PROGRAM FOR FISCAL ADJUSTMENT AND MAINTENANCE OF SOCIAL SPENDING

(BO-0173)

EXECUTIVE SUMMARY

BORROWER AND: GUARANTOR:	Republic of Bolivia	
EXECUTING AGENCY:	Ministry of Finance	
AMOUNT AND SOURCE:	IDB: (FSO)	US$50 million
	Total:	US$50 million
FINANCIAL TERMS AND CONDITIONS:	Amortization period:	40 years
	Grace period:	10 years
	Disbursement period:	30 months
	Interest rate:	1% during grace period and 2% for the last 30 years
	Inspection and supervision:	1%
	Credit fee:	0.5%

OBJECTIVES:

The general objective of this quick-disbursing sector program is to support the government in protecting priority social spending with the greatest impact on the lowest-income groups, while maintaining the goals of the macroeconomic stabilization process. Its specific objectives are to: (i) provide quick-disbursing funds to cover part of the temporary shortfall resulting from the fiscal emergency, while supporting maintenance of the economic stabilization process; (ii) protect social spending on priority investment programs selected on the basis of their impact on low-income groups, in education, health and child welfare; (iii) support the implementation of reforms in the education, health, low-cost housing and child welfare sectors; and (iv) help strengthen the government's institutional structure in order to optimize the coordination, programming and monitoring of its social policy.

DESCRIPTION:

The following components of the program will be monitored to ascertain eligibility for disbursement: (i) maintenance of macroeconomic stability and social matrix indicators under the Highly Indebted Poor Countries (HIPC) Initiative described in paragraph 1.6; (ii) protection of social spending on education, health and child welfare in 1998, 1999 and 2000, in a manner consistent with the reforms under

way in those sectors, at the levels established under the priority social reform programs being implemented by the Bolivian government with financing from the Inter-American Development Bank (IDB) and the World Bank (WB) and referring to spending by the central, departmental and municipal governments and through investment and development funds; and (iii) measures to support social sector reforms, designed to eliminate bottlenecks for social spending and help ensure proper performance.

ROLE OF THE PROJECT IN THE BANK'S COUNTRY AND SECTOR STRATEGY:

This operation is consistent with the Bank's operating strategy, which seeks to promote the alleviation of poverty through measures to improve living conditions by facilitating access to basic education, health, sanitation and housing services. The lines of action under this strategy include support for macroeconomic stability and broad-based growth, development of human capital and access to basic social services, together with consolidation of the reforms. This operation will contribute substantially to all these objectives, in addition to supporting effective execution of Bank operations in related fields.

Execution of the program is also expected to help meet the HIPC social matrix targets agreed upon, especially those connected with protection of investments and nonwage expenditures to ensure proper execution of the priority programs and actions identified in that matrix.

DISBURSEMENTS:

The loan will be disbursed in three tranches, an initial tranche of US$20 million and two subsequent tranches of US$15 million each, as shown in the matrix attached as Annex II-1. The first disbursement, which would be made in November 1998, will consider the findings of the evaluation of the HIPC agreement, partial performance of the budget for protected programs in 1998 and the Executive's proposed protected programs budget for 1999. The second disbursement will consider the budget approved for 1999, budget performance for 1998 and that of the first half of 1999. The third disbursement will consider achievement of the HIPC social matrix targets, the budget approved for the year 2000, budget performance in 1999 and that of the first half of the year 2000.

REVIEW OF ENVIRONMENT AND SOCIAL IMPACT: The priority social programs financed by the Bank and the World Bank be set out in detail in order to demonstrate that they incorporate mechanisms that will ensure compliance with applicable environmental legislation and regulations (see paragraphs 3.14 and 3.15).

BENEFITS: This program is expected to produce the following benefits: (i) by providing quick-disbursing funds to help cover the fiscal deficit, it will make it possible to balance public finances and maintain economic stability, which will in turn foster sustained growth of the economy and increased income levels, especially for the most disadvantaged groups of the population; (ii) by protecting public social investment in education, health and child welfare, it will ensure spending levels that will allow for provision of these services designed to assist the lowest-income groups, thereby helping to improve the country's social indicators, as included in the targets agreed upon in the HIPC Initiative; (iii) by supporting the government in the implementation of major reforms in education, health, social housing and child welfare, the program will contribute to the acceleration of the process and long-term sustainability of efforts to improve the quality and coverage of social services, thereby developing the country's human capital and furthering improvement in income distribution; and (iv) by promoting linkage of the social sectors at programming level and their comprehensive monitoring, the program will help improve the planning systems, and service management and evaluation.

RISKS: Bolivia's external **vulnerability** and the resulting fiscal fluctuations will be addressed by establishing a program-monitoring mechanism based on control instruments that have proven effective in the past for surmounting unfavorable economic circumstances. This mechanism will also allow for timely detection of any management problems in the protected social programs (PSPs).

The difficulty of linking social programming with the country's financial and budgetary programming is a risk that the program seeks to minimize by establishing a monitoring system headed by the Vice Ministry of Public Investment and External Financing (VIPFE) and including all the institutions that participate in social programs.

Ensuring **simultaneous compliance** with multiple conditions by various sectors and institutions, including departmental governments that operate on a decentralized basis and autonomous municipalities, is a risk that will be reduced by including incentives in the PSPs (matching grants, agreements, etc.), in combination with the mechanism that the National General Treasury (TGN) has agreed to implement to ensure cooperation by the decentralized entities.

The possibility of **resistance to the program-supported social reforms** on the part of groups affected in the political and labor-union sphere is a risk that will be minimized, especially as regards reform actions involving potential conflicts, by establishing a climate of dialogue in which the social ministries will exercise an important influence for promoting a sense of ownership of the reforms among those affected by them.

The **management deficiencies** of the protected programs will be addressed by the execution mechanisms and the program conditionalities, which take this risk into account and include the necessary precautionary measures.

SPECIAL CONTRACTUAL CLAUSES:

General conditions: As a condition precedent to each disbursement, the borrower will submit evidence satisfactory to the Bank regarding: (i) maintenance of macroeconomic stability and the Enhanced Structural Adjustment Facility (ESAF); (ii) implementation of the HIPC agreements; (iii) consistency of the macroeconomic environment with the program objectives; and (iv) the progress achieved in the respective measures specified in the Social Policy Letter (see paragraph 3.6).

Special conditions: Release of each tranche will be subject to fulfillment of the conditions established in Chapter III, as follows: (i) the protected amounts match the physical progress of the programs with the budget and the budget performance of the PSPs; (ii) the procedure adopted for ensuring the local counterpart funding required from the departmental and municipal governments for the social investment programs must be submitted; (iii) the funds required for the financing of the National Housing Subsidy Program (PNSV) are available; (iv) the property of the Low-Cost Housing Fund (FONVIS) has been assessed, a sales strategy devised, and the FONVIS portfolio and assets liquidated; (v) the system for linkage and monitoring of the

social policy and of the programs composing it has been designed and implemented; (vi) the necessary legal steps have been taken to ensure normal operation of the Welfare Program for Girls and Boys Under Six (PAN); and (vii) the system for budgetary programming and execution for public investment has been improved. The borrower will also be required to submit by December 31, 1998 the monitoring plan for accomplishment of the HIPC goals for the years 1999-2000, including a set of social policy indicators, goals and measures, and the PSP programming for the year 1999-2000, detailing the physical targets and flow of funds projected for that period (see subparagraph 3.7 (a), (b) and (c)).

In addition, the borrower will be asked to agree to ensuring compliance with general environmental legislation and specific regulations in the protected programs (see paragraph 3.8).

POVERTY TARGETING AND SOCIAL SECTOR CLASSIFICATION:

The conditionality seeks to protect programs in the social sectors selected on the basis of their impact on poverty. Since the great majority of the beneficiaries of these programs belong to the lowest income brackets according to the classification set forth in document AB-1704 (paragraph 2.15), this program qualifies as a poverty targeted investment (PTI).

Regarding the social classification of the loan (paragraph 2.13 of document AB-1704), this project falls in the social equity and poverty reduction category, since it protects investments in the health, education and child welfare sectors.

EXCEPTIONS TO BANK POLICY:

None

I. BACKGROUND

A. Introduction

1.1 Over the past decade, Bolivia has created important conditions for accelerating its economic growth. The structural reform program launched in 1985 with basic measures for macroeconomic stabilization and market liberalization reduced inflation and the fiscal deficit and stimulated moderate growth of the economy. Between 1985 and 1993, fiscal policy limited the size of the fiscal deficit to the expected level of concessional external financing, in order to avoid Central Bank financing of the nonfinancial public sector. The fiscal deficit was then brought down from 30% of gross domestic product (GDP) in 1984 to 4% in 1986 and 2% in 1996.

1.2 With support from the Inter-American Development Bank (IDB) and the World Bank (WB) and under an Enhanced Structural Adjustment Facility (ESAF) agreement with the International Monetary Fund (IMF), in 1994 Bolivia began a second generation of reforms that included fiscal decentralization, education reform, capitalization of government enterprises, pension reform and reform of the State. It also established a maternal-and-child insurance scheme and undertook initiatives in the areas of health, child nutrition and preschool education. As of the end of 1997, the country had achieved the majority of the economic goals agreed upon with the IMF in 1994 and had made significant progress in the structural reforms.

1.3 The present government has pledged to maintain the structural reforms and programs adopted during the previous administration, with emphasis on the fight against poverty and dialogue between the State and civil society to set the country's priorities.

