	16.6	18.4	18.5	19.4	19.8	19.1	17.4	18.0	17.9

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1993 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Bank operations (61-90 days), three-month average, in dollars. [e] Annualized effective rate, in dollars . [f] Net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [g] Refers to total credit extended by the banking system.

implemented as originally planned, partly because of deteriorating macroeconomic conditions that forced the government to make compromises, but also because the reform failed to provide for foreseeable costs such as the public pension system's assumption of the liabilities of various complementary funds. Lastly, administrative problems upon implementation resulted in the fraudulent registration of beneficiaries.

(b) Monetary policy

Although Bolivia's monetary policy has little room for manoeuvre in the country's highly dollarized economy, the central bank had to fulfil its role as lender of last resort several times in order to ward off impending banking crises.

Since 1999 low growth rates and political instability have generated a process of financial disintermediation. In May 2004 deposits and the banking portfolio stood at 71% and 59% of their December 1998 levels, although they shrank far less in 2003 than they had in 2002: between December 2002 and December 2003 the assets and liabilities of the financial system as a whole (banks and other intermediation institutions) went down by 2.8% and 3.2%, respectively, compared to a 10% reduction over the year-earlier period. In 2003 bank deposits (which account for 78% of the system's total deposits) contracted by 3.8%, or about US$ 106 million, after having dropped by US$ 420 million in 2002.

The downturn in bank deposits was particularly severe during four critical episodes: the uncertainty surrounding the July 2002 presidential election, the political crises of February and October 2003 and the announcement of the financial transactions tax in the first four months of 2004, which triggered a steady outflow of deposits. On these occasions the central bank injected liquidity into the system through measures such as reverse repo operations. Given the economy's high level of dollarization, deposit withdrawals have an immediate effect on the level of reserves. For example, US$ 150 million in net consolidated international reserves (central bank and commercial banks) were lost in October 2003. The central bank altered the composition of reserves by using commercial banks' liquid assets abroad to offset the decline in deposits. In October the reverse repo rate (which indicates the cost of liquidity offered by the central bank) stood at 8.12%. By late December commercial banks had repaid their liquidity credits and the level of reserves had recovered, but deposits and reserves dipped again in the first four months of 2004, with reserves dropping by nearly US$ 240 million, while the reverse repo rate stood at 7.5% in April. Although both deposits and reserves began to recover in May, the potential effects of the financial transactions tax are impossible to predict. In the current climate of uncertainty, the banking system is operating with large reserves of liquidity.

The financial system's weakness is also reflected by the high delinquency rate. The rate peaked at one fifth of the total loan portfolio in April 2003 before gradually subsiding to 16.7% by December. This improvement was reversed in the first few months of 2004, as the index had climbed to 18.8% by May. Loan delinquency is linked to the weakness of domestic economic activity and to expectations that loan renegotiations could be favourable to debtors. For the banking system, the write-off of a large number of loans represents an additional problem, since it entails the accumulation of illiquid assets. Although both lending and deposit rates have trended downward in 2003 and 2004, the spread between them is still wide, not only because of the perceived high risk of lending, but also because the government's demand for financing has kept lending rates from falling below a certain threshold.

(c) Exchange-rate policy

In 2003 the monetary authority acted to slow the boliviano's devaluation under the country's crawling-peg exchange-rate regime. The nominal depreciation between December 2002 and December 2003 was 5.1%, compared to 9.5% in the course of 2002. The real effective exchange rate depreciated by 14.6% in 2003 because the nominal devaluation outpaced inflation and, especially, because the currencies of Bolivia's trading partners rose in value. In the first half of 2004 the boliviano maintained the record level of competitiveness it had attained in late 2003, although it appreciated slightly between May and June.

3. The main variables

(a) Economic activity

Gross domestic product grew by 2.45% in 2003, boosted by exports of goods and services, which were up by 10.3% for the year as a whole. Domestic demand contracted by 1.3%, however, owing to a sharp decline in investment (-17%), while total consumption expanded by 1.2%, with the most buoyant component being government consumption. The fall in investment mainly reflected the completion of the Yacuiba-Río Grande gas pipeline. Slack domestic demand also resulted in a dip in imports (2.7%). Gross fixed capital formation trended downward between 1998 and 2003, slipping from 23.4% to 12.5% of GDP over that period, clearly reflecting the sluggish pace of economic growth since 1999.

