CENTER FOR ECONOMIC AND POLICY RESEARCH

Bolivia's Challenges

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Executive Summary

Bolivia's new government took office in January 2006 with a strong mandate for economic reform, and with promises that such reform would both increase economic growth and benefit the poor. Nonetheless an electoral mandate for economic change does not necessarily translate into reform. There are various external pressures, from foreign governments (especially the United States), multi-lateral lending institutions, and other sources that can influence policy. This paper looks at Bolivia's potential vulnerability to pressures in conjunction with external public debt and debt relief, grants and foreign borrowing, and trade.

The demand for new economic policies stems from a long-term economic failure: real GDP per capita in Bolivia is less today than it was 27 years ago (see **Figures 1 and 2**), and 64 percent of the country lives below the poverty line. Furthermore, Bolivia has completed numerous structural reforms (see **Figure 3**) that economists from multi-lateral lending institutions have recommended, and has operated under IMF agreements almost continuously for 20 years. In the IMF's April 2005 country report on Bolivia, the authors discuss the Bolivian "puzzle" – "that a country perceived as having one of the best structural reform records in Latin America experienced sluggish per capita growth, and made virtually no progress in reducing income-based poverty measures" (IMF 2005a, p. 4).

More than 70 percent of Bolivia's $6.7 billion public debt is external, and most of this external debt (more than 90 percent) is owed to multilateral lending institutions (see **Table 1**). The IMF cancelled almost all of Bolivia's debt to it this year and the World Bank is set to cancel $1.53 billion. The Inter-American Development Bank (IDB) holds $1.6 billion of Bolivia's debt, and is also expected to cancel this debt, although this has not yet been decided.

Net foreign borrowing by Bolivia has diminished in recent years, to $79.7 million or 0.9 percent of GDP in 2005 (See **Table 4**). Concessional, low-interest foreign lending to Bolivia can be expected to be reduced in the near future, as the country's per capita income level passes the maximum amount that allows for eligibility for such loans.

Grants and donations from foreign countries comprise about $110 million, or 1.05 percent of GDP, in the government's budget for 2006 (See **Table 3**).

With regard to debt cancellation, loans, and aid flows, it would be politically difficult to treat Bolivia differently from other countries in the same category. The IDB cancellation would be expected to apply to the four Latin American HIPC (Heavily Indebted Poor Countries) debtors, under which Bolivia has received prior debt cancellation. Bolivia has passed the "completion point" for the Enhanced HIPC initiative, meeting a set of quantitative financial benchmarks and structural reform criteria under the IMF's Poverty Reduction and Growth Facility (PRGF). The IMF and World Bank decided that "virtually all quantitative targets had been met" (IMF and IDA 2001, p. 21) under the PRGF. A "long track record of sound macroeconomic policies and substantial structural adjustment" (IMF and IDA 2001, p. 4) according to the IMF and World Bank, had enabled Bolivia to reach the completion point under the original HIPC initiative.

Since meeting these conditions Bolivia's macroeconomic performance – according to the criteria most important to the multilateral lenders – has improved considerably. In 2002 the government was running a public sector budget deficit of 8.8 percent of GDP; for 2005 it is 3.5 percent and the

IMF projects 3.0 percent for 2006 (IMF 2005b, p. 26). The country has also gone from a $324 million (4.1 percent of GDP) current account deficit in 2002 to a $205 million (2.1% percent of GDP) surplus for 2005 (IMF 2005b, p. 30). So it would be very difficult to conceive of a performance-based reason to deny debt relief, loans, or grants to Bolivia.

It would also be difficult to single out Bolivia with regard to trade preferences in the U.S. market. Although preferences under the Andean Trade Preferences and Drug Eradication Act (ATPDEA) are set to expire at the end of the year, they will very likely be extended. Even if Bolivia eventually loses these preferences because it does not sign a new Free Trade Agreement with the United States, this would affect less than two percent of the country's exports.

Another question with regard to external pressures regarding the new government's economic policies is the future role of the IMF in Bolivia. Traditionally, the IMF has served as a "gatekeeper" for other sources of external financing, and therefore – together with its dominant stakeholder, the U.S. Treasury Department – has been able to exert considerable influence over economic policy. For a number of reasons discussed below, it seems unlikely that the IMF will play this role in Bolivia in the future.

The new government is therefore in a relatively good position to choose policies that could accelerate growth and deliver on its promises to the poor. The May 2005 hydrocarbons law has substantially improved the fiscal situation of the government for the foreseeable future. Although the government does depend on some foreign financing for its operations, this dependence has been diminishing as the fiscal situation has improved and should fall considerably as the World Bank and IDB debt – accounting for about three-quarters of the country's external public debt – are cancelled.

One thing that the new government could do, as a precautionary measure and to help smooth the country's transition to non-concessional and domestic borrowing, is to apply for a line of credit with the Venezuelan government. Venezuela's lending from its surplus foreign exchange reserves to Argentina and Ecuador has been a very important source of financing for those countries, and will almost certainly be available to Bolivia should it become necessary. But by opening a line of credit in advance – one that it is not expected to draw upon in the foreseeable future – Bolivia can significantly reduce some risks of financial instability. For example, this pre-approved credit would reduce the risk of the kinds of runs on deposits that the country experienced in 2002 and 2004, as depositors would know that the country has access to an additional supply of foreign exchange reserves.

Another move that could improve the government's fiscal situation in the immediate future as well as for many years, would be to reverse the privatization of the country's public pension system. As noted above, and also by the IMF (IMF 2005a, p. 17-18), this privatization has created very large, long-term transition costs, as the income from current payroll taxes is not available to pay current retirees. By returning to a "pay-as-you-go" system as the United States has, the government's fiscal deficit could be substantially reduced. The potential deficit reduction from switching back to a traditional public defined-benefit system is large enough that this option is definitely worth considering.

Introduction

On December 18, 2005, Evo Morales became the sixth Latin American president[1] to be elected after campaigning against the economic reforms of the last 25 years, or "neoliberalism" as they are commonly referred to in the region, and promising an alternative.[2]

Like Lula da Silva in Brazil, Morales won with an unprecedented electoral mandate – in his case 54 percent of the vote, the highest for any elected president in Bolivia's 20 years of democratic elections, and a record voter turnout. Furthermore, Morales' party has a majority in the lower house of Congress and a possible working majority in the Senate.

The need for new economic policies can be seen from the severe economic failure over the last quarter-century. As shown in Figure 1, Bolivia's per capita income today remains below its level of 1978. Figure 2 shows Bolivia's economic growth (per capita GDP) over the last 25 years, as compared with the 1960-1980 period; the same measures are also shown for the entire Latin American region. As can be seen from the graph, Bolivia's per capita income has grown by less than 2 percent over the past 25 years, as compared to 60 percent from 1960-1980. This is even worse than the region as a whole, which during the last 25 years also suffered its worst growth performance in the last century. Per capita GDP growth for the region was only 10 percent for 1980-2005, as compared with 82 percent for 1960-1980 (Figure 2).

Over the last 20 years, Bolivia has been operating continuously under International Monetary Fund (IMF) agreements (with the exception of an 8-month period).[3] Partly in accordance with these agreements with the Fund, which coordinated its policies in Bolivia with the World Bank and Inter-American Development Bank (IDB)[4] – Bolivia has undertaken some of the most wide-ranging structural reforms in Latin America. Figure 3 shows Bolivia's ranking according to a "Structural Reform Index" developed by Lora (2001).[5] It can be seen that for most of the past two decades, Bolivia has outperformed the region in implementing the recommended structural reforms. Indeed, in the IMF's April 2005 country report on Bolivia, the authors discuss the Bolivian "puzzle" – "that a country perceived as having one of the best structural reform records in Latin America experienced sluggish per capita growth, and made virtually no progress in reducing income-based poverty measures" (IMF 2005a, p.4).