1.4 In 1998 the economy is experiencing its twelfth year of sustained growth and low inflation, the outcome of the sound macroeconomic policy which combined monetary discipline with fiscal deficit reduction, while still allowing flexibility in exchange policy and grains in competitiveness. Inflation is following a steady downward trend, due to the combination of low fiscal deficits, conservative monetary and credit policies and a stable exchange rate policy. Inflation is not expected to exceed 6.5% in 1998 and savings and investment will be around 19% of GDP.

B. Debt reduction process: HIPC Initiative

1.5 In September 1997, Bolivia's participation in the HIPC initiative for external debt reduction was approved, which would reduce the direct public external debt by US$448 million in present value. The IDB is participating with approximately US$155 million in present value (US$252.9 million in nominal terms) and has played a

central role in the preparation of the social matrix that is part of the agreements under the initiative.

1.6 The Heavily Indebted Poor Countries (HIPC) Initiative recognizes Bolivia's macroeconomic performance to date and makes effective debt reduction conditional upon measures in the social sectors (see Table I-1). In this connection, the government has agreed with the multilateral agencies on a matrix that summarizes the social priorities and comprises three types of indicators: (i) policy measures and decisions; (ii) indicators of financial resources and other inputs for the execution of social programs in the areas identified as priority; and (iii) target indicators for results expected in each of the areas identified.

1.7 Since the improvement in the social indicators is only perceptible over the medium term and all the factors involved are not under the government's control, the Bank has placed special emphasis on the monitoring of the resources and execution of the social programs identified as priorities in the HIPC matrix, which are precisely the ones that contribute to human capital development and poverty reduction.

Table I-1

HIPC SOCIAL GOALS

Increase spending (especially nonwage expenditures) on basic education.

Develop a plan for reducing expenditures on higher education as a proportion of total sector spending.

Improve the coverage of basic education in rural areas, increase the number of students who complete this cycle, upgrade the quality of primary education and expand access to preschool education.

Amend the Education Reform Law to adapt it to the decentralization process being implemented in the country.

Develop a service-delivery strategy for the health sector, in the context of decentralization, with a new financing mechanism.

Increase public spending on health.

Improve access to and the coverage of the maternal-and-child health services and reduce the incidence of endemic diseases.

Improve the control of expenditures and transfers in the social and rural development sector and establish clear policies and strategies for the funds serving those sectors.

Provide communities with services and infrastructure.

Strengthen the land-tenure system, improve distribution and intensify agricultural research.

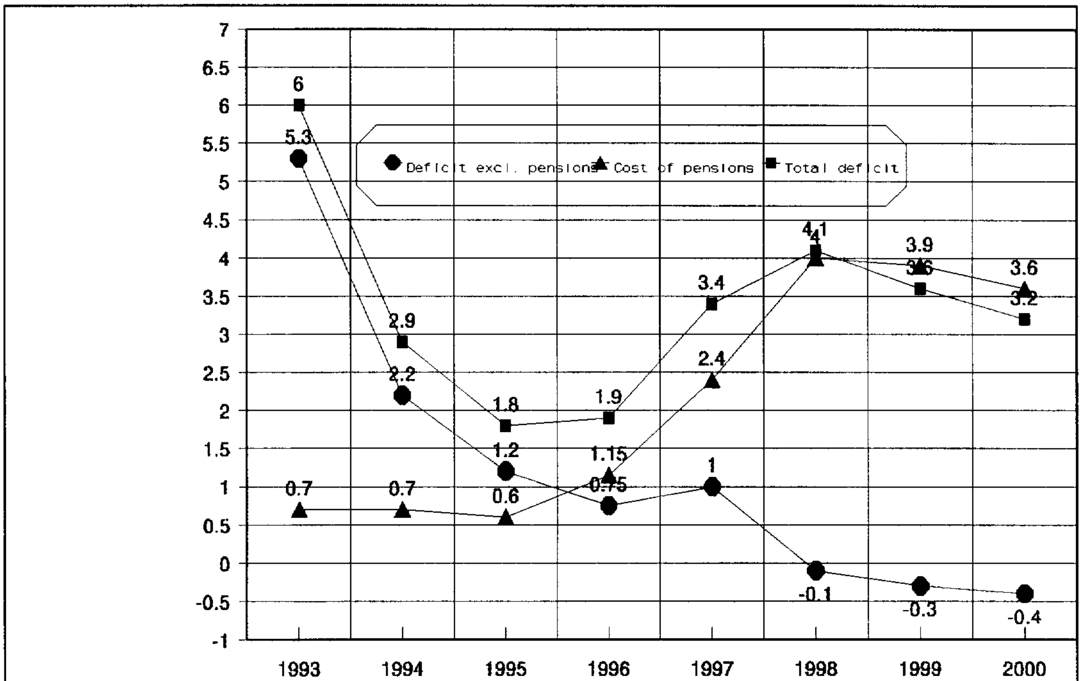
Establish a policy and framework for the provisions of microcredit and rural financing.

1.8 Joint analysis of the achievement of the HIPC goals as of September 1998, conducted by the IDB, the WB and the IMF, indicates that substantial progress has been made towards the matrix targets and indicators. The majority of the goals of the original agreement have been met and steps are being taken to ensure the ongoing monitoring and achievement of the remaining ones. The HIPC agreement calls for monitoring the social targets beyond the completion point by means of the IDB's and WB's lending operations in the social sectors. The present operation is an important tool

for the monitoring. To this end, during the execution of this operation, the indicators and instruments for monitoring of the priority social policies and programs will be developed with the national authorities in order to ensure their consistency with the HIPC social targets for the years 1999 and 2000.

C. The fiscal crisis

Table I-2
Public deficit (% of GDP) *



	1993	1994	1995	1996	1997	1998	1999	2000
Deficit excl. pensions	5.3	2.2	1.2	0.75	1	-0.1	-0.3	-0.4
Cost of pensions	0.7	0.7	0.6	1.15	2.4	4	3.9	3.6
Total deficit	6	2.9	1.8	1.9	3.4	4.1	3.6	3.2

* Source: IMF, Central Bank of Bolivia and Ministry of Finance. The figures cited through 1997 are from records. The figures for 1998 to 2000 are the projections used in the ESAF agreement for that period.

1.9 Despite the government's efforts to maintain fiscal discipline, the public sector deficit will rise in the short term because the cost of the structural reforms has been higher than was originally

expected. In particular, the pension system reform 1/ and the fall in tax revenues associated with oil and gas have exercised so much pressure on public spending that the deficit in 1998 is expected to reach 4.1% of GDP, as compared with the original estimate of 3.2%. In the medium term, the pressure on the fiscal deficit resulting from pension system reform is expected to reach an order of magnitude of some 3.6% of GDP. The net reduction in the cost of pensions will be less than initially expected because people eligible for retirement are opting to do so under the old social security system.

1.10 The discrepancy between the original projection and the current deficit, equivalent to 0.9% of GDP, is attributable to:

a. the fact that the number of persons who opted for early retirement under the reform was larger than expected, entailing additional costs in an amount equivalent to 0.4% of GDP;

b. a Supreme Court decision in favor of pensioners and involving a cost of 0.3% of GDP; and

c. various other factores totaling an amount equivalent to 0.2% of GDP, such as the drop in tax collections in the oil and gas sector resulting from the recent amendment of the Hydrocarbons Act.

1.11 The difference between the deficit originally projected for 1998 and the current figure (approximately US$80 million) would be funded with domestic and external borrowings. Specifically, in the context of the new ESAF agreement with the IMF, the national authorities are working closely with the IMF, the IDB and the WB to increase the volume of freely available external financing, by developing both quick-disbursing programs in the financial sector (WB) and the program presented in this document which would generate an injection of funds equivalent to 0.5% of GDP for 1998. Domestic borrowing combined with measures to improve collection efficiency should close the gap. The situation for 1999 is similar to that for 1998, but it is estimated that as of the year 2000 the deficit will shrink to levels that can be absorbed by means of normal budget programming, with no more than minor recourse to special external financing.

1/ Prior to the pension reform, the fiscal cost of pensions was equivalent to 1% of GDP. The initial estimate of the cost of the reform implemented in 1996 was 3% of GDP: 1% due to reduction of income, 1% for payments to the new pensioners under the old system, and 1% because the State assumed responsibility for payments under private pension-supplementing schemes that were underfunded.

D. Stability, social spending and impact on the poor

1.12 The general macroeconomic situation and social spending are closely linked to the incidence of poverty and the quality of the public services targeting the lowest income brackets. The experience of various countries of the region shows that a high degree of macroeconomic instability manifested in high levels of inflation and significant declines in the product disproportionately affects the poor, both directly through the impact on employment, and indirectly through the impact on real wages. Measures to control hyperinflation in 1984-1985, which cost a 10% reduction in GDP, had to be accompanied by programs to protect employment and incomes, such as the Social Emergency Fund which was the direct predecessor of the present Social Investment Fund (FIS).

Table I-3
Bolivia: History of social indicators

Indicator	1980	1990	1995
Birth rate (%)	3.8	3.6	3.3
Infant mortality rate (%)	10.9	7.5	6.6
Life expectancy (years)	54	59	61
Primary and secondary school enrolment (%)	n.a.	77	87
Illiteracy (%)	* 37	** 20	n.a.
Water supply coverage (%)	* 39	** 54	n.a.

* 1986 ** 1992
Source: UDAPE

1.13 The stability of the past 12 years and the resultant growth enabled Bolivia to regain the level of per capita income it had achieved by the late 1970s prior to the crisis. While Bolivia has not been able to achieve any dramatic reduction in the country's poverty rate, which is still around 70%, the political and economic stability has had a great impact on the social indicators which, while still below the average for the region, have posted substantial improvement over the long period of stability (see Table I-3).

