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BOLIVIA

FISCAL POLICY AND DECENTRALIZATION SUPPORT PROGRAM (BO-L1061)

LOAN PROPOSAL

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ELECTRONIC LINKS	
REQUIRED	
1.	Policy Letter http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35305144
2.	Results Matrix http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35306964
3.	Means of Verification http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35306968
OPTIONAL	
1.	Evaluation of Public Finances (Public Expenditure and Financial Accountability-PEFA) http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35308229
2.	Action Plan for Enhancing Public Finance Management (draft) http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35308270
3.	Framework Law on Autonomy and Decentralization http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35308241
4.	Monitoring and Evaluation Plan http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35304381
5.	Law on the 2010 General Government Budget http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35305129
6.	2010 General Government Budget - Aggregate Financial Flows http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35305092

ABBREVIATIONS

FSO	Fund for Special Operations
GDP	Gross domestic product
HIPC	Heavily Indebted Poor Countries
IMF	International Monetary Fund
LMAD	Ley Marco de Autonomías y Descentralización [Framework Law on Autonomy and Decentralization]
MEFP	Ministerio de Economía y Finanzas Públicas [Ministry of Economy and Public Finance]
OC	Ordinary Capital
PBL	Programmatic policy-based loan
PCR	Project Completion Report
PEFA	Public Expenditure and Financial Accountability
SIGMA	Sistema Integrado de Gestión y Modernización Administrativa [Integrated Management and Administrative Modernization System]
VTCP	Viceministerio de Tesoro y Crédito Público [Office of the Deputy Minister for Treasury and Public Credit]

PROJECT SUMMARY

BOLIVIA FISCAL POLICY AND DECENTRALIZATION SUPPORT PROGRAM (BO-L1061)

Financial Terms and Conditions				
Borrower: Plurinational State of Bolivia Executing agency: Ministry of Economy and Public Finance (MEFP)			CO	FOE
		Amortization period:	30 years	40 years
		Grace period:	6 years	40 years
		Disbursement period:	18 months	18 months
Source	Amount	Credit fee:	*	0%
IDB (OC)	US\$14 million	Interest rate:	LIBOR**	0.25%
IDB (FSO)	US\$6 million	Inspection and supervision fee:	*	0%
Total	US\$20 million	Currency:	U.S. dollars from the Single Currency Facility	U.S. dollars
Project at a Glance				
Program Objective The objective of the program is to support the process of fiscal decentralization by designing and updating the regulatory framework and strengthening the institutional framework in a way that helps ensure the sustainability of public finances. The program is structured as a programmatic policy-based loan (PBL). The loan amount for the first operation is US\$20 million.				
Special contractual conditions Disbursement of proceeds for this operation will be contingent upon implementation of the policy reform or institutional change measures, as established in this document (paragraph 1.32), as well as fulfillment of the targets agreed upon and set forth in the policy matrix (Annex II).				
Exceptions to Bank policies: None				
Project consistent with Country Strategy: Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>				
Project qualifies as: SEQ <input type="checkbox"/> PTI <input type="checkbox"/> Sector <input type="checkbox"/> Geographic <input type="checkbox"/> Headcount <input type="checkbox"/>				

(*) The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

(**) For the Ordinary Capital loan, an interest rate will be set in accordance with the Bank's policy.

I. DESCRIPTION AND RESULTS MONITORING

A. Frame of reference and rationale

1. Recent macroeconomic performance

- 1.1 In recent years, Bolivia has seen strong macroeconomic performance bolstered by a favorable external environment. Sustained growth in the volumes of and international prices for Bolivia's main exports was key to the country's solid macroeconomic performance between 2004 and 2008. As a result, Bolivia obtained economic growth rates on average of around 5%, together with significant and consecutive external and fiscal surpluses, low inflation rates, and stable monetary and financial markets. During this period, per capita gross domestic product (GDP) increased significantly, from US\$973 in 2004 to US\$1,776 at the end of 2008 (Table 1.1).

Table 1.1: Key macroeconomic indicators 2004-201

Indicator	2004	2006	2008	2009	2010e	2011e
Real GDP growth (%)	4.2	4.8	6.1	3.4	4.0	4.0
Nominal GDP (US\$ millions)	8,762	11,384	17,217	17,390	19,086	20,520
Nominal per capita GDP (US\$)	973	1,217	1,776	1,763	1,830	1,930
Inflation (%)	4.6	4.9	11.8	0.3	4.0	3.5
Total public revenues (% of GDP)	26.8	34.3	35.2	35.2	34.3	34.7
Direct tax on hydrocarbons	5.0	11.6	10.6	9.8	8.2	8.6
Total public spending (% of GDP)	32.3	29.8	31.9	35.1	34.6	34.5
Primary balance of the public sector (% GDP)	-2.6	7.0	5.3	1.7	-0.3	0.2
Current account balance (% of GDP)	3.9	11.6	11.7	4.6	2.6	2.0
Exports (US\$ millions)	2,146	3,875	6,448	4,848	5,527	6,029
Imports (US\$ millions)	1,844	2,814	4,980	4,377	5,195	5,673
Foreign direct investment (% of GDP)	0.9	2.4	2.9	2.4	1.4	1.2
Net international reserves (US\$ millions)	1,123	3,178	7,722	8,580	9,257	9,576
Financing needs (% of GDP)					1.2	0.5

Source: Instituto Nacional de Estadísticas [National Institute of Statistics] and Central Bank of Bolivia. International Monetary Fund, for the years 2010 and 2011 (estimate)

- 1.2 In 2009, though the international crisis adversely affected Bolivia's economic outcomes, the magnitude of the impact was regarded as moderate. Weakening global demand for commodities led to a 23% drop in total exports and halved Bolivia's trade surplus, which is highly dependent on exports of three basic products: natural gas, non-ferrous metals (primarily zinc, silver, and tin) and soybeans. A nearly 8% dip in the flow of remittances from Bolivian workers abroad also had adverse consequences. Finally, the flow of fiscal revenues from

hydrocarbons, which represent almost half of total revenues, fell by approximately 35%.

- 1.3 Bolivia's solid macroeconomic position cushioned it from the direct blows dealt by the international crisis. High levels of fiscal and international reserves accumulated during the expansionary phase of the economic cycle allowed the country to mitigate the adverse effects of the international crisis. This, together with the relatively low degree of integration of Bolivia's financial system with international capital markets, minimized financial contagion in the country. Bolivia therefore managed to negotiate the crisis without falling into recession and still maintaining fiscal and external surpluses. In fact, in 2009 it boasted the highest growth rate in the region and positive balances in its fiscal and external accounts.
- 1.4 A relatively prudent economic policy stance during the export boom enabled the Bolivian economy to run external and fiscal surpluses for four consecutive years between 2006 and 2009. Consequently, Bolivia went into 2010 with fiscal reserves and high liquidity ratios that have positioned it to cope reasonably well with the recessionary phase of the economic cycle. Accumulated public sector deposits representing 18