1 The others were Néstor Kirchner of Argentina (2003), Lula da Silva of Brazil (2002), Lucio Gutiérrez of Ecuador (2002), Tabaré Vázquez of Uruguay (2005), and Hugo Chávez of Venezuela (1998 and 2000).

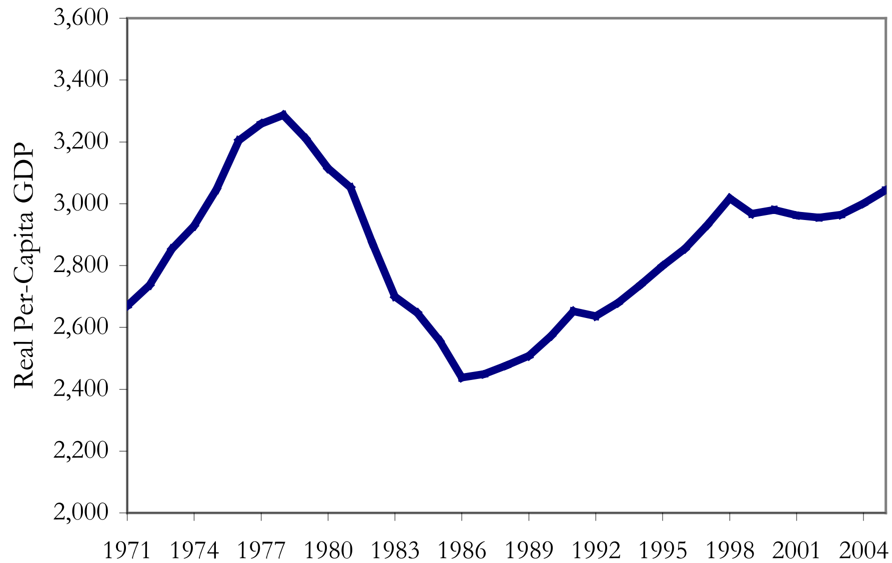
2 The second of "Ten Proposals to Change the Country," by Movement Toward Socialism (MAS in Spanish), Evo Morales' party, which also took a majority of the lower house and the presidency of the Senate, proposes a Constitutional Assembly to "uproot the exclusionary, discriminatory and colonial, neoliberal state, and design a new dignified, communitarian and productive state for all" (http://www.mas.org.bo/nueve.htm).

3 June 2002 to April 2003.

4 See, for example, IMF (2005a, p. 11): "Over the last ten years, the Fund has collaborated extensively with the World Bank and IDB on fiscal and financial sector reforms as well as other structural reforms [in Bolivia]. With respect to financial sector reforms, the World Bank has generally taken the lead until recently. . . The Bank also took the lead in advising the authorities on capitalization (privatization)."

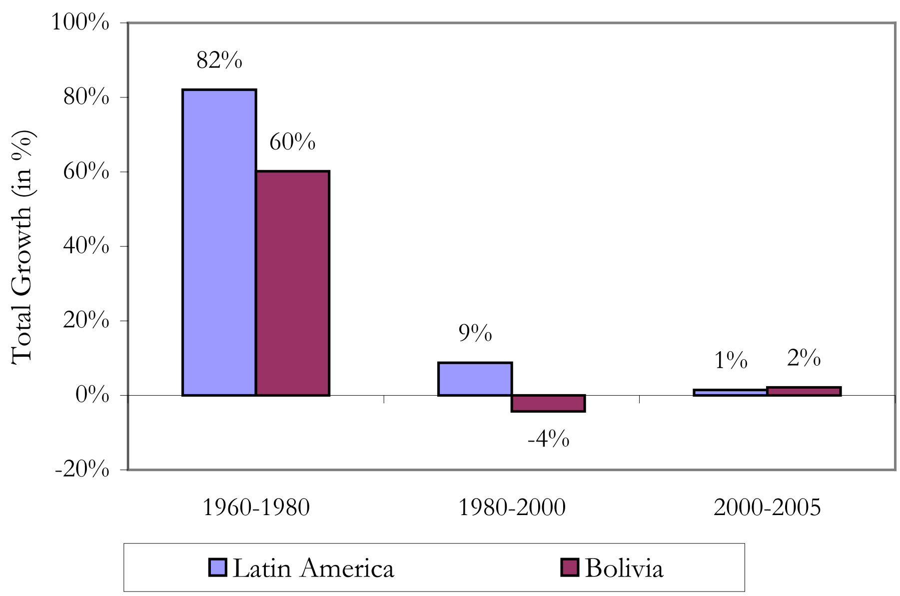
5 The Structural Reform Index is based on five sub-indeces in the areas of trade, finance, taxation, labor and privatization for 19 countries of Latin America and the Carribean.

FIGURE 1. Bolivia, Real per capita GDP based on Purchasing Power Parity (PPP), 1971-2005



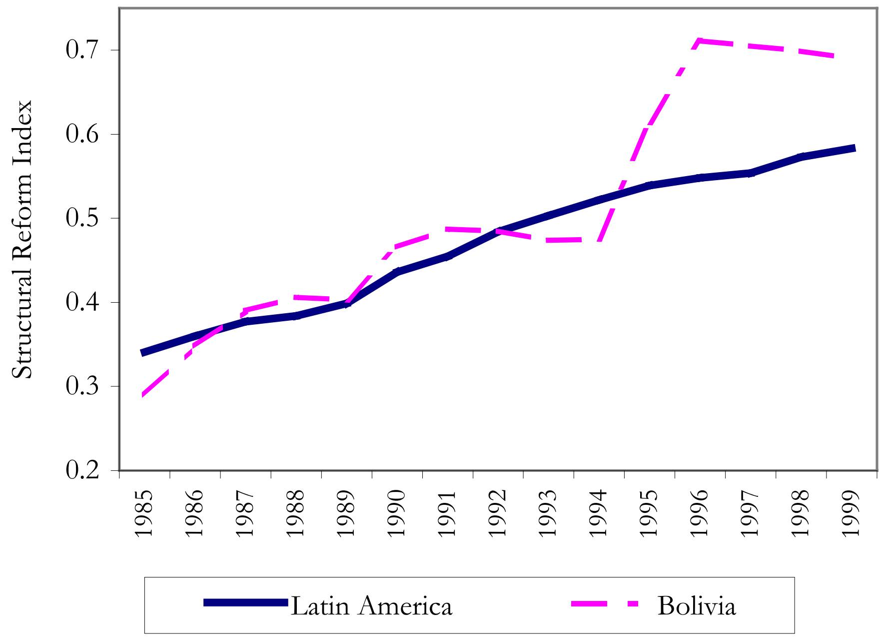
Source: Maddison 2005, IMF 2005d, and author's calculations.

FIGURE 2. Real per capita GDP growth in Latin America, 1960-2005



Source: Maddison 2005, IMF 2005d, and author's calculations.

Figure 3. Structural Reforms, Bolivia and Latin America, 1985-1999



Source: Lora 2001.

Bolivia is also the poorest country in South America, with a per capita income of $2,800, as compared to an average of $8,200 for Latin America and $42,000 for the United States (IMF 2005d).[6] About 64 percent of the population lives below the poverty line.[7] There is no doubt that this majority voted for economic change in the hope that this would better their conditions.