1.14 The government's purpose to favor social spending is reflected in the 34% increase in this category in 1998 over 1996, compared with growth of just under 24% in total public spending during the same period, 2/ as shown in Table I-4.

2/ Although per capita social spending has been increasing in recent years, per capita spending on health (US$18) and basic education (US$29) is still lower by one third than the averages for Latin America and the Caribbean.

Table I-4
History of Public Social Spending 3/
(US$ millions)

Component	1996	1997	1998
Gross domestic product	7,165.3	7,747.6	8,557.6
Population (thousands)	7,588	7,767	7,950
Total public spending	2,372.2	2,623.9	2,935.2
Public social spending	566.6	607.8	759.9
% of GDP	7.9	7.8	8.9
Per capita (US$/person)	75	78	96
% of total public spending	23.9	23.2	25.9

Source: UDAPE

1.15 However, to preserve the macroeconomic equilibrium in the context of a fiscal crisis, the government has few alternatives for reducing the deficit given the structure of public sector expenditures, the chief component of which is staff remuneration. One of the variables of fiscal adjustment is therefore reducing investment and nonwage social spending. This in its turn implies a more than proportionate reduction in the quality and coverage of the social services, a situation that has a direct impact for the poor in that it prevents greater access to such services by the low-income population.

1.16 To cover the costs associated with the structural reforms, the government authorities were forced to cut expenditures on investments and other nonwage items in education and health, which were reduced by 20% and 12%, respectively, in 1996 and 1997 (see Table I-5). These cutbacks delayed the execution of priority programs in the two sectors, such as education reform, maternal-and-child care and control of communicable diseases.

3/ Includes: basic and secondary education, health and social security, housing and basic sanitation and rural development.

Table I-5
History of the Health and Education Budget: 1996-1998
(US$ millions)

Selected Social sectors	Budget performed			Budget for 1998	
	1996	1997	% change	Approved	% change
Education *					
Wages	254.7	276.4	8.5	300.6	8.8
Nonwage	20.0	16.0	-20.0	16.3	1.5
Total	274.7	292.4	6.4	316.9	6.4
Health					
Wages	49.3	52.7	6.9	53.7	1.9
Income and pensions	54.7	46.4	-15.2	51.7	11.4
Nonwage	6.8	6.0	-12.0	7.7	28.3
Total	110.8	105.1	-5.2	113.7	7.6

* Not including universities
Source: UDAPE

1.17 If the historical trend of budget performance is maintained, 4/ investment and other nonwage expenditures in education in 1998 are likely to be even lower than in the previous year, while in the health sector, whose budget for 1998 is 28% above the budget executed in 1997, actual spending under the same items could be only slightly above that in the preceding year. These performance levels would be clearly inadequate to meet the challenges of improving the social indicators, although it is recognized that various government programs in this area are only just getting under way.

E. Rationale of the operation

1.18 Among the Bolivian government's priorities, the fight against poverty is one of the most important, so in recent years the government has been making efforts to cover the demand for financing from the social sectors, while maintaining the goals to reduce the fiscal deficit and inflation.

1.19 To finance the public expenditure needed to maintain the macroeconomic equilibria, the Bolivian authorities requested a quick-disbursing loan for temporary coverage of the special fiscal costs arising from the pension reform and agreed with the Bank on the need to averting pressure for cutbacks in other areas of social spending, thereby protecting priority programs in education, health and child welfare. The conditionalities of the operation will

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4/ In Bolivia, traditionally between 75% and 85% of budgeted nonwage expenditures are actually effected.

ensure that the priority programs do not suffer cutbacks of the type described in the preceding section in the years ahead.

F. Strategy and justification for the Bank's participation

1.20 This operation is consistent with the Bank's operating strategy, which seeks to promote the alleviation of poverty through measures to improve living standards by facilitating access by the low-income population to basic education, health, sanitation and housing services. The lines of action under this strategy include support for macroeconomic stability and broad-based growth, development of human capital and consolidation of the reforms. This operation will make a substantial contribution to all these objectives, in addition to supporting effective execution of Bank operations in related fields.

1.21 The program will also help implement the HIPC agreements (see paragraph 1.8), especially as regards the protection of nonwage expenditures in health and education, in order to guarantee proper execution of the priority programs and actions identified under the initiative.

G. Relationship with other Bank operations

1.22 The IDB lending program in Bolivia emphasizes reforms in the social sectors. In this context, the ongoing loans with the greatest impact in terms of poverty reduction are those to partially finance the programs for education reform (931/SF-BO), comprehensive child care (995/SF-BO), health services (858/SF-BO) and low-cost housing (1006/SF-BO). For 1998-99, a social project demand of US$180 million has been identified which includes, in addition to the recently approved loan for low-cost housing (US$60 million), health projects (BO-0115) for US$45 million, basic sanitation projects in small municipalities (BO-0175) for US$40 million and support for microenterprises (BO-0171) for US$35 million.

1.23 Regarding execution of sector projects in Bolivia, the Bank, jointly with the World Bank, has financed the capitalization support program (953/SF-BO) in the amount of US$70 million, the last disbursement of which will be effected in the course of this year. This loan has supported the privatization of the main State enterprises, making the private sector the main shareholder in those enterprises. The Bank also financed the financial sector reform and private investment support program (628/OC-BO), through which State banks were closed down, the Investment Act was promulgated and the second-tier bank known as Nacional Financiera Boliviana (NAFIBO) was established.

1.24 The proposed operation includes expediting the education reform, low-cost housing program and the child welfare program financed by the loans mentioned in paragraph 1.22. It will also accelerate

startup of the health project, currently in preparation, also mentioned in paragraph 1.22.

II. THE PROGRAM

A. Objectives

2.1 The general objective of the program is to support the government in protecting priority social spending with the greatest impact on the lowest-income groups, while maintaining the goals of the macroeconomic stabilization process. Its specific objectives are to:

a. provide quick-disbursing funds to cover part of the temporary shortfall resulting from the fiscal emergency, while supporting maintenance of the economic stabilization process;

b. protect social spending on priority investment programs selected on the basis of their impact on low-income groups, in education, health and child welfare;

c. support the implementation of reforms in the education, health, low-cost housing and child welfare sectors; and

d. help strengthen the government's institutional structure in order to optimize the coordination, programming and monitoring of its social policy.

B. Program components

2.2 The program will consist of the following components: (i) maintenance of macroeconomic stability and meeting of the HIPC Initiative social matrix indicators; (ii) protection of social spending; and (iii) support for social reforms. Annex II-1 presents a summary matrix of the problems, proposed solutions and expected impact of the program. Annex II-2 contains the Policy Letter setting out the main measures that the government intends to carry out in the priority social sectors and areas.

1. Component A. Maintenance of macroeconomic stability and monitoring of the HIPC Initiative

a. Agreement on macroeconomic goal (IMF agreements)

2.3 The measures to be monitored under this component are in compliance with the new ESAF agreement with the IMF, 5/ the goals of which

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5/ The government is in the final stages of negotiating a new ESAF agreement for US$130 million with the IMF, which would be in effect from September 1998 to September 2000. The objectives of tis agreement would be to deepen the reforms and maintain economic stability.

will be to ensure the macroeconomic equilibria required to sustain growth and maintain economic stability.

b. <u>HIPC Initiative</u>

2.4 The conditionalities of this operation stipulate periodic verification of achievement of the HIPC agreement target indicators and any adjustments that the government may agree on with the IDB during the disbursement period. An agreement will be reached on the plan in 1998 (see paragraph 3.8).

c. <u>Macroeconomic consistency</u>

2.5 This subcomponent will monitor the consistency of macroeconomic policy with the program objectives.

2. <u>Component B. Protection of social spending</u>

a. <u>Protected social programs</u>

2.6 This component includes the verification that the necessary measures have been taken to protect investments in selected education, health and child welfare programs during the 1998-2000 period, in accordance with the agreements on fiscal sustainability and the HIPC Initiative.

2.7 The activities to be protected are part of the framework of the priority social reform programs that the Bolivian government is carrying out with financing from the IDB and the World Bank, bilateral cooperation and local counterpart funding through central government agencies (including the FIS), departmental governments and municipalities. The Protected Social Programs (PSPs) are summarized in the following paragraphs.

2.8 **In education**, the two phases of the education reform that will be protected emphasize improving quality and expanding coverage, through enhanced internal efficiency and measures designed to reduce inequity in the provision of education services:

a. **Education Reform Program** I. This program assigns priority to primary education for children living in rural communities where indigenous languages are spoken, through bilingual education. The reform includes measures to transform the structure and operation of the national education system (SEN) and raise the pedagogic quality of primary education, to benefit 1.5 million children attending some 13,000 primary schools. The estimated cost of the program is US$196 million, financed by the National General Treasury (TGN) (22%), the IDB (41%), the World Bank (20%) and bilateral agencies (17%). The activities to be protected include the purchase of school materials and equipment, curriculum development, training of

teaching and administrative staff, quality measurement and education information systems, administration, programming and monitoring systems, equipping of the district offices and training of the school boards.

b. **Education Reform Program II.** The emphasis in this second phase of the program will be on strengthening municipal management of the sector, enrolment of girls and the financing education projects and rehabilitation of schools cofinanced by the municipalities. The program seeks to provide infrastructure and support for the teaching processes in central schools, implement municipal education development plans and establish administrative mechanisms that will improve the relationship between the Ministry of Education, municipalities and the FIS. It is estimated that the program will benefit 500,000 children and will cost US$115 million, with local financing equivalent to 28%, a World Bank loan covering 61%, and KfW financing representing 11%. The activities that will be protected concern implementation of education projects in most of the central schools, institutional strengthening of the sector at municipal level and civil works to improve the school infrastructure.