The fastest-growing sectors of activity in 2003 were agriculture (5.8%) and hydrocarbons extraction (10.7%). The strongest upturns within agriculture were a 25% rise in soybean output, which reached 1.5 million tons, and a 13% increase in rice production. Gas extraction climbed by 15%, registering a dramatic upswing of 32% in the final quarter of 2003 as daily output reached an average of 25.5 million cubic feet in those three months. Growth in manufacturing has been linked to soybean production and to textiles and leather intended for export under the Andean Trade Promotion and Drug Eradication Act (ATPDEA). Mining performed poorly owing to the depletion of a major gold deposit. Construction was depressed as well because of low investment.

In the first quarter of 2004 GDP grew by 3.8% in relation to the year-earlier period, boosted by exports, especially of hydrocarbons and soybeans. The economy will need to maintain this rate for the rest of the year in order to meet the official 2004 growth projection of 3.6%. Growth prospects picked up in the wake of the referendum on gas and the resulting agreement to increase gas sales to Argentina from 4 million to 6.5 million cubic metres a day.

(b) Prices, wages and employment

Inflation came in at 3.94% in 2003 (December 2002-December 2003), overshooting the target of 2.8% agreed upon with IMF. As a result of supply shortages caused by the crisis, price rises accelerated in July and August and surged in October. This behaviour also reflected currency appreciation in neighbouring countries; underlying inflation was only 2.6%.

The inflation target for 2004 has been set at 3.5%, and cumulative inflation from December 2003 to June 2004 amounted to 1.73%. The latter month saw a substantial rise due in part to adjustments in hydrocarbon prices (which, in turn, affected transport and bread prices) and in part to problems in the cultivation of certain crops, including potatoes and various fruits. Fuel prices rose again in July, when the price of a cylinder of liquefied gas increased from 21.50 to 22 bolivianos.

Although no employment and wage data are available for 2003, preliminary central bank estimates suggest that open unemployment in urban areas rose from 8.7% in 2002 to 9.5% in 2003.

(c) The external sector

Favourable conditions on international commodity markets, together with sluggish domestic demand and income from grants, had positive effects on the balance of payments in 2003. The current account posted a small surplus (US$ 19 million) for two reasons. First, there was a surplus on the merchandise trade account thanks to a 21.1% rise in exports and a 7.3% fall in imports. Second, official transfers soared from US$ 175 million in 2002 to US$ 272 million in 2003. Total transfers (excluding debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative) also increased, this time by 29%. These inflows, representing revenues of US$ 501 million in all, were partially offset by the combined deficits on the services trade and income accounts, which amounted to some US$ 482 million. These shortfalls widened by about US$ 100 million compared to their 2002 levels. Exports achieved a record figure (US$ 1.573 billion) thanks to increased sales of gas, soybeans and various minerals, whose prices remained very high throughout the year.

Foreign direct investment dropped off dramatically (from US$ 674 million in 2002 to US$ 160 million in 2003). Nonetheless, the government obtained 23% more financing than in 2002, and capital outflows were smaller than they had been that year. Thus, the combination of the current account surplus and the positive net inflows of capital yielded an overall balance of US$ 139 million; US$ 152 million was added to the country's reserves.

Estimates by the National Institute of Statistics for the first five months of 2004 show that exports totalled US$ 778 million, representing a 39% increase over the figure for the same period of 2003. This growth was led by foreign sales of hydrocarbons, soybeans and minerals such as tin and zinc. Imports, on the other hand, slipped by 6.8% in the first quarter as a result of a sharp decline in capital goods purchases.[3] Although this period saw a small surplus on the current account, net capital flows (including errors and omissions) were negative and the deficit, of just over US$ 100 million, was financed out of reserves.

3 The central bank estimates a 3.7% increase in imports over the same period, however.