Nonetheless, an electoral mandate does not immediately translate into policy changes. In addition to conflicting economic, regional, ethnic,[8] and sectoral interests within the country, there are often external pressures that play a role in setting the parameters for economic and social change. In developing countries and in Latin America in particular, these pressures often come from multilateral lending institutions (the IMF, World Bank, IDB), international financial markets, or rich country governments. Access to foreign markets for exports can also be made conditional on the country adopting certain economic policies. In Latin America, the United States government has historically been a very powerful influence in all of these arenas, and an important political force as well, especially vis-à-vis the smaller economies. Bolivia, with 8.7 million people, has an economy that is less than three-thousandths the size of the United States.[9]

Most of these influences and pressures – including trade, aid, debt, and other political pressures– are likely to come into play as the new Bolivian government tries to steer a path of economic and political reform. In contrast to some of the rhetoric during the election campaign, the new government has stated clearly its desire to maintain good relations with the United States. The Bush

[6] Data are purchasing power parity (PPP) GDP per capita.
[7] The latest poverty estimate is for 2002. Instituto Nacional de Estadística, Bolivia (http://www.ine.gov.bo/).
[8] The country has an indigenous majority, which is disproportionately poor and heretofore politically marginalized and excluded; the new president, Evo Morales, is the country's first indigenous president and has pledged to remedy this situation.
[9] This is also on a PPP basis; on an exchange rate basis, which is useful for some comparisons, Bolivia's GDP is much less, just $9.5 billion or less than one-thousandth of U.S. GDP.

Administration has so far given mixed signals.[10] More importantly, Washington appears to have goals for Bolivia that are strongly opposed by the political base of the current government, and go against its promises to the electorate. Among these are an aggressive coca eradication program,[11] Bolivia's accession to an AFTA, and a rewriting of the country's May 2005 hydrocarbons law that provided for increased royalties and renegotiation of contracts with private foreign-owned gas companies.

It is therefore worth looking at Bolivia's potential vulnerability to any reductions in foreign aid, export markets, loans and debt cancellation. This paper looks at Bolivia's current economic situation, with a focus on the external sector and various potential "pressure points." It also considers the possibilities for reducing the country's vulnerability to external political decisions, so as to allow for more policy space for the new government to promote more rapid economic growth and poverty reduction.

[10] President Bush did call President Morales on February 1 to congratulate him on his victory. On the other hand, Defense Secretary Donald Rumsfeld said that "elections like Evo Morales in Bolivia take place that clearly are worrisome." See "Secretary Rumsfeld's Remarks at the National Press Club," Washington DC, February 2, 2006, (http://www.defenselink.mil/transcripts/2006/tr20060203-12436.html). And Washington cut off military aid in the federal budget proposal released on February 8 because the Bolivian Congress has refused to ratify an agreement which would exempt United States citizens from being brought before the International Criminal Court. U.S. law prohibits military aid to countries that have not ratified such an agreement, but some countries who, like Bolivia, have signed the agreement but not had it ratified by their legislatures, have not been cut off. See "Budget Would Slash Bolivia Military Aid," by Joel Brinkley, *The New York Times*, February 8, 2006.

[11] See e.g. "Bolivia's Knot: No to Cocaine, But Yes to Coca," by Juan Forero, *New York Times*, February 12, 2006.

External Public Debt and Conditionality

Table 1 shows the structure of Bolivia's public debt, in millions of current dollars and as a percentage of GDP, for the last 5 years. As can be seen from the chart, most of the government's debt (70.2%) is external debt. More than 90 percent of that external debt is owed to multilateral lending institutions. The chart includes $243.8 million that was owed to the IMF, of which $232.5 million was cancelled this year. Thus, the second column for 2005 shows the current total of $13.9 million.

The cancelled IMF debt represented only 4.7% percent of the total external public debt. Nonetheless this cancellation is very important. First, it is still a significant amount of money, about 2.5 percent off GDP; and the IMF had projected debt service payments to the Fund of $236 million for the years 2006-2009, which have now been reduced to $16.5 million.

Perhaps more importantly, the cancellation of IMF debt makes it easier for the new Bolivian government to re-evaluate its relationship with the Fund, which has had a heavy presence there for the last 20 years, as noted above. Bolivia is currently under a Standby Arrangement[12] with the IMF, which expires March 31. The Standby Arrangement was originally approved in April 2003 for a one-year period and has been extended several times; it was intended to be a bridge agreement towards a longer term agreement under the IMF's Poverty Reduction and Growth Facility (PGRF).[13] The question of whether Bolivia wants to continue borrowing from the Fund – in either a short-term or long-term agreement – given the conditions attached to its lending, could prove to be very important for the new government.

The track record of the Fund's involvement in Bolivia over the last 20 years raises serious questions about its policy advice. As noted above, the country's income per person remains below its level of 20 years ago. The government's fiscal situation is still seriously weakened from the 1998 privatization of Bolivia's social security system, which was one of the reforms that the country implemented under the advice and promotion of the IMF/World Bank. When switching from a "pay-as-you-go" system, as the United States currently has, to a system of private accounts, there are very large transition costs. Current retirees must be paid for a period of decades, without the revenue that had previously been provided from payroll taxes, while the private accounts accumulate enough savings to pay a retirement income. The government is currently spending 4.1 percent of GDP annually on pensions, more than the entire public sector deficit. Most of this spending is the result of Social Security privatization.[14] Thus, this one structural reform is responsible for most of the government's current budget deficit, as well as a significant amount of debt accumulation since 1998.

[12] This is a short-term IMF lending facility that requires certain structural and financial benchmarks and performance criteria to be met.

[13] This is an IMF facility known until November 1999 as the Enhanced Structural Adjustment Facility (ESAF). Countries that borrow under the PGRF must be eligible for loans from the World Bank's concessional lending arm, the IDA (International Development Association).

[14] This has been a major problem for other privatized systems in Latin America, including Chile and Argentina (see Baker and Weisbrot (2002), "The Role of Social Security Privatization in Argentina's Economic Crisis,"). For a poor country such as Bolivia with a lower tax base it is even more of a problem.

TABLE 1

Bolivia: Total Public Debt, 2000-2005

(in current US$ millions and % of GDP)