2.9 **In health**, protection will be provided for the following programs which focus on improving access to services and equity in their delivery, and specifically target low-income groups in the rural and periurban areas:

a. **Integrated program for health services and institutional strengthening of the sector (PSF).** The PSF involves activities to expand the health-care network in depressed areas and low-income communities, provide food assistance and purchase and distribute medicine, and support initiatives for better organization and management in the health sector. Protection of spending under this Bank-financed program will guarantee its completion in the period 1998-2000;

b. **Bolivian epidemiologic shield.** Protection will be provided for programs to eradicate communicable diseases such as malaria, Chagas' disease and tuberculosis. The program includes the purchase of insecticides and equipment for fumigating homes and buildings in the areas affected by those diseases and treatment of persons with the diseases. In addition, the epidemiologic surveillance system will be strengthened at municipality level by means of the procurement of laboratory equipment and human resource training.

c. **Family health program.** Protection will be provided for spending on the development and implementation of a primary care system based on the family health strategy, with special emphasis on the rural and periurban areas, through a

multiplicity of public and private agencies and NGOs for the purpose. This system will deliver a basic health-care package to the low-income communities included in the basic health insurance activities and will recover costs from the higher-income groups and social security beneficiaries. The program includes physical investments and human resource training, together with administrative adjustments in the Ministry of Health, departmental governments and municipalities for managing this new form of service delivery.

d. **Expanded immunization program**. This program for the prevention of major childhood diseases, seeks to keep diseases such as poliomyelitis eradicated and to promote the eradication of measles and neonatal tetanus. It also includes activities to control yellow fever and ensure surveillance of rubella, pneumonia and meningitis. Purchase and distribution of vaccines and syringes, investment in cold chains, personnel training and communication and national mobilization will be financed; and

e. **Basic health insurance**. The purpose of this program is to ensure the delivery of a package of essential health services in order to reduce the main causes of mortality and mobidity, subsidizing program services for the low-income groups. Protection will be provided for recurrent expenditures for the purchase of a basic package, which will be made available through the family health networks (in the rural and periurban areas) and other providers. The financing its intended for the procurement of medicine, inputs and hospital services.

2.10 **In child welfare**, protection will be provided for the programs targeting at-risk children under six, and designed to help raise the school enrolment rate and ensuring the proper growth and development of the children, by providing comprehensive early education, health, nutrition and protection services. The protected programs in this area are the National Welfare Program for Children under 6 (PRONAM-6) and the Comprehensive Infant Development Program (PIDI), which together will benefit 148,000 infants through direct-care activities and a further 85,000 indirectly, for a total of 233,000 boys and girls, with US$118 million in financing for the period 1998-2000, of which the domestic sources would contribute 39%, the IDB 17%, the World Bank 36% and the World Food Program (WFP) 8%. The expenditures to be protected include the construction, remodeling and equipping of child-care facilities, health care, payment of teachers, school materials, food, training for families and educators, and institutional strengthening of departmental governments and municipalities in the child-welfare area.

b. Protected spending levels

2.11 The set of priority programs and the spending levels to be protected, presented in Table II-1, were the outcome of decisions by the Bolivian authorities and of the coordinated work by the IDB, the World Bank and the IMF to ensure that the amounts included were consistent with the HIPC targets, the schedule for execution of programs financed by external loans and the macroeconomic targets of the ESAF agreement.

2.12 The amounts protected, US$27 million in 1998, up to US$102 million in 1999 and US$120 million in the year 2000, reflect the funding levels that will ensure the satisfactory progress of the education reform currently under way and the startup of health and child welfare programs. The table below shows the protected spending by priority programs, summarized as follows:

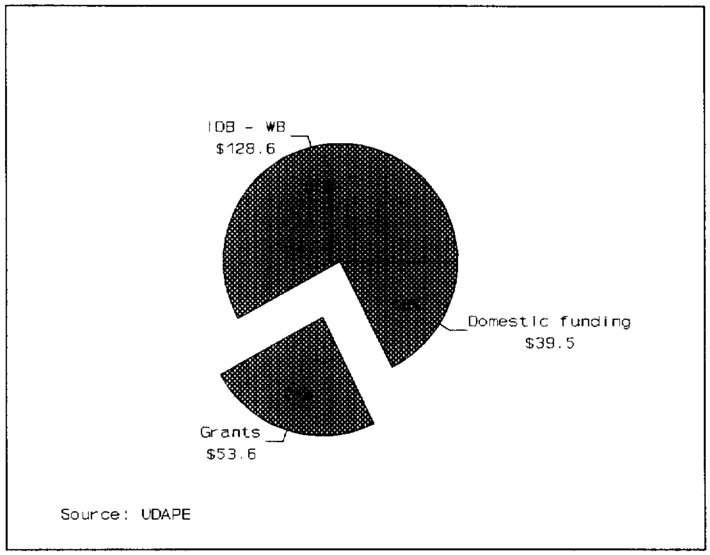
Table II-1
SOCIAL INVESTMENT IN PRIORITY PROGRAMS, 1998-2000
(amounts in US$ thousands)

PROTECTED SOCIAL PROGRAMS	1998	1999	2000
I. EDUCATION SECTOR	**11,433**	**49,951**	**53,469**
Education Reform Program I	9,404	22,851	25,769
Education Reform Program II	1,500	7,000	3,700
FIS	529	20,100	24,000
II. HEALTH SECTOR	**7,158**	**27,442**	**41,896**
Health Services Program (PSF)	5,500	3,000	2,000
Epidemiologic Shield	658	6,158	8,785
Family Health Program	1,000	6,584	15,811
Recurrent costs*	0	11,700	15,300
III. CHILD WELFARE	**8,399**	**24,344**	**24,638**
PAN Central Unit	1,654	1,138	1,172
PAN: Regional	6,745	23,206	23,466
TOTAL PROTECTED PROGRAMS	**26,990**	**101,737**	**120,003**

* Includes immunization program, basic health insurance and inputs for municipal services.

2.13 The above amounts would be subject to review when compliance with the conditionalities established for each program disbursement tranche is evaluated, on the basis of the following criteria: (i) since the child welfare programs are demand driven, the

Table II-2
Sources of PSP financing, 1999-2000
(US$ millions)



protected amounts will vary depending on the degree to which that demand becomes effective and on whether agreements have been entered into between the executing unit of the PAN and the regional and municipal governments to execute the projects and guarantee the counterpart funding; (ii) the grant component incorporated into the sources of financing for the PSPs would be adjusted if: (a) the respective agreement has not been signed; (b) the grant has not been incorporated in the National Budget; (c) disbursements have not been made for reasons beyond the borrower's control; and (d) the donor has not declared the value of the grants made; and (iii) given that the health programs include an external financing component which has not yet been committed, the adjustment required for the period 1999-2000 will depend on the date of approval of those funds.

3. <u>Component C. Support for social policy</u>

2.14 This component calls for activities to spur the social reform process, eliminate bottlenecks for social spending and ensure proper implementation of the social reforms. The main lines of action set forth in the Social Policy Letter (see Annex II-2) are:

a. <u>Education</u>

2.15 The reforms envisaged are fundamental to improve efficiency in the management of the system, deepen decentralization in education and strengthen school autonomy and community participation in education. They consist of the following:

(i) Gradual decentralization of education management to the municipalities and implementation of a plan to optimize the assignment of teachers to the schools on the basis of education needs. These two actions are mutually complementary and are included in the Policy Letter for this operation. They are expected to have a significant impact in the improvement of efficiency in the provision of education services.

(ii) Design and implementation of a reform strategy for higher education that will: (a) improve efficiency in the use of the resources assigned to the sector and the promotion of sources of financing in addition to public funds; and (b) set in motion the process of evaluating the universities that will contribute gradually to the raising of the quality of higher education and of the administrative management of the institutions concerned.

b. <u>Health</u>

2.16 The program seeks to ensure the availability of funds for the inplementation of reforms that will help improve coverage and increase efficiency and equity in the delivery of health services. Such reforms may represent an additional cost for the public sector in the early years of their implementation, until such time as adequate coordination is achieve between public and private sources and philanthropic and international organizations that enables the central government to focus on its regulatory and financing functions while delegating the direct provision of the services to other parties. The purpose of the health sector reforms the program will support is to:

(i) Generate new epidemiologic surveillance systems, through the creation of structures for the recording and dissemination of the basic epidemiologic information and early identification of new foci of disease transmission.

(ii) Create, finance and regulate the basic health insurance scheme.

(iii) Establish a new structure for providing health care services that will help improve linkage of the activities for the provision of basic insurance with those for disease prevention, immunization and epidemiologic surveillance and the primary care services with the second and third level services, by increasing the response capacity of the less complex levels and preventing unnecessary referral of patients to higher levels, thereby helping to lower system costs. This network will be progressively organized and financed by demand, in order to incorporate a variety of providers (NGOs, church services, private sector, departmental, municipal and Social Security public establishments) and to remunerate the services through incentives linked to user preferences and needs and to the results achieved in improving health conditions. Over the coming two years the legal and regulatory framework of the family health care system

will be put in place and implementation of the system will be started.

