

## **Authorities' Statement on Bolivia Staff Report for the 2022 Article IV Consultation**

We thank staff for the report and the cordial dialogue within the 2022 Article IV Consultation. We also express our gratitude to the Management and the different departments for their support through technical assistance on relevant topics for the country.

The staff report addresses critical issues for the Bolivian economy. While we agree with staff on some aspects, we disagree on others related to the economic assessment and on policy advice. Regarding the latter, we consider that several of the recommendations are not appropriate at the current juncture and go against the principles of Bolivia's economic and social model.

Over the past decade and a half, the Bolivian economy has showed a positive performance, with sustained growth, even in periods of adverse external context. This economic progress was joined by substantial improvements in the population's quality of life, which was evident in the significant decrease in poverty and inequality, increased life expectancy, greater access to basic services, improvement in access to health and education, among others.

This economic and social progress was possible thanks to the application of a state-led economic model in Bolivia since 2006, called the Economic Social Communitarian Productive Model, which considers the domestic demand as the major engine of growth, with the promotion of public investment as one of its main instruments; a firm income redistribution policy; and sovereignty in the definition of economic policy.

The model proved to be effective, especially during years of complex external environment, when the Bolivian economy showed resilience. The global economy is once again experiencing other shocks, which are generating growing uncertainty and risks. Against this backdrop, the national government is applying and will implement the necessary and appropriate measures to protect the current process of economic recovery and safeguard the population's well-being.

### **Recent Economic Performance**

After the strong impact of the pandemic and the domestic political and social instability scenario in 2020, which led the economy to its worst contraction in 67 years and marked a setback in the social progress achieved up to 2019, in November 2020 the Economic Social Communitarian Productive Model was resumed, with President Luis Arce's government taking office.

In this framework, in 2021 the Bolivian economy recovered significantly, reaching a growth rate of 6.1 percent, mainly driven by transportation, mining, manufacturing, and construction.

On the spending side, the upturn in the economy was attributed to the rebound in domestic demand. The economic and social policy applied by the government was a key element in the positive economic performance, with measures to boost demand and supply, and to fight the pandemic.

Since November 2020 a set of policies has been implemented to strengthen the domestic demand, including the reestablishment of public investment, the cash transfer Bono contra el Hambre, the increase in rents for the retired population, the minimum wage rise after a year of being frozen, among others. Moreover, measures have been applied to boost production, such as VAT exemption for the importation and sale of capital goods, the SIBOLIVIA program that promotes access to financing at an interest rate of 0.5 percent for sectors that substitute imports, the restitution of the limits of the productive portfolio, and so on.

A key policy was the fight against the pandemic, making the necessary efforts to guarantee vaccines, tests, medical supplies, and others, and coordinated work with local governments. We highlight the remarkable progress on this matter. While the country has faced new waves of COVID-19, they have been less deadly. The mortality rate in the fifth wave, the peak of which was at the beginning of the second half of this year, reached 0.1 percent, well below the 6.2 percent recorded during the first wave. The vaccination process is progressing.

The Bolivian economy remains dynamic so far in 2022. In the first quarter, GDP grew by 4.0 percent y-o-y. The recovery continues amid a highly complex external scenario, with large inflationary pressures and the threat of recession in the world's major economies.

At this juncture, we highlight the low inflation that Bolivia is experiencing, with an accumulated rate of 1.6 percent as of August 2022, the lowest in the South American region and one of the lowest in the world. This is the result of a solid performance of agricultural production, which for instance recorded a growth of 5.3 percent y-o-y in the first quarter of the year, and the fuel and food subsidies scheme; among other measures. These have been applied in the country for many years, within the framework of the national food security and sovereignty policy, and which are allowing, in the current context, to preserve price stability and contain possible impacts on the population's welfare.

## **Fiscal Policy**

In 2021, the country's fiscal policy was expansionary, mainly oriented to promote the economic recovery, the reactivation of public investment, and the continuity of efforts against the pandemic. Revenues recorded a significant recovery, with a rebound in tax collections that reflected the greater dynamism of economic activity. Thus, in 2021 Bolivia showed a fiscal

deficit of only one digit, 9.3 percent of GDP, which was lower than the 12.7 percent of GDP in 2020.