	2000		2001		2002		2003		2004		2005 (before IMF cancellation)		2005 (after IMF cancellation)	
External														
Multilateral	3077.3	36.6%	3261.1	40.0%	3637.2	45.8%	4318.4	53.3%	4662	53.1%	4519.9	48.4%	4290.0	45.9%
IMF	220.2	2.6%	207	2.5%	194.6	2.5%	276.5	3.4%	306	3.5%	243.8	2.6%	13.9**	0.1%
IDB	1392.8	16.6%	1373.7	16.8%	1450.2	18.3%	1626.5	20.1%	1658.2	18.9%	1622.8	17.4%	1622.8	17.4%
World Bank	1096.3	13.0%	1146.8	14.1%	1323.5	16.7%	1571.2	19.4%	1748.6	19.9%	1666.6	17.8%	1666.6	17.8%
CAF	255.4	3.0%	420.7	5.2%	577.4	7.3%	740.6	9.1%	836.9	9.5%	871.3	9.3%	871.3	9.3%
Other	112.6	1.3%	112.9	1.4%	91.5	1.2%	103.6	1.3%	112.3	1.3%	115.4	1.2%	115.4	1.2%
Bilateral	1371.8	16.3%	1227.2	15.1%	757	9.5%	820.6	10.1%	382.9	4.4%	420.7	4.5%	420.7	4.5%
Japan	523.4	6.2%	464.1	5.7%	513.5	6.5%	567.6	7.0%	71.6	0.8%	63	0.7%	63	0.7%
Germany	325.4	3.9%	306.1	3.8%	6.9	0.1%	9.5	0.1%	39.1	0.4%	34	0.4%	34	0.4%
Belgium	57.7	0.7%	54.8	0.7%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Spain	142.3	1.7%	137.8	1.7%	134.9	1.7%	130.9	1.6%	142.8	1.6%	139.3	1.5%	139.3	1.5%
France	40.7	0.5%	37.9	0.5%	16.1	0.2%	17.2	0.2%	17.2	0.2%	13.3	0.1%	13.3	0.1%
USA	60.1	0.7%	59.3	0.7%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
UK	18.1	0.2%	17.9	0.2%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Brazil	21.9	0.3%	33.5	0.4%	56.2	0.7%	73.5	0.9%	87.4	1.0%	121.5	1.3%	121.5	1.3%
Other	182.2	2.2%	115.8	1.4%	29.4	0.4%	21.9	0.3%	24.8	0.3%	49.6	0.5%	49.6	0.5%
Private	11.2	0.1%	8.4	0.1%	5.5	0.1%	2.8	0.0%	0.4	0.0%	0.2	0.0%	0.2	0.0%
Total External	4460.3	53.0%	4496.7	55.1%	4399.7	55.4%	5141.8	63.5%	5045.3	57.4%	4940.8	52.9%	4710.9	50.4%
Domestic														
Public Sector*	55.0	0.7%	68.5	0.8%	64.5	0.8%	55.3	0.7%	38.9	0.4%	44.6	0.5%	44.6	0.5%
Private Sector	780.6	9.3%	1192.9	14.6%	1267.0	16.0%	1463.6	18.1%	1729.5	19.7%	1953.3	20.9%	1953.3	20.9%
OMAs (Market Auctions)	263.6	3.1%	538.9	6.6%	460.5	5.8%	531.7	6.6%	660.5	7.5%	726.3	7.8%	726.3	7.8%
AFPs (Pensions)	517.0	6.1%	654.0	8.0%	786.0	9.9%	913.1	11.3%	1049.0	11.9%	1207.0	12.9%	1207.0	12.9%
Other	0.0	0.0%	0.0	0.0%	20.5	0.3%	18.8	0.2%	20.0	0.2%	20.0	0.2%	20.0	0.2%
Total Domestic*	835.6	9.9%	1261.4	15.5%	1331.4	16.8%	1518.9	18.8%	1768.4	20.1%	1997.8	21.4%	1997.8	21.4%
Grand Total	5295.9	63.0%	5758.1	70.6%	5731.1	72.2%	6660.7	82.2%	6813.7	77.6%	6938.6	74.3%	6708.7	71.8%

Sources: Banco Central de Bolivia, Ministerio de Hacienda, WEO Sept. 2005
* Does not include domestic debt owed to the Central Bank
** This value reflects IMF debt cancellation of US$ 232.5 million plus exchange rate variation of US$ 2.6 million

Moreover, in recent documents the Fund has been advocating against the May 2005 hydrocarbons law[15], which increased the royalty payments by foreign gas companies and provided for the renegotiation of some of their contracts. The increased revenue from these legal changes is very important to the government's fiscal balance as well as its ability to undertake projects that would reduce poverty or improve the health of the population. Table 2 shows the IMF's most recent projections (from November 2005) for government revenue from hydrocarbons.

TABLE 2

Bolivia: Macroeconomic Indicators, (2005-2010) Projections (International Monetary Fund)*

	Prel. 2004	Proj. 2005	Proj. 2006	Proj. 2007	Proj. 2008	Proj. 2009	Proj. 2010
			(Annual percentage changes)				
Real GDP Growth	3.6	3.9	4.1	3.9	3.0	3.0	3.0
Growth in hydrocarbons production	23.8	14.9	7.1	0.0	0.0	0.0	0.0
CPI (end of period)	4.6	4.2	3.5	3.0	3.0	3.0	3.0
			(In percent of GDP)				
Public Sector							
Total Revenue	26.8	29.0	29.6	29.2	28.8	28.3	28.0
Of which: Hydrocarbons 1/	3.4	5.4	6.7	6.3	5.9	5.5	5.2
Interest	2.9	2.9	2.6	2.6	2.5	2.4	2.3
Overall balance	-5.5	-3.5	-3.0	-2.6	-2.3	-2.2	-1.9
Of which: Pension-related balance	-4.3	-4.1	-3.9	-3.7	-3.7	-3.7	-3.7
Net domestic financing	1.6	1.2	1.0	0.9	0.9	0.9	0.7
Net external financing	3.9	2.3	2.1	1.7	1.4	1.3	1.2
			(In percent of GDP)				
External Sector							
Trade balance	3.4	2.3	1.7	1.7	1.8	1.2	0.8
Current account balance	3.2	2.1	1.5	1.1	1.0	0.1	0.2
Gas exports	7.1	9.2	9.6	9.2	8.7	8.1	7.6
Net foreign direct investment	1.3	1.6	1.6	0.2	0.1	0.1	0.2
Memorandum item:							
GDP (US$ million)	8784.0	9751.0	10471.0	11209.0	11879.0	12607.0	13367.0

* IMF 2005b, table 7
1/ Excluding excise taxes on fuel products

As can be seen from the table, the increase from 3.4 percent of GDP in 2004, to 5.4 percent in 2005 and a projected 6.7 percent ($628 million) for 2006 is quite significant. The Fund then projects a decline in revenues – with zero growth in hyrdrocarbons production between 2007 and 2010 – and

[15] "The design of that [hydrocarbons] law raises serious concerns in terms of its potential adverse impact on the development of this key sector of the Bolivian economy" (IMF 2005b, p.22). See also pp. 12, 14, and 18.

correspondingly reduced GDP growth – on the theory that the new law will discourage investment in the industry.[16]

But these projections are almost certainly wrong. On February 10, Petrobras, the Brazilian state-run oil company, announced a plan to invest $5 billion in Bolivia's gas industry.[17] This is an enormous amount of investment relative to Bolivia's economy, and exceeds the total invested in gas production by private companies since the sector was privatized ten years ago. This should provide grounds for caution with regard to the Fund's projections, and advice that is based on them.[18]

Some of the IMF's goals for Bolivia[19] such as de-dollarization of the economy, or the creation of a system of deposit insurance, are potentially beneficial.[20] But others are not necessarily helpful: for example, the privatization of remaining banks where the state has a majority interest, increased flexibility of the exchange rate, increasing the independence of the central bank, or legal changes regarding corporate restructuring and bankruptcy. The IMF's track record in the last few years on macroeconomic policy, for example in Argentina,[21] provides further grounds for caution in concluding any further agreements with the Fund.

In light of these considerations and others[22] it would not be surprising if the new government of Bolivia were to allow the current agreement with the IMF to expire at the end of March and not seek any renewal. However, this would not necessarily end the role of the IMF in Bolivia's future. Historically, the IMF has played the role of "gatekeeper" for credit from other sources of loans and grants – including the much larger lending of the World Bank (for non-project lending), the IDB,

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16 "Discussions with the private sector suggest that these provisions [increased tax burden on foreign corporations and renegotiation of current contracts] will likely discourage new large investment in the hydrocarbons sector over the medium term. Accordingly, the updated medium-term outlook incorporates a broadly flat path for natural gas production and export volumes and correspondingly conservative real GDP growth assumptions." (IMF 2005b, p.15).