(iv) Institute a new health care financing model that will help target public funds to the neediest groups and recover the costs of the services provided to the protected population from Social Security, enterprises and families with the capacity to pay.

(v) Establish a new legal framework for the Social Security health services, which would separate financing from the provision of services, thus eliminating obligatory membership and guaranteeing freedom of choice for insured individuals.

c. Low-cost housing

2.17 The National Housing Subsidy Program (PNSV), financed by employer contributions of 2% of payroll and the surplus funds from the liquidation of the Low-cost Housing Fund (FONVIS), provides counterpart funds for low-cost housing and basic sanitation programs targeting low-income groups. To ensure the availability of PNSV funds, the government will issue a legal instrument establishing procedures for the transfer of employer contributions and will take the necessary steps to ensure that the liquidation of FONVIS is transparent, profitable and swift, including the independent technical, legal and financial appraisal required prior to the disbursement of funds for works currently under construction.

2.18 In order to improve the living conditions of the rural and low-income urban population, the government will expedite execution of the neighborhood-improvement component of the PROVIVIENDA program (1006/SF-BO) and the program to provide basic sanitation for small municipalities (BO-0175).

2.19 To prevent infection with Chagas' disease due to structural deficiencies in homes in rural and low-income urban areas, the government plans to introduce a specific subprogram in the PNSV to help eradicate the disease.

d. Child protection

2.20 The merging of the programs serving children under six and their decentralization has given rise to shortcomings in the management of the PAN and caused delays in meeting the targets set. To remedy this situation, the government plans to expedite the structuring of the PAN at the national and departmental levels so that the execution of the respective activities can get back on track.

III. FINANCING AND EXECUTION

A. Borrower and executing agency

3.1 The Republic of Bolivia will be the borrower for the operation and the Ministry of Finance will be responsible for its execution. The Vice Ministry for Public Investment and External Financing (VIPFE), the main functions of which are to propose policies and regulations for public investment and external financing and to control the annual investment program, will act as coordinating unit for the program (see Table III-1).

3.2 Program execution will also require the participation of other units of the Ministry of Finance, such as the Economic Policy Analysis Unit (UDAPE) and the Fiscal Programming Unit (UPF). The UDAPE is responsible for advising the government in the formulation of economic, sector and social policies, while the UPF is responsible for the fiscal program and control of government spending. The Ministry of the Presidency will also be part of the program execution mechanism, since the PAN reports to this ministry, as do the departmental governments, which are decentralized institutions that administer the social sectors at the level of each of the nine departments into which the country is divided. The Ministries of Education, Health and Housing would also be involved, in that they would provide support to the coordinating unit in the monitoring of the PSPs, and the PSP executing units, which would provide information on the physical and financial progress of the respective PSPs.

Table III-1
Institutional roles of the executing agencies

Agency	Role
Vice Ministry of Public Investment and External Financing (VIPFE)	General coordination. Programming of grants. Control of physical and financial execution of the protected programs.
Fiscal Programming Unit (UPF)	Tracking of the agreement with the IMF. Programming of cash flows of the protected programs.
Economic Policy Analysis Unit (UDAPE)	Tracking of the HIPC agreement and the Letter of Social Policy.
Ministry of the Presidency (MP), prefectures, Ministry of Education (ME), Ministry of Health (MH), Ministry of Housing (MHg)	Control and tracking of the execution of the PSPs of their sectors and of the Letter of Policy.
Protected Social Program (PSP) executing units	Administration of the PSPs. Information on budget performance and physical progress of the PSPs.

B. Financing and execution, amortization and grace periods

3.3 The US$50 million program would be financed with resources from the Bank's Fund for Special Operations (FSO) through a sector loan that

would be disbursed within a period of 30 months from the effective date of the loan contract, with the following terms and conditions:

Amortization period:	40 years
Grace period:	10 years
Interest rate:	1% during the grace period and 2% for the remaining 30 years
Inspection and supervision:	1%
Credit fee:	0.5%

C. Disbursements

3.4 The loan would be disbursed in three tranches: an initial tranche of US$20 million and two subsequent tranches of US$15 million each. The first disbursement, which would be made in November 1998, will consider the findings of the evaluation of the HIPC agreement, partial performance of the 1998 budget and the Executive's proposal for the 1999 budget. The second disbursement will consider the budget approved for 1999, performance of the 1998 budget and that of the first half of 1999. The third disbursement will consider achievement of the HIPC social matrix targets, the budget approved for the year 2000, budget performance for 1999 and that of the first half of the year 2000.

D. Conditionalities

3.5 Prior to each disbursement under the program, the executing agency will be required to demonstrate compliance with the general and specific conditions detailed below:

1. General condition for disbursements

3.6 As a condition precedent to each disbursement, the borrower must submit evidence satisfactory to the Bank regarding: (i) maintenance of macroeconomic stability and implementation of the HIPC and ESAF agreements; (ii) consistency of the macroecononic environment with the program; and (iii) the progress achieved in the respective measures specified in the Policy Letter, the criteria for evaluation of which were agreed upon during project negociations.

2. Specific disbursement conditions

3.7 The disbursement of program funds for each of the proposed three tranches will be subject to presentation of documentation evidencing achievement of the targets set for the respective components, as follows:

a. First tranche

(i) evidence that in the first three quarters of 1998, the budget performance of the PSPs reached at least 60% of

the amount set in the PSP investment table (Table II-1) and, when added to the PSP financial programming for the rest of the year, equals the amounts agreed upon in that table;

(ii) a copy of the draft public investment budget for 1999, indicating the amounts allocated to the PSPs, in accordance with the figures in Table II-1;

(iii) evidence that a system for coordination and tracking of social policy and the programs composing it is in place, including institutional roles, information flows for annual integrated and medium-term programming, the methodology for the physical and financial monitoring of the programs and evaluation of the social policy action process;

(iv) the proposed procedures to be adopted by the government for the PAN to ensure the availability of the local counterpart funding from the departmental and municipal governments for the PSPs; and

(v) evidence that the necessary legal measures have been taken to ensure normal operation of the child welfare program, defining the institutional structure at central, departmental and municipal levels; establishment of a national committee and departmental committees; and organization of single teams at the national and departmental levels.

b. Second tranche 6/

(i) copy of the plan for monitoring achievement of the HIPC targets for the years 1999-2000, including a set of indicators and measures under the social policy delivered by December 31, 1998;

(ii) copy of the financial and physical programming of each PSP for 1999-2000 in education, health and the PAN delivered by December 31, 1998;

(iii) copy of the public investment budget approved by Congress for the year 1999, indicating the amounts allocated to the PSPs in accordance with the figures in Table II-1;

6/ To ensure that the necessary information will be at hand for evaluating progress in the achievement of the HIPC targets, the PSPs and the social policy, the second tranche includes conditions that the borrower must fulfill by December 31, 1998.

(iv) evidence that the budget performance of the PSPs for 1998 matches the figures programmed in Table II-1 for that year and that PSP performance for the first half of 1999 amounts to at least 30% of the amount agreed for the year, and that this figure, when added to the PSP financing programmed for the rest of the year, equals the amounts set forth in the investment table (Table II-1);

(v) evidence that the physical and financial progress of the PSPs in the first half of 1999, in education, health and child welfare, is substantially in accordance with the targets agreed upon in the programming carried out in December 1998;

(vi) contracts awarded for studies on the valuation and strategy for the sale of FONVIS assets;

(vii) evidence that the necessary legal measures have been taken to ensure that the resources needed to finance the PNSV will be available; and

(viii) study completed on improved budget management of public investment, identifying and proposing solutions to improve and expedite budget programming and execution for public investment, preserving the fiscal equilibrium and macroeconomic environment.

c. <u>Third tranche</u>

(i) evidence of compliance with the HIPC targets in accordance with the monitoring plan approved in December 1998;

(ii) copy of the public investment budget approved by Congress for the year 2000, indicating the amounts allocated to the PSPs, in accordance with the figures programmed in Table II-1;

(iii) evidence that the budget performance of the PSPs for 1999 matches the figures programmed in Table II-1 for that year and that the performance for the first half of 2000 amounts to at least 35% of the figure set for that year which, when added to the PSP financing programmed for the rest of the year, is consistent with the amounts shown in the investment table (Table II-1);

(iv) evidence that the physical and financial progress of the PSPs during the period July 1999-June 2000 is substantially in accordance with targets agreed upon;

(v) financial and physical programming of the PSPs for the period July 2000-December 2001;

(vi) evidence that the studies for the FONVIS asset valuation and sales strategy have been completed and that liquidation of the FONVIS portfolio and assets has been launched; and

(vii) a progress report on implementation of the recommendations made in the study on improving budget management for public investment.

3. Other special conditions

3.8 In addition, the borrower will be asked to commit to ensuring compliance with the general legislation and particular rules and regulations on the environment in the execution of the PSPs.