In 2022, the government continues with the priority of promoting the economic recovery, even more so given the adverse external environment. Furthermore, due to this context, the necessary efforts will be made to protect the population, with the permanence of the existing social measures and fuel and food subsidies. Hence, a fiscal deficit of around 8.5 percent of GDP is expected for this year.

We recognize the need to reduce the fiscal deficit and actions are being taken to address it; however, the current context demands that fiscal policy protects the ongoing recovery process and the population's well-being. In this vein, we completely disagree with staff's recommendation on an abrupt fiscal adjustment and with the instruments proposed for this. We also note that this recommendation goes against the general advice provided by the IMF regarding the position of fiscal policy in the short term, which even considers as acceptable, for instance, the use of subsidies under certain circumstances to address the impact of inflation on the population's welfare. Therefore, we believe that the elimination of the fuel subsidy is not appropriate in the present scenario, given that this subsidy, together with the food one, is helping the country face the strong external pressures on prices, and ultimately, to protect the population.

Moreover, on the recommendation on limiting public investment, despite that it is easier to apply a fiscal adjustment by cutting it as staff acknowledges, public investment is one of the pillars of the Bolivian economic model. Public investment plays a significant role in the economy by promoting growth, job creation, and the provision of goods and services that eventually benefit productive activity and the population. Hence, public investment restraint cannot be considered by the government because it undermines the economic model foundations and threatens medium and long-term growth prospects.

The government cannot accept either the recommendation to eliminate the supplementary end-year bonus, called *segundo aguinaldo*. This benefit is part of the income redistribution policy, with a legal framework, and which payment is activated when the economy reaches a defined percentage of growth in a 12-month period.

Regarding financing, which is a concerning issue for staff, who points out that it can lead to macroeconomic risks and a disorderly adjustment, the Bolivian government does not agree with such assessment. Public debt is at sustainable levels, as also stated in the staff's debt sustainability analysis. Furthermore, the issue of financing is being addressed. In this line, although under more restrictive global financial conditions, the government has been working and has open options for accessing to multilateral financing, with several projects underway

with different organizations. Moreover, sovereign financing can be accessed if external conditions turn favorable.

In the medium term, the government expects the country's income prospects to improve as a result of important public investment projects, such as the Mutun iron plant, lithium industrialization, zinc refining plants, and others. Similarly, the import substitution strategy is of key priority at this end, with both public projects, such as the biodiesel plant, and incentives for private productive sector strengthening, where the SIBOLIVIA program stands out. The substitution of imports will also help avoid the loss of foreign currency and face the fuel subsidy weighting on fiscal accounts.

Relating to financing from pension funds, we consider that this does not represent a risk for the country. The dependence on this type of domestic financing has decreased substantially in recent years. In 2006, 75 percent of the pension fund investment portfolio was concentrated in government bonds; in April 2022 these represented 23 percent of the total. Currently, more than 50 percent of the investments of these funds corresponds to financial system fixed term deposits (DPF).

### **Monetary and Financial Sector Policy**

The financial system has robust indicators, such as adequate liquidity, capitalization above the required levels, low rate of non-performing loans (NPLs), and significant growth in deposits and loans. In fact, in 2021 deposits grew by 6 percent and loans by 4 percent. This last percentage is not negligible as staff states, and even less if considering its composition, which was driven by a solid growth in productive loans, and especially in microcredits, that had fallen sharply in 2020.

The policy of loan rescheduling and/or refinancing, after the end of the credit deferral period, provided support to debtors who were facing difficulties. These measures do not affect the financial system health, which recorded a low level of NPLs, less than 2 percent. Moreover, the Supervisory Authority of the Financial System (ASFI) closely monitors the performance of the sector.