17 See "Petrobas to invest $5bn in Bolivia's gas sector," by Hal Weitzman, *Financial Times*, February 13, 2006.

18 The IMF has been shown to have a systematic bias in its projections on Latin America (see Baker and Rosnick (2003) "Too Sunny in Latin America," and "The Accuracy of World Economic Outlook Growth Forecasts: 1991-2000" in IMF 2001, pp. 37-39). This study shows a systematic upward bias for growth, but it appears to be the opposite in cases where the IMF opposes the government's policies – e.g. Argentina and Venezuela. In Argentina, where the government rejected the IMF's advice on a number of important policies, the IMF in January of 2003 projected 35 percent inflation and 2.5 percent growth for that year. The actual results were 3.7 percent inflation and 8.8 percent growth.

19 As set forth in IMF 2005a, IMF 2005b, IMF 2005c.

20 The Bolivian economy is sensitive to runs on deposits in the banking system (as happened in 2002 and 2004), because about 60 percent of the country's deposits are held by just one percent of depositors (IMF 2005b, p.16). A deposit insurance system, provided it was properly regulated, could reduce this source of instability. The high level of dollarization of the economy is also a source of instability, as the balance sheets of companies with liabilities in dollars and revenues in domestic currency (bolivianos) are very vulnerable to exchange rate changes.

21 There is strong evidence that Argentina's rapid economic recovery from the severe 1998-2002 recession – growth has averaged more than 9 percent annually over the last three years – was accomplished with policies that were opposed by the Fund. Among these were the Central Bank's targeting of a stable and competitive exchange rate, an export tax (which helped close most of the fiscal gap in the early stages of recovery), and a freeze on utility prices. The Fund also advocated a tighter fiscal and monetary policy and a more favorable settlement with foreign creditors than was ultimately chosen by the government of Argentina (See Cibils, Weisbrot, and Kar (2002), "Argentina Since Default: The IMF and the Depression;" Frenkel and Rapetti (2006), "Monetary and Exchange Rate Policies in Argentina after the Convertibility Regime Collapse;" and Damill, Frenkel, and Rapetti (2005), "The Argentinean Debt: History, Default and Restructuring."

22 The internal politics of Bolivia would also favor a break with the IMF, as the institution is not well liked among the government's base, some of whom hold the Fund's policies responsible not only for Bolivia's economic failure but also for the violence of February 2003 (Shultz 2005), see Schultz, Jim. 2005. *Deadly Consequences*. Cochabamba: The Democracy Center.

bilateral lenders (e.g. USAID), and the governments of high-income countries. At its strongest this informal relationship among lenders (it is not a part of these organizations' written rules) has resulted in a powerful creditors' cartel that, headed by the U.S. Treasury Department,[23] has had a considerable influence over the economic policies of low-and middle-income countries; at its mildest it is seen by e.g., European donor governments as an "auditor" to insure that their money is not being wasted.

The relevant question here is whether an agreement with the IMF, or the lack of it, will be a condition for other sources of funding – especially the World Bank, IDB, and the high-income country governments. In the past this would almost certainly be true, as it generally has been over the last 20 years of IMF agreements with Bolivia. However, this may not be true today. The power of the IMF has declined drastically since the late 1990s. After the East Asian economic crisis the middle income countries of that region began to accumulate large amounts of foreign exchange reserves, partly to avoid ever having to borrow from the IMF again. The experience of Argentina since 2002, in which the country rejected key policy recommendations of the IMF and received no net funding from the Fund or allied multilateral lenders,[24] and experienced a robust economic recovery, also had the effect of greatly reducing the IMF's influence over middle-income countries. Most recently, there has been a sharply reduced demand for IMF loans. In the past few months two of its biggest borrowers – Argentina and Brazil, paid in full their remaining debt to the IMF. These were considerable amounts of money: $9.8 billion (5.5 percent of GDP) for Argentina and $15.5 billion (2 percent of GDP) for Brazil. Indonesia, another of the IMF's largest borrowers has recently decided to pay off its $7.8 billion (2.8 percent of GDP) to the IMF.

As noted, it has been middle-income developing countries where the Fund has lost influence – the situation for poorer countries with respect to the multi-lateral lenders has not changed much. So it remains to be seen whether the IMF's traditional role will be invoked at this time in Bolivia. As with the other questions considered below, it will be a decision that will be influenced by political conditions, including Bolivia's perceived bargaining power.

The July 8, 2005 decision among the G-8 countries to cancel the IMF debt for 18 HIPC countries, including Bolivia, also set in motion a process to cancel these countries' World Bank debt (IDA 2005). For Bolivia, the amount to be cancelled is $1.53 billion of the $1.62 billion owed to the Bank, although the terms of the cancellation have not been finalized. The cancellation will take place over a period of 40 years, although it is not exactly clear why it is being implemented in this way. From the point of view of Bolivia's (or other recipient countries') annual finances, it does not appear to be different from the cancellation of the debt all at once, as was done with the IMF debt. In other words, once the cancellation is finalized, Bolivia will not be paying interest or principal on the debt that remains on the books over the 40-year period. The commitment to cancel the World Bank debt is at this time probably irreversible, although it has recently been delayed. So this debt ($1.53 billion) can be seen as cancelled in the near future.

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[23] The United States Treasury Department has a dominant role in IMF decision making, especially with regard to Latin America and any other areas that are of strategic interest to the U.S. government. Voting is proportional to contributions, and the U.S. not only holds a veto power over important decisions, but in practice the other high-income countries have virtually always deferred to U.S. Treasury on matters of concern to Washington over the last 61 years.

[24] The multilateral lenders actually took a net $4 billion (almost all IMF) out of Argentina during 2002, and more than $14 billion from 2002-2005.

The other large portion of Bolivia's debt – $1.6 billion or 32 percent of the country's external debt – is owed to the IDB. Discussions are underway for the cancellation of debt owed to the IDB by the four Latin American HIPC countries (Bolivia, Guyana, Honduras, and Nicaragua) plus Haiti. For Bolivia, this would be $1.3 billion of the $1.6 billion owed to the IDB.

It would be expected that the IDB would participate in the debt cancellation that has been arranged through this latest Multilateral Debt Relief Initiative (MDRI). The IDB provided 34.5 percent ($155 million) of Bolivia's debt relief under the original HIPC debt relief and committed to 36 percent ($307 million) of cancellation under the enhanced HIPC initiative (IMF and IDA, 2001). And as recently as December, the U.S. State Department reiterated President Bush's remarks at the Mar del Plata Summit, that the IDB should "implement measures that will better employ the bank's assets, including addressing the debt sustainability of the poorest countries in the region, and possible debt relief".[25] The question thus arises as to whether the possibility of IDB debt cancellation could be used to pressure Bolivia with regard to its economic policies.

If the IDB decides to proceed with debt cancellation for these HIPC countries, it would be politically difficult to single out Bolivia for denial of this cancellation. Three of the four countries are at about the same per capita income level, with only Nicaragua significantly lower: Bolivia ($960), Guyana ($1030), Honduras ($990), and Nicaragua ($790).[26]

Furthermore, Bolivia has passed the "completion point" for the Enhanced HIPC initiative, which made it eligible for debt cancellation under this latest MDRI. This meant passing the latest hurdles in a long list of conditions over several years. A "long track record of sound macroeconomic policies and substantial structural adjustment" according to the IMF and World Bank 2005, had enabled Bolivia to reach the completion point under the original HIPC initiative in September 1998 (IMF and IDA 2001, p. 4). The next step was the "decision point" for the Enhanced HIPC initiative, which was reached in February 2000; then the completion point for Enhanced HIPC in June 2001. For the latter, Bolivia had to meet a set of quantitative financial benchmarks and structural reform criteria under the IMF's Poverty Reduction and Growth Facility (PRGF). The IMF and World Bank decided that "virtually all quantitative targets had been met" under the PRGF; and also that there was progress on structural reforms, for example in the areas of customs, the internal revenue service, tax procedures, and budget management (IMF and IDA 2001, p. 21).