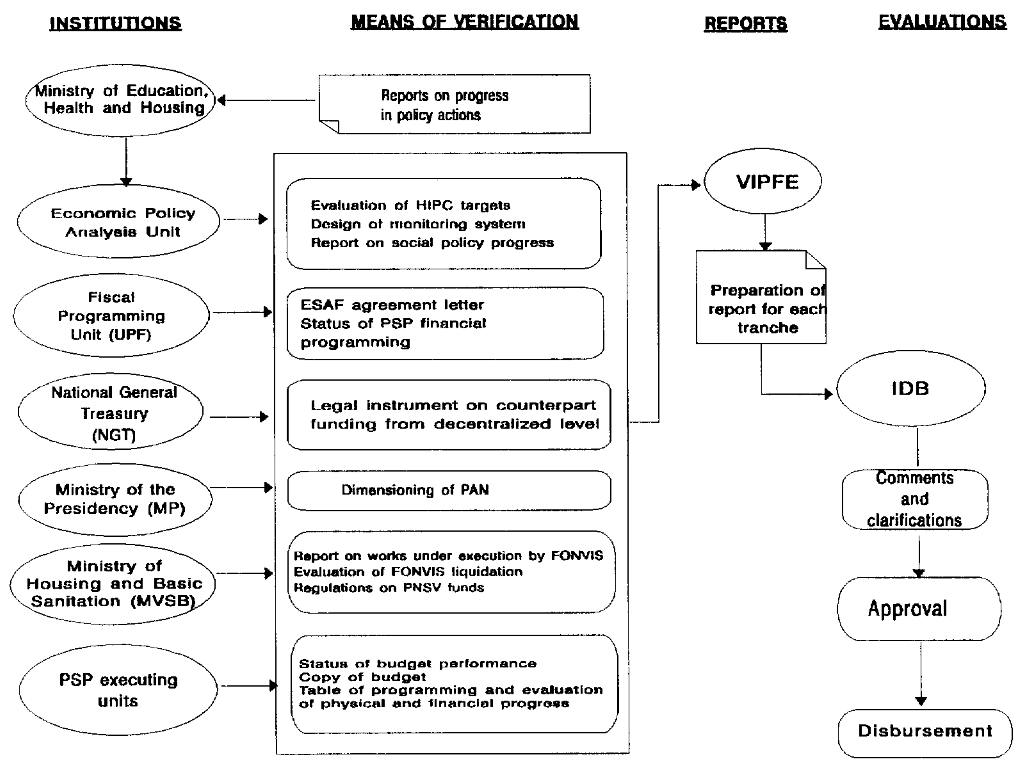
E. Periodic reviews

3.9 In order to evaluate compliance with the conditions precedent for each tranche and the results achieved during program execution, three reviews will be conducted during the disbursement period and are scheduled to take place in November 1998, July 1999 and July 2000. To this end, the borrower will be required to submit to the Bank 15 days prior to the date scheduled for each review: (i) a summary of the measures adopted to fulfill the commitments assumed in the Policy Letter; (ii) an evaluation of compliance with the HIPC targets, according to the timetable in effect on the date of the report; (iii) the summaries of the budget and general status of budget performance of the public sector; (iv) the tables setting out the physical and financial progress of the PSPs and their analysis, status of budget performance; (v) progress reports on the FONVIS liquidation process; and (vi) the progress achieved in the measures to improve budget programming and execution of public investment.

3.10 The summary of the progress achieved in the measures set forth in the Policy Letter will include: (i) the status of decentralization of the education sector to the municipalities and progress in the teacher assignment plan and its impact; (ii) achievements in the higher education reform process; (iii) the study of new health surveillance system and its subsequent implementation in the course of the program; (iv) the study defining the basic health insurance system, its regulation and implementation; (v) the legal and regulatory framework for the family health care system and its implementation; (vi) studies and legal provisions governing the new model for health care service financing; (vii) the new legal framework for the Social Security health services; (viii) the status of the basic sanitation programs for small municipalities and rural and low-income housing at risk for Chagas' disease; (ix) evidence that the FONVIS Liquidation Commission has not

disbursed funds to complete works in progress, except in cases where (a) an independent technical, legal and financial evaluation has so recommended, and (b) the work is at least 80% complete and the contractor has provided a guarantee for an amount equivalent to the disbursement and which would be released solely against a favorable technical, legal and financial evaluation; and (x) evidence that the responsible PAN unit has been dimensioned with an appropriate organization and functions and that it has been implemented and is operating with the required personnel.

Table III-2
Execution Mechanism



F. <u>Disbursement procedures and conditions</u>

3.11 The quick-disbursing program funds will be used to finance the added cost in hard currency of eligible imports from Bank member countries. In this case the Bank's new simplified procedures for sector loans will be applied, which eliminate the international public competitive bidding required under the old procedures. The funds will be disbursed when requested by the borrower upon

submission of evidence of compliance with all the contractual conditions.

G. Accounting and audit

3.12 The borrower will be responsible for keeping separate records of the transactions chargeable to the loan proceeds, in order to facilitate any inspections required and the timely preparation of statements of account and reports. The records must identify the goods procured through such transactions, the cost of the imports and the origin of the goods.

3.13 The Bank will require that the borrower maintain appropriate records of the loan proceeds disbursed and reserves the right to request the borrower to provide an audited report.

H. Environmental quality and social impact of the project

1. Environmental impact

3.14 This operation is not expected to have any adverse impact on the environment since it will promote the execution of programs and reforms financed mainly by IDB and World Bank loans. The respective loan contracts contain environmental provisions and monitoring mechanisms that were thoroughly analyzed when the respective operations were prepared and approved.

3.15 To verify the foregoing, the program executing agency will have access, through the Vice Ministry for Public Investment and External Financing (VIPFE), to the National Public Investment System, which contains the regulations to be followed for public sector investments to be included in the national budget. The PSPs will accordingly be included subject to the applicable environmental parameters.

2. Social and gender impact

3.16 The social impact of the program will be positive given that the conditionality of the operation will support the execution of reforms and other measures in the education, health and housing sectors. The health programs to be protected include activities specifically for maternal-and-child care in rural areas where such services are not currently available. All the PSPs will have a major gender impact because they basically target mothers and children and target the most vulnerable groups in the low-income segments of the population.

IV. FEASIBILITY, BENEFITS AND RISKS

A. Feasibility

4.1 The sizing of the operation is consistent with the support needed for fiscal adjustment and the conditionalities relating to social spending levels have been analyzed jointly with the government and are in line with the efforts being made by the government, the IDB, the World Bank and the IMF to maintain macroeconomic stability and improve the human development indicators.

4.2 The counterpart funding required by the PSPs is included in the government's budget and has been taken into consideration in current projections of the public deficit, and will therefore not increase the pressure on the National General Treasury beyond the fiscal programming agreed upon with the IMF.

4.3 The design of the institutional mechanism for the execution of the social measures and the monitoring of the PSPs and the Policy Letter takes into account all the institutions and levels of government involved in the program, delegating coordination to the policy-making body of the public investment system, with the active participation of the sector institutions and of the bodies responsible for social policy formulation and fiscal control, and using instruments that will help ensure the counterpart funding to be provided by decentralized institutions and the contribution of the bilateral agencies to the PSP.

B. Benefits

4.4 The program is expected to produce the following benefits:

a. By providing quick-disbursing funds to help cover the fiscal deficit, it will make it possible to balance public finances and maintain economic stability, which will in turn enable sustained growth of the economy and increased income levels, especially for the most disadvantaged groups of the population.

b. By protecting public social investment in education, health and child welfare, it will ensure spending levels that will allow for the provision of such services targeting the lowest-income segments. In this respect, a particularly important factor is the stimulus that the program will give to investments in the health sector, expediting the execution of such programs as the family health and epidemiologic shield programs. Moreover, by protecting public social investment that benefits basically the lowest-income groups, it will help develop the human capital of the beneficiaries and thereby contribute to improving income distribution in the medium and long terms.

c. By supporting the government in the implementation of major reforms in education, health, low-cost housing and child welfare, the program will help accelerate the process and foster the long-term sustainability of the efforts to improve the quality and coverage of the social services.

d. By promoting linkage of the social sectors at the programming and comprehensive monitoring level, it will help improve the planning systems and service management and evaluation.

C. Risks

4.5 The volatility of the markets and Bolivia's external vulnerability could prompt deeper cutbacks in fiscal spending and render the commitments called for under the program unsustainable. To address this risk, a periodic monitoring mechanism is included that will allow timely response to such situations, together with a monitoring system based on the control instruments used by the IMF and which are considered effective to ensure continuity of the protected social spending.

4.6 The nature of the operation underscores the difficulty of linking social programming with the country's financial and budget programming, due to the recent changes in the institutional structure of the public sector. This situation could place achievement of the physical targets at risk and delay the social policy actions. To mitigate this risk, the program emphasizes the establishment of a monitoring system headed by the VIPFE and including all the institutions participating in social programs.

4.7 Moreover, the fact that various sectors and institutions, including departmental governments that operate on a decentralized basis and autonomous municipalities, are involved in the operation generates the risk that disbursements might be delayed or blocked. To reduce this risk, together with the monitoring system and the incentives incorporated in the PSPs (matching grants, agreements, etc.), the TGN has agreed to set up a procedure that will ensure the timely provision of the counterpart funding from the decentralized levels for the PSPs.

4.8 There may be strong resistance to the program-supported social reforms since they will affect the interests of groups in the political and labor union sphere. To minimize this risk, where the reform measures are expected to encounter particular resistance, the Policy Letter call for the establishment of a climate of dialogue in which the social ministries will have considerable leverage for promoting a sense of ownership among those affected by the reforms.

4.9 Lastly, even under conditions where the flow of funds is normal and the legal and institutional framework is adequate, there is the risk of noncompliance – especially with respect to the targets set

for the PSPs – due to the deficiencies in the management of these programs. In this case, too, an effective monitoring system will lessen the risk, while the conditionalities incorporated also contain provisions that will promote efficiency in execution.