Deposits and loans have been more dynamic so far in 2022. Within loans, the significant growth of the productive and Social Interest Housing (VIS) credits is notable. Such loans are encouraged in the country through the policy of portfolio limits and preferential interest rates. Productive credit is a relevant component of the government's general policy to promote the productive sector and, thus, strengthening the diversification of the economy. Furthermore, VIS loans allow the population to ease their access to housing. In this vein, we cannot agree with staff's recommendation to eliminate the portfolio limit and preferential interest rates scheme.

Regarding monetary policy and the Central Bank of Bolivia (BCB), since 2006 the authorities have coordinated the country's economic policy. In this understanding, the Ministry of Economy and Public Finance and the BCB annually sign a Fiscal Financial Program that defines the macroeconomic objectives for the year and the instruments to achieve them. Therefore, the BCB continues to apply a monetary policy that promotes the country's targets, contributing to the economic recovery process and at the same time protecting the purchasing power of the domestic currency. In our view, the coordination of economic policy is essential to achieve the economy's objectives.

## **External Sector**

During 2021, the external sector variables showed a noteworthy performance. For the first time in seven years, the current account recorded a surplus, driven by the positive outcome in the trade balance, also after several years of deficit. Exports played a significant role in these results, reaching the highest level since 2014 and a growth rate close to 60 percent compared to 2020. Within it, the sales of the manufacturing industry achieved historical levels. Moreover, imports grew by 35 percent, driven by purchases of capital goods, raw materials, and inputs, which represented 78 percent of total imports and help strengthen Bolivia's productive capacity. Overall, it is notable that in 2021 the country stopped recording twin deficits.

The external variables continue to show a positive performance in 2022. Exports and imports remain dynamic, and a trade surplus is still recorded, which will contribute to the result of the current account.

International reserves stabilized in 2021. Even though their level showed a decrease compared to the previous year, the reduction was notably lower than that experienced in 2020, when the economy had lost around US\$ 1,500 million. In the first half of this year, international reserves remained at adequate levels according to reference parameters, managing to cover five months of imports.

One of the central elements within staff's recommendations is the transition to a flexible exchange rate regime. In this regard, the stability of the exchange rate in Bolivia has played a fundamental role in generating economic certainty, containing imported inflation pressures, and in the de-dollarization process. Furthermore, this orientation has promoted a scenario of stability despite the external turbulences of the last decade. Moreover, by reviewing the same document to which staff refers, we note among its results that a potential exchange rate flexibilization would not generate significant gains for the country with respect to the current exchange rate scheme. Therefore, the Bolivian government does not consider this transition as appropriate and does not expect to modify the exchange rate position.

## **Social Policy**

Improving the population's living standards, especially of the most vulnerable, is one of the main objectives of the Bolivian economic model. In this vein, the application of the income redistribution policy together with the higher dynamism of the economy have driven an outstanding advance in the country's social indicators. That said, poverty has decreased significantly, from 60.6 percent in 2005 to 36.3 percent in 2021 in the case of moderate poverty, and from 38.2 percent to 11.1 percent in extreme poverty. Inequality, measured by the Gini Index, also fell, from 0.60 in 2005 to 0.42 in 2021. The income gap between the highest and the lowest income deciles reduced from 128 times to 20 times. Access to basic services was also expanded, among other results, which overall show the improvement in the Bolivian population's well-being.

We emphasize that after the setback of these advances in 2020, in 2021 the country returned to the downward path of poverty and inequality, and to the gradual restoration of the Bolivian people's living conditions. Moreover, we highlight the significant drop in unemployment, from close to 12 percent in mid-2020 to 4.6 percent in July 2022.

During this year and in the face of the strong external inflationary pressures, the Bolivian government continues applying policies to preserve price stability and protect the population's welfare.

## **Conclusion**

Since the current external situation is one of high uncertainty and risks, the national government is making every effort to continue to support the recovery of the economy in general and Bolivian households in particular, especially the most vulnerable. We expect the economy to grow by around 5 percent and an inflation rate of 3.3 percent in 2022. In the medium term, growth will be driven by major public investment projects, some underway and others to be implemented soon, within the framework of the National Development Plan, 2021-2025, with a fundamental role played by the import substitution strategy and the strengthening of the productive sector.