Perhaps more importantly, since meeting these criteria, Bolivia's macroeconomic performance – according to the criteria most important to the multilateral lenders – has improved enormously. In 2002 the government was running a public sector budget deficit of 8.8 percent of GDP; for 2005 it is 3.5 percent and the IMF projects 3.0 percent for 2006. The country has also gone from a $324 million (4.1 percent of GDP) current account deficit in 2002 to a $205 million (2.1% percent of GDP) surplus for 2005 (IMF 2005b, pp. 26, 30). So it would be extremely difficult, if not impossible, to conceive of a performance-based reason to deny debt relief to Bolivia for which the other HIPC countries in the hemisphere were deemed eligible.

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[25] See, "A Prosperous Third Border," speech given by the Assistant Secretary for Economic and Business Affairs, E. Anthony Wayne, to the Caribbean Central American Action's 29th Annual Miami Conference, December 7, 2005. Available via the internet: http://www.state.gov/e/eb/rls/rm/2005/57923.htm

[26] This is GNI (Gross National Income) per capita in 2004 U.S. dollars, Atlas Method, which is the method used to determine IDA and HIPC eligibility, and presumably would be used for the IDB as well. But if PPP GDP or even dollar GDP per capita based on and exchange rate conversion were used, it would not put Bolivia significantly ahead of any country but Nicaragua.

Financial Flows: Loans and Grants

Tables 3, 4 and 5 show the disbursements, debt service, and net transfers for Bolivia's external public borrowing for the years 2000-2005. Looking at disbursements first (Table 3), it can be seen that these peaked at $701.6 million (8.7 percent of GDP) in 2003, declining to $447.3 million (4.8 percent of GDP) in 2005. Of the multilateral lenders, the largest by far has been the Corporación Andina de Fomento (CAF), which lends at non-concessional (commercial) interest rates. This was not true in the past; prior to 1999, the CAF was far behind the World Bank and IDB in its lending.

This highlights an important trend for Bolivia that is almost certain to continue: the movement from concessional (low-interest) loans to non-concessional lending.[27] As part of the arrangement by which the World Bank debt is to be cancelled, future Bank loans may be reduced (IDA 2005, p. 7). The IDB could also have a similar arrangement for its debt cancellations. These are the two major sources of concessional lending to Bolivia, and they can be expected to decline in coming years.

A major reason that Bolivia will lose concessional lending is that as the economy grows, it will exceed the per capita income limits for concessional lending – the operational cutoff for eligibility for IDA[28] lending for fiscal year 2006 is $965 (2004 GNI); Bolivia's 2004 GNI is $960.

TABLE 3

Bolivia: External Debt, Disbursements (2000-2005)

(in current US$ millions and % of GDP)

Debtholder	2000		2001		2002		2003		2004		2005	
Multilateral	263.7	3.1%	436.3	5.4%	495.1	6.2%	679.6	8.4%	461.8	5.3%	364.9	3.9%
IMF	15.1	0.2%	23.7	0.3%	0	0.0%	88.8	1.1%	54.9	0.6%	14.6	0.2%
World Bank	60.6	0.7%	101.9	1.2%	103.8	1.3%	142.4	1.8%	124.2	1.4%	70.4	0.8%
IDB	96.3	1.1%	84.3	1.0%	99.4	1.3%	195.4	2.4%	91.5	1.0%	111.4	1.2%
CAF	83.9	1.0%	216.2	2.7%	288.5	3.6%	241.4	3.0%	180.4	2.1%	154.8	1.7%
Other	7.8	0.1%	10.2	0.1%	3.4	0.0%	11.6	0.1%	10.8	0.1%	13.7	0.1%
Bilateral	41.3	0.5%	49	0.6%	47.2	0.6%	22	0.3%	90.2	1.0%	82.5	0.9%
Germany	16.9	0.2%	13.4	0.2%	11	0.1%	1.1	0.0%	28	0.3%	0.1	0.0%
Japan	4	0.0%	11.5	0.1%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Spain	14.9	0.2%	5.8	0.1%	9.9	0.1%	3.2	0.0%	19.9	0.2%	7.3	0.1%
Italy	1.5	0.0%	1.4	0.0%	1.9	0.0%	0	0.0%	5	0.1%	1.5	0.0%
Brazil	0	0.0%	11.6	0.1%	22.7	0.3%	17.3	0.2%	35.8	0.4%	42	0.4%
China	0.8	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	21.9	0.2%
Other	3.2	0.0%	5.4	0.1%	1.6	0.0%	0.4	0.0%	1.4	0.0%	9.8	0.1%
Private	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Total	305	3.6%	485.4	6.0%	542.3	6.8%	701.6	8.7%	552.2	6.3%	447.3	4.8%

Source: Banco Central de Bolivia

[27] CAF lending is non-concessional.
[28] IDA is the branch of the World Bank that lends to low-income countries.

TABLE 4

Bolivia: External Debt, Debt Service (2000-2005)

(in current US$ millions and % of GDP)

Debtholder	2000		2001		2002		2003		2004		2005	
Multilateral	200.5	2.4%	195.7	2.4%	235.6	3.0%	251.6	3.1%	273.7	3.1%	347.5	3.7%
IMF	21.1	0.3%	21.2	0.3%	18.4	0.2%	22.2	0.3%	24.3	0.3%	45.5	0.5%
World Bank	13.3	0.2%	1.4	0.0%	11.8	0.1%	14.5	0.2%	19.6	0.2%	20.9	0.2%
IDB	96.9	1.2%	86.7	1.1%	86.7	1.1%	105.6	1.3%	108	1.2%	99	1.1%
CAF	57.6	0.7%	75.1	0.9%	113	1.4%	104.1	1.3%	116.4	1.3%	173.7	1.9%
Other	11.6	0.1%	11.3	0.1%	5.7	0.1%	5.2	0.1%	5.4	0.1%	8.4	0.1%
Bilateral	61.6	0.7%	49.9	0.6%	19.2	0.2%	18.2	0.2%	10.5	0.1%	19.9	0.2%
Germany	9.3	0.1%	5.4	0.1%	0	0.0%	0.1	0.0%	0.1	0.0%	0.3	0.0%
Japan	17.4	0.2%	15.6	0.2%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Belgium	0.5	0.0%	0.5	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Spain	16.7	0.2%	12.3	0.2%	10.7	0.1%	6.4	0.1%	1.9	0.0%	2	0.0%
France	3.2	0.0%	2.2	0.0%	1.7	0.0%	2.3	0.0%	2.7	0.0%	2.7	0.0%
USA	4.4	0.1%	3.2	0.0%	0.1	0.0%	0	0.0%	0	0.0%	0	0.0%
Other	10.1	0.1%	10.9	0.1%	6.7	0.1%	9.3	0.1%	5.8	0.1%	14.9	0.2%
Private	6.3	0.1%	3.6	0.0%	3.3	0.0%	3	0.0%	2.6	0.0%	0.2	0.0%
Total	268.4	3.2%	249.2	3.1%	258.2	3.3%	272.6	3.4%	286.9	3.3%	367.6	3.9%