BO-0173
BASIC SOCIAL MATRIX

EM	ACTIONS	IMPACT	FIRST TRANCHE	SECOND TRANCHE	THIRD TRANC
			MACRO AND HIPC		
it macro hich affects ost acutely.	Maintenance of macro conditions that ensure stability, by financing part of the deficit through a loan.	Achievement of macroeconomic targets.	• ESAF agreement in effect. • Evidence of consistency between macroeconomic policy framework and the program.	• ESAF agreement in effect. • Evidence of consistency between the macroeconomic policy framework and the program.	• ESAF agreement in e • Evidence of consiste the macroeconomic framework and the p
high overty.	Actions in the social area in accordance with the HIPC Initiative social matrix.	Social indicators improve, especially for poorest groups (HIPC social matrix).	• Evidence that current HIPC agreement targets are achieved.	• Plan for monitoring the HIPC targets for the years 1999-2000 that includes a set of indicators and social policy actions delivered by 12/31/98.	• Evidence that HIPC targets are achieved, accordance with the plan agreed upon by
			PROTECTION OF SOCIAL EXPENDITURE		
enditure cutbacks al .	Maintain levels of social spending and public investment in priority sectors, because of their impact on the living conditions of the lowest-income groups.	Prevent reduction of social spending, so as not to block investments in the social sector, and especially not those assigned priority because they target low-income groups.	• Evidence that in the first three quarters of 1998 PSP budget performance reached at least 60% of the figure set in Table II-1, which when added to the PSP financial programming for the rest of the year it matches the agreed amounts in that table. • Copy of the draft public investment budget submitted to Congress for 1999 or the government's proposed budget with a breakdown of the amounts allocated to the PSPs in accordance with amounts programmed in Table II-1.	• Financial and physical programming for each protected program for 1999-2000 in education, health and child welfare delivered by 12/31/98. • Public investment budget approved by Congress for 1999, with a breakdown of the amounts allocated to the PSPs in accordance with Table II-1. • Evidence that PSP budget performance for 1998 matches the Table II-1 programming for that year and that PSP performance in the first half of 1999 is at least 30% of the amount agreed for that year, which when added to the PSP financial programming for the rest of the year it matches the amounts programmed in Table II-1. • Evaluation of the physical and financial progress of the PSPs in the first half of 1999 shows it to be substantially in line with the targets agreed in the programming carried out in December 1998.	• Budget approved for 2000 includes a brea the amounts allocate PSPs in accordance amounts programme Table II-1 • PSP budget performa 1999 matches the pr in Table II-1 for that y PSP performance of of 2000 is at least 35 figure set for that yea when added to the P programming for the year is in line with th set in Table II-1. • Evaluation of the phy financial progress of during the period Jul 2000 shows it to be s in accordance with th targets. • Programming of the period July 2000-Dec with details of physic and projected flows c

3

BO-0173
BASIC SOCIAL MATRIX

EM	ACTIONS	IMPACT	FIRST TRANCHE	SECOND TRANCHE	THIRD TRANC
		SUPPORT FOR SOCIAL REFORMS			
CTOR: rdinate nancial gthen and ial policies ns.	Prioritization of social actions in a Policy Letter and strengthening of UDAPE and planning units in social sector ministries.	Acceleration of main social reforms and improvement of coordination between the social ministries and the Ministry of Finance in budgetary and performance matters.	• Evidence of progress achieved in the Policy Letter actions. • Establishment of a system for coordination and monitoring of social policy and of the programs composing it, including institutional roles, information flows for annual and medium-term programming, methodologies for physical and financial tracking of the programs and evaluation of the progress of the social policy actions. • Proposal establishing the procedure adopted by the government through the PAN for assuring the local counterpart funding from the departmental and municipal governments for the PSPs.	• Evidence of progress in the Policy Letter actions. • Study completed on improving budget management for public investment.	• Evidence of progress Policy Letter actions. • Progress report on implementation of the recommendations ma study on improving b management for pub investment.
FARE: tutional d ion of on .	Institutional definition	Institutionalization of the program and stability that supports accomplishment of the program's objectives.	• Implementation of the measures needed for ensuring normal operation of the Child Welfare Program, defining the institutional structure at central, departmental and municipal levels; establishment of the national and departmental committees and of single teams at the national and departmental levels.		

BO-0173
BASIC SOCIAL MATRIX

EM	ACTIONS	IMPACT	FIRST TRANCHE	SECOND TRANCHE	THIRD TRANC
l Housing ogram to loss of nce ns to it (2% can be vernment urposes; plus from of FONVIS source of or the ere is a risk l not be , profitable	Approval of the legal measures necessary for ensuring the funding needed for the PNSV. Ensuring that the liquidation of FONVIS is transparent, profitable and swift.	Ensure the availability of the resources needed for carrying out subprograms designed to remedy the housing deficiencies of the low-income groups.		• Studies commissioned on the valuation and sales strategy for FONVIS assets. • Evidence that the legal measures necessary have been taken to ensure the availability of the funding needed for the PNSV.	Evidence that the studie evaluation and sales str FONVIS assets have be completed and that the of the FONVIS portfolio has been initiated.

POLICY LETTER

In connection with the Program for Fiscal Adjustment and Maintenance of Social Spending, a summary is presented below of the conceptual framework of this operation, the measures taken by the Government of Bolivia and the actions it plans to carry out in the immediate future, from August 1998 to March 2000, during which time the program will be executed.

I. MACROECONOMIC SITUATION AND FISCAL ADJUSTMENT

In 1998, the economy is in its twelfth year of sustained growth and low inflation, a situation attributable to a sound macroeconomic policy that combined monetary discipline with a reduction in the fiscal deficit, while still allowing flexibility in the exchange policy and gains in competitiveness. This economic growth has been spearheaded by investment, which has increased significantly since 1995 (when it represented 15.7% of GDP), and reached 17.8% of GDP in 1997. The bulk of the growth was almost entirely attributable to the increase in private investment, a factor in which was the restructuring and modernization of the capitalized and privatized enterprises. The downward trend in inflation has continued, thanks to the combination of low fiscal deficits, conservative monetary and credit policies and a stable exchange-rate policy. Inflation in 1997 was 6.7%, a rate below the 8% observed in the previous year and the average of 9.8% for the period 1992-1996. For 1998, inflation is not expected to exceed 6.5%, while savings and investment should reach some 19% of GDP.

Despite the government's efforts to maintain fiscal discipline, the fiscal deficit will increase in the short term because the cost of the structural reforms has been higher than originally estimated, while tax revenues from the oil and gas sector will be lower as a result of the change in the tax system under the new Hydrocarbons Act. The fiscal deficit in 1998 is expected to amount to 4.1% of GDP, compared with an initial estimate for the year of 3.2%, as opposed to less than 2% of GDP in 1995 and 1996 and 3.3% of GDP in 1997. The real cost of the pension reform for 1998 was 4% of GDP, higher than the original projected cost of 3.3% of GDP. The difference between the original projection and the current one is due in part to the existence of a retroactive obligation to pensioners which would be paid during the year (and amounts to 0.3% of GDP) and the fact that a larger number of persons than expected opted for retirement under the old system, which entailed additional costs amounting to 0.4% of GDP.

The government has programmed measures to reduce the fiscal deficit, including heightened surveillance of major taxpayers, a renewed effort to reduce evasion of customs duties and ceilings for wage and salary increases in the public sector. In addition, to cover the costs associated with the above-mentioned structural

reforms, the government authorities have been forced to limit spending on certain budget items, such as nonwage expenditures in education and health, which were reduced by some 20% and 12%, respectively, between 1996 and 1997.

II. SOCIAL SITUATION AND THE HIPC DEBT-REDUCTION INITIATIVE

The economic reforms Bolivia has been executing over recent years are laying the foundations for sustainable growth. In addition, Bolivia has launched important reforms in the areas of education, health, child welfare and low-cost housing as part of its strategy to fight poverty and build human capital. Over the past 10 years, social spending as a proportion of GDP has increased significantly, but the challenge of improving social development indicators requires still greater efforts. The present administration is committed to deepening the social reforms in order to expand the coverage and upgrade the quality of education, health, child-welfare, housing and basic sanitation services.

Notwithstanding the higher levels of economic growth achieved by Bolivia, progress in the fight against poverty has been less than was hoped for. It has become evident that economic stability and growth, while necessary elements, are not sufficient in and of themselves to achieve a sustainable reduction in poverty. Decisive steps are needed in the area of human capital development that will enable low-income groups to improve their opportunities to participate in the country's economic growth.

In September 1997, Bolivia's participation in the HIPC Initiative for external debt reduction was approved, to help Bolivia achieve a sustainable debt level so that funds could be released to deepen the structural reforms, especially in the social sectors. The HIPC Initiative makes effective debt reduction conditional upon compliance with the ESAF agreement and with the expenditure and performance targets set forth in the HIPC Social Matrix. The Social Matrix indicators emphasize precisely the programs and reforms that will contribute to human capital development and poverty reduction. Achievement of these targets is to be evaluated in September 1998 and a positive result is expected. The present administration will take the steps necessary to ensure that the HIPC targets for the years 1998-2001 continue to be met.

III. PROTECTED PROGRAMS

The country's current fiscal situation greatly reduces the possibility of any increase in social spending in the national budget. However, the Government of Bolivia is aware that it is important to achieve adequate spending levels in the programs with the greatest impact on long-term poverty reduction. Among the social programs, the government has selected a group of priority programs in education, health and child welfare, for which adequate

spending and execution levels are vital during the execution period of the sector program.