Source: Banco Central de Bolivia

TABLE 5

Bolivia: External Debt, Net Transfers (2000-2005)

(in current US$ millions and % of GDP)

Debtholder	2000		2001		2002		2003		2004		2005	
Multilateral	63.4	0.8%	241.3	3.0%	259.7	3.3%	428.2	5.3%	188.2	2.1%	17.3	0.2%
IMF	-5.9	-0.1%	2.5	0.0%	-18.4	-0.2%	66.6	0.8%	30.6	0.3%	-31	-0.3%
World Bank	47.3	0.6%	101	1.2%	92.1	1.2%	128	1.6%	104.5	1.2%	49.5	0.5%
IDB	-0.6	0.0%	-2.4	0.0%	12.7	0.2%	89.8	1.1%	-16.4	-0.2%	12.4	0.1%
CAF	26.3	0.3%	141.9	1.7%	175.6	2.2%	137.4	1.7%	64	0.7%	-18.9	-0.2%
Other	-3.7	0.0%	-1.7	0.0%	-2.3	0.0%	6.4	0.1%	5.5	0.1%	5.3	0.1%
Bilateral	-20.3	-0.2%	-0.9	0.0%	27.9	0.4%	3.9	0.0%	79.7	0.9%	62.6	0.7%
Germany	7.3	0.1%	7.9	0.1%	11	0.1%	1	0.0%	27.9	0.3%	-0.2	0.0%
Japan	-13.4	-0.2%	-4.2	-0.1%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Spain	-1.7	0.0%	-6.5	-0.1%	-0.8	0.0%	-3.2	0.0%	18	0.2%	5.2	0.1%
Brazil	0	0.0%	11.6	0.1%	22.4	0.3%	16.8	0.2%	33.9	0.4%	29.9	0.3%
Other	-12.5	-0.1%	-9.8	-0.1%	-4.7	-0.1%	-10.7	-0.1%	-0.1	0.0%	27.7	0.3%
Private	-6.3	-0.1%	-3.6	0.0%	-3.3	0.0%	-3	0.0%	-2.6	0.0%	-0.2	0.0%
Total	36.8	0.4%	236.9	2.9%	284.3	3.6%	429	5.3%	265.3	3.0%	79.7	0.9%

Source: Banco Central de Bolivia

Bilateral lending in 2005 was $82.5 million, or 23 percent of external public borrowing. Most of this came from Brazil and China.

Although multilateral lending has been an important source of funding for Bolivia's public sector, the picture changes somewhat when we subtract debt service (Table 4) from disbursements (Table 3) and look at net transfers (Table 5). Net transfers to the government were only $17.3 million from the multilateral lenders in 2005, with bilateral transfers at $62.6 million. Total net transfers for external borrowing by the government were $79.7 million, or 0.85 percent of GDP.

This is significant but not a very high level of dependence on net external borrowing. For the near future, Bolivia's debt service to the IDB is projected at $476 million, and to the World Bank is projected at $173 million. If both of these debt cancellations come through, most of this $649 million in debt service over the next four years would be cancelled. It is worth noting (see Table 2) that even the IMF's projections – which as noted above, assume (probably incorrectly) that growth in the hydrocarbon sector falls off sharply to zero – show a sharp falloff in the amount of external financing for Bolivia's public sector, from 3.9 percent of GDP in 2004 to 1.4 percent in 2008.

The next set of aid flows to consider consists of grants and donations. Table 6 lists grants and donations that are included as revenues for Bolivia's national budget. For 2006, these are projected at $110 million or about one percent of GDP. The largest amount, $24.6 million or nearly a quarter of the total, comes from the European Union. Another $29 million is contributed by Spain, the Netherlands, and Germany; thus a majority of grants and donations to the Bolivian government come from Europe, and EU countries also contribute to the "basket funding" of $17 million. Only $8.5 million comes directly from the United States, from USAID.

The United States does supply other funding through its "Bureau of International Narcotics and Law Enforcement Affairs" – $90.3 million for 2005. Washington also contributed $48.2 million for other projects.[29] However, other than the $8.4 million from USAID noted in Table 6, this money does not fund the central government.

Summing up the situation regarding aid flows, it does not look like Bolivia would be very vulnerable to threats of aid reduction. With regard to net external borrowing, as described above, concessional lending is winding down, and debt cancellation will greatly reduce future debt service.

As we have seen, grants and donations that form part of government revenue are fairly small, with most coming from Europe. The other money from USAID is similar in amount but since it does not fund government operations, it matters mainly as a source of foreign exchange. But Bolivia's foreign exchange reserves are growing, and can be expected to grow with expanding hydrocarbon revenues; and the country is running a current account surplus.

The United States therefore does not have much direct leverage with regard to aid flows. The big question, other than the cancellation of the IDB debt, is what role the IMF might play in deciding on future loan disbursements and aid flows. In the past, the Fund was the gatekeeper for most of these flows, including the IDB, the World Bank, and also some of the grants and donations that Bolivia has received from European governments. As described previously, the IMF's role in this respect is in a state of transition internationally. For the reasons listed above, it would seem

[29] Most of the money from both of these sums is funneled through USAID.

TABLE 6
Bolivia: Grants and Donations 2006

Government / Organization	US$ millions	% of GDP
European Union	24.64	0.24%
Basket Funding*	16.94	0.16%
Netherlands	12.99	0.12%
Spain	10.32	0.10%
USAID	8.46	0.08%
German Bank for Reconstruction	5.64	0.05%
International Development Agency (IDA)	5.17	0.05%
Denmark	5.13	0.05%
World Food Program	3.57	0.03%
Japan International Cooperation Agency	2.90	0.03%
Belgian Technical Cooperation	2.14	0.02%
UN Global Environment Facility	1.99	0.02%
Inter-American Development Bank	1.10	0.01%
Swiss Agency for Development and Cooperation	1.05	0.01%
UNICEF	0.81	0.01%
Other	6.90	0.07%
Total**	109.75	1.05%

Source: Presupuesto General de la Nacion, Ministerio de Hacienda
Viceministerio de Presupuesto y Contaduria
Note: Dollar amounts and percentages are based on a projected exchange rate of
Bs. 8.12 per US$ and a nominal GDP of Bs. 85,029 millions by the Ministry of Finance of Bolivia

*Funds donated by various sources, including countries, multilateral organizations or financial institutions, geared toward specific government programs. Funders contributing to basket funding include: Denmark, EC, Finland, France, Germany, IADB, IMF, Netherlands, Norway, OECD, Sweden, UK, UNDP, United States and World Bank.

** Total does not include debt relief under HIPC initiative

inappropriate for the IMF to continue to play this role. This is even more true if the government does not sign a new agreement with the IMF.

Another factor that has significantly changed the equation for the region with regard to countries' vulnerability to foreign aid and capital flows has been Venezuela's lending to governments. Venezuela has committed some $2.4 billion to Argentina, and has bought $300 million of government bonds from Ecuador. In the case of Argentina, the Venezuelan bond purchases helped enable the country to pay off its remaining debt to the IMF, and Venezuela's President Hugo Chavez stated that Venezuela would loan whatever would be necessary for the Argentine government to cut loose from the IMF.[30] Chavez has made similar commitments to the new government of Bolivia, and Venezuela has over $30 billion in foreign exchange reserves, a large part of which are not necessary to guarantee the country's foreign transactions or exchange rate. So it appears that for the near future, at least, Bolivia will likely have access to other sources of foreign financing, should they become necessary.