IV. SUPPORT FOR SECTOR REFORMS

In the education, health, child welfare and housing sectors, reforms will be implemented that will have a direct impact on the availability of public funds or the efficiency of social spending in each sector. Some of the main challenges to be addressed by the structural reforms in the social sectors are described below, along with the measures the government proposes to take in the immediate future to overcome them.

A. Education

The policy measures the government plans to take in education are designed to improve efficiency in the allocation of resources and management of the school system, deepen decentralization and strengthen school autonomy, and foster community participation in education.

Improved teacher assignment. One of the main constraints for education reform concerns problems in teaching staff management. The current system for teacher allocation in the education system is not based on criteria of efficiency, equity or quality, as evidenced by the fact that teacher allocation bears no relation to either the size or the distribution of school enrollment. Moreover, recruitment and remuneration of the teaching staff represents considerable resources, since the largest share of the basic education budget is used for payroll. The fiscal effort put into the continuous increase in the number of teachers is therefore not having the desired impact on academic performance. Accordingly, efforts need to be made to improve control in the allocation of teaching staff and thereby increase efficiency in that area. The national government therefore will design and implement a plan to optimize teacher distribution in the country's public schools, improving information systems and instruments for control.

Strengthening of education management. Because the teaching staff is administered at the departmental level, management of education resources is difficult since many are provided at the municipal level. Mechanisms will therefore be devised to achieve decentralized management of education to the extent possible at the municipal level so as to improve resource allocation, respond better to school needs and allow better social control by the community. To this end, the government will promote agreements with the municipalities that will allow gradual decentralization of education management and will begin transferring basic education administration to the municipal governments through a pilot program in which municipalities will participate on a volunteer basis.

Secondary education. At the present time, the curricula of three of the eight grades in basic primary education have been overhauled. The other grades are expected to undergo the curricular overhaul at a faster pace in the coming years. Accordingly, plans should be made for launching secondary education reform, especially since, given the complexity of the secondary curricula, which requires specific steps to be taken, such as teacher training. The national government will therefore design the secondary education reform component, depending on the progress achieved in basic education reform.

Changes in resource allocation for higher education. Higher education, particularly university education, accounts for a much higher proportion of the overall education budget than the share of higher education enrollment in total enrollment. This situation compromises the availability of resources for the other levels of education, especially basic education (which represents the largest share of total enrollment). It is therefore essential that mechanisms be established to improve efficiency in the use of university resources. The government is committed to designing and implementing a strategy to improve the use of these resources by promoting accreditation and evaluation of higher education institutions and allocating resources according to university management efficiency indicators.

B. Health

The purpose of the health sector reforms is to improve the coverage and increase efficiency and equity in health care service delivery through implementation of a new financing system that will guarantee the availability of resources. The health reform is consistent with the strategic lines of action set forth in the Strategic Health Plan (PES), the main components of which are the epidemiologic shield, basic health insurance and family health.

Endemic diseases. Chagas' disease, malaria and TBC currently occur at endemic proportions and are generating high economic costs due to absenteeism estimated in some studies at US$594 million. Chagas' disease causes 13% of deaths among persons aged 15 to 75. One of the government's objectives is to implement the epidemiologic shield in endemic areas over the next five years, in order to: (i) prevent endemic diseases through fumigation of areas of transmittal, in the case of vectors; (ii) treat the affected population; and (iii) strengthen the epidemiologic surveillance system, to obtain regular information on the epidemiologic profile of the country in order to take timely steps for prevention and control.

Basic health insurance (SBS). To reduce the main causes of mortality and morbidity, the government plans to implement the SBS, the objective of which is to guarantee universal delivery of a

basic package of essential health care services. Providers of the basic package may be, among other institutions, public or private establishments, Social Security, NGOs and church establishments participating on a voluntary basis. Insurance coverage is universal, that is, all the inhabitants of the country are protected, subject to the established limitations in service delivery. The insurance covers health care and nutrition for children, health care and nutrition for women and health care for the general population, with diagnosis and treatment only for tuberculosis, malaria, cholera and sexually transmitted diseases (STD), except AIDS. The SBS will be financed with contributions by municipalities from central government transfers, departmental contributions from *Cajas de Salud* (Health Funds) and international cooperation.

Linkage of services. In order to improve linkage of the SBS delivery activities with those for prevention, immunization and epidemiologic surveillance and the primary care services with those for the second and third level care, a new structure will be established for the provision of health care services, based on a family health network. The new structure will increase the response capacity of the less complex levels and avoid unnecessary referral of patients to higher levels, thereby helping to reduce system costs. Network services will be provided by a variety of providers (NGOs, church services, private sector, public departmental, municipal and Social Security establishments, among other institutions). The legal and regulatory framework for the family health system is expected to be ready in the next few years and will then be implemented.

Health care financing. The financing available for expansion of the primary health care model is insufficient. The SBS will be offered free of charge, since it consists of only a basic package of services that any individual should have access to. However, the SBS will gradually evolve into a comprehensive health insurance system that will include a series of complex services with cost recovery so that public funds can be used to target the neediest population. Moreover, the national government plans to promote agreements or other legal instruments that will allow Social Security to transfer resources to the Ministry of Health and Social Insurance, inasmuch as the public sector will be in charge of primary care services, including the population covered by Social Security. However, these resources may prove insufficient and other possible alternatives will be studied.

Human resources. The family health model requires human resource management in the framework of a decentralized system in which financial incentives can be given to ensure the staffing needed in each health area and district. The possibility of instituting payment for training will also be examined. In addition, in order to lend continuity to the various programs, a health career will be

implemented. The national government plans to formulate a proposal with these features.

C. Child welfare

As a major element in the fight against poverty, the government is implementing the National Program for the Welfare of Children Under Six (PAN), the purpose of which is to help ensure proper development of at-risk boys and girls through comprehensive services in early childhood education, health, nutrition and child protection.

The PAN is the outcome of institutional reorganization of child welfare programs (PIDIs, CIDIs and PRONAM-6). It was launched in 1997 and was consolidated in April 1998 through decree D.S. 25017 which dissolved the previous programs and officially established the PAN. The program is executed through an executive office and is attached to the Ministry of the Presidency. It has autonomy for technical, financial and administrative management and involves the direct participation of the departmental and municipal governments. As of September 1998, the PAN had a single team at the national level, which was in the process of reformulating coverage goals, cost structure and financing needs.

Institutional framework. To achieve the goals and objectives of the PAN, the government is taking the necessary measures to strengthen implementation in a decentralized framework, by seeking greater institutionalization and sustainability. Measures will also be taken to expand coverage by incorporating executing agencies from civil society.

Technical framework. New types of care will be implemented, placing greater emphasis on the role of the family, and seeking financially feasible alternatives for expansion of the program. Such new alternatives will be supplemented with systems for training, supervision, monitoring and evaluation of the new PAN structure.

D. Housing and basic sanitation

Financing of National Housing Subsidy Program (PNSV). The National Housing Subsidy Program (PNSV) constitutes the main instrument for implementation of the housing subsidy policy to provide the housing solutions needed by low-income groups, while ensuring equity, transparency and efficiency in the use of resources. The PNSV is authorized to finance subprograms with mechanisms for group or individual financing subject to fulfillment of the eligibility criteria established in the PNSV Operating Regulations. The PNSV currently consists of the following subprograms: (i) neighborhood improvement; and (ii) prevention, mitigation of risks and emergency assistance. Other subprograms are being studied.

According to decree D.S. 24935, the employer contribution of 2% of payroll is to be allocated to the PNSV and to meet other obligations. In order to ensure the availability of the employer contributions necessary to carry out the PSNV subprograms, the government will take any additional technical and legal measures that may be necessary.

Moreover, since the remaining funds from the liquidation of the former National Low-Cost Housing Fund (FONVIS) are a source of funding for the PNSV, the government will take the necessary measures to ensure that the liquidation of FONVIS is transparent, profitable and swift, such as hiring independent consulting services to perform the legal, technical and financial verification necessary to make payments to construction firms that have works under way or to release their letters of guarantee.

Coverage of basic services. Despite the strides the country has made in basic sanitation, there are still low-income groups in urban and rural areas that lack water supply and excreta-disposal services. The government plans to significantly improve basic service coverage rates by executing specially designed programs. In the framework of the PNSV, the national government signed an agreement with the IDB for financing for a program to support the housing policy (PROVIVIENDA), which has been approved by the National Congress. One of the objectives of PROVIVIENDA is to provide basic infrastructure to families belonging to groups with high levels of basic unmet needs, through neighborhood improvement projects. In addition, a program for the provision of basic sanitation to small municipalities (PROAGUAS) is being identified, designed and formulated with the IDB financing. Its purpose is to make investments to improve the quality of housing by providing water supply and/or sanitation systems to improve the conditions of the rural population.

Chagas' disease control. Structural shortcomings in dwellings in rural and low-income urban areas are currently causing a higher rate of Chagas' disease. The government will implement a PNSV subprogram to improve such rural and low-income housing that exposes people to Chagas' disease, in coordination with the Ministry of Health and Social Insurance.

Herbert Muller
Minister of Finance

PROPOSED RESOLUTION

BOLIVIA. LOAN /SF-BO TO THE REPUBLICA DE BOLIVIA PROGRAM OF FISCAL ADJUSTMENT AND MAINTENANCE OF SOCIAL EXPENDITURES

The Board of Executive Directors

Resolves:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the República de Bolivia, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Program of Fiscal Adjustment and Maintenance of Social Expenditures. Such financing shall be for the amount of up to US$50.000.000, or its equivalent in other currencies, except that of Bolivia, which are part of the Fund for Special Operations resources of the Bank, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.