[30] See, for example, "Argentina Debt Plan Praised, Criticized," December 16, 2005, *Associated Press Financial Wire.*

Trade

About $359 million, or 16 percent of Bolivia's exports go to the U.S. market.[31] Access to this market is almost certain to remain unaffected, in the foreseeable future, by any disagreements with the United States over coca eradication, hydrocarbons policy, or other non-trade issues. With regard to trade, then, the main issue is whether Washington will use preferential access to the U.S. market – under the Generalized System of Preferences (GSP) or the Andean Trade Promotion and Drug Eradication Act (ATPDEA) – as leverage to try to get Bolivia to sign a new trade agreement.

The new proposed trade agreement would most likely be the AFTA, for which negotiations began in May 2004 with Colombia, Peru, and Ecuador, with Bolivia as an observer. The negotiations have not proceeded smoothly, which generally has been true for regional and multilateral agreements in recent years. Among the U.S. demands that have been problematic are increased protection for intellectual property rights, particularly pharmaceutical patents, where Washington has demanded in its bilateral and regional agreements protections and rights for patent holders that go beyond those provided by the World Trade Organization, and that would increase the price of medicines in signatory countries. The opening of agricultural markets, in many cases to subsidized exports from the United States, has also been a sticking point in regional and bilateral negotiations and could cause problems for Bolivia.

The ATPDEA preferences expire at the end of 2006, and some important U.S. legislators have threatened that they will not be renewed – that is, only countries that have signed a new AFTA or similar agreement will enjoy these trade preferences. However that is extremely unlikely at this time. Ecuador has not concluded negotiations on a trade agreement with the United States, and while the administration has announced that negotiations with Peru and Colombia have concluded, the official notification of the intent to sign a commercial agreement has not been sent to the U.S. Congress for the latter country. Under the Trade Promotion Authority Act of 2002, such notification triggers a mandatory, minimum 90-day waiting period before an agreement can be officially signed. Only once this period has passed and an agreement has been signed may Congress take a vote on ratification of implementing legislation.[32]

In the United States, these agreements have not passed Congress easily as of late. The Central America Free Trade Agreement (CAFTA) took more than a year and passed, after formidable White House lobbying, by only one vote. Since this is an election year, it is unlikely that such controversial agreements would be brought to a vote before the November 2006 election, which means not until next year. Thus the ATPDEA preferences will very likely have to be renewed; once again, there is no politically feasible way to single Bolivia out for denial of these preferences.

However, even in the very unlikely event that the preferences for Bolivia under the ATPDEA were allowed to expire at the end of the year, the impact on Bolivia would not be very large. Only a small portion of Bolivia's exports would be affected, since most of Bolivia's exports fall under the Generalized System of Preferences (GSP)[33] or the WTO's MFN treatment. The total value of exports at risk of losing their preferential access is almost certainly less than 2 percent of Bolivia's exports. Although this is not insignificant, it should be kept in mind that most of this is in the textiles and apparel sector, which is facing very harsh, unrestricted competition from China since the

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31 Figures are for 2004, the latest complete data available.

32 See 19 U.S.C. § 3805 ("Bipartisan Trade Promotion Authority: Implementation of Trade Agreements"), and "Notice of Intention to Enter Into a Free Trade Agreement with Peru," White House Press Release, Jan. 6, 2006.

33 The GSP also expires at the end of 2006 but there seems to be little controversy over its renewal.

beginning of 2005, when the system of quotas that developing countries were allocated for the U.S. market (the Multi-Fiber Arrangement) expired.

It is also worth noting that in coming years the market for imports in the United States is not going to grow as it has in the past. It is widely recognized by the vast majority of economists that the U.S. trade and current account deficit is not sustainable. As a result, the dollar will have to fall, and the U.S. trade deficit will adjust. The result of this adjustment is that the market for imports (measured in non-dollar terms) in the U.S. will have to shrink over the next decade.[34] This means that developing countries that want to increase their exports to the U.S. market will have to displace other exporters (e.g. Mexico or China) that are already there.

To sum up the situation regarding trade, it seems unlikely that that threat of canceling trade preferences could be used to alter the new government's course with regard to either trade or other policy issues.

[34] This is not an adjustment to balanced trade, but rather to an amount that allows the U.S. foreign debt to stabilize at a sustainable level. See Baker and Weisbrot (2004), http://www.cepr.net/publications/trade_2004_01_08.pdf .

Conclusion

Bolivia's new government has come to power promising to reform economic policy so as to improve the condition of its poor majority. This paper has looked at the country's various external vulnerabilities that might prevent it from carrying out its mandate. The new government is in a relatively good position to choose policies that could accelerate growth and provide the economic basis for improved living standards, such as a proposed expansion of access to water for households and for agriculture. The new hydrocarbons law has significantly improved the fiscal situation of the government for the foreseeable future, and is likely to provide even more revenue in the coming years. As such, although there is opposition from foreign companies and interests, it would seem that this is one reform that may be vital to the new government's avowed goals.

Although the government does depend on some foreign financing for its operations, this dependence has been diminishing as the fiscal situation has improved and should fall considerably as the World Bank and IDB debt – accounting for about three-quarters of the country's external public debt – are cancelled. With regard to this future debt cancellation, loans, or grants, it would seem extremely difficult as a political matter for Bolivia to be singled out and treated differently from other countries in the same category, e.g. HIPC countries in Latin America. The same is true for trade preferences. Although Bolivia is likely to continue to lose access to concessional lending because it is growing beyond the IDA low-income category, its need for such lending will also decrease as the fiscal situation improves and the economy grows. The IMF has not expressed any opposition to the new government's policies, other than its opposition to the hyrdrocarbons law, which was enacted under the previous government. But since the Fund has cancelled Bolivia's debt, and the IMF's role as "gatekeeper" for international loans and grants is currently in question, it is not clear that Bolivia will face any significant pressure from these quarters either.

One thing that the new government could do, as a precautionary and transitional measure, is to apply for a line of credit with the Venezuelan government. As noted above, Venezuela's lending from its surplus foreign exchange reserves to Argentina and Ecuador has been a very important source of financing for those countries, and will almost certainly be available to Bolivia should it become necessary. But by opening a line of credit in advance – one that it is not expected to draw upon in the foreseeable future – Bolivia can significantly reduce some risks of financial instability. For example, this pre-approved credit would reduce the risk of the kinds of runs on deposits that the country experienced in 2002 and 2004, as depositors would know that the country has access to an additional supply of foreign exchange reserves. This is especially important in an economy that remains as dollarized as Bolivia's.

A line of credit with Venezuela would also insulate Bolivia against any unanticipated reductions in external lending or grants, and help smooth the country's transition to non-concessional and domestic borrowing, while reducing the need for the country's own accumulation of reserves and therefore reducing pressure on the current account. It would also discourage foreign creditors and donors from trying to exert undue influence or attach unwanted conditions to their loans, debt cancellation, or grants, as they would know that Bolivia has another source of foreign exchange.

Another move that could improve the Bolivian government's fiscal situation in the immediate future as well as for many years, would be to reverse the privatization of the country's public pension system. As noted above, and also by the IMF,[35] this privatization has created very large, long-term transition costs, as the income from current taxes is not available to pay current retirees. By switching back to a "pay-as-you-go" system as the United States has, the government's fiscal deficit could be substantially reduced. Any revamped public system would of course have to be actuarially sound and ensure that future promised benefits were fundable according to plausible economic and demographic assumptions. But the potential deficit reduction from switching back to a traditional public-defined benefit system is large enough that this option is definitely worth considering.

[35] See e.g. IMF 2005a, pp.17-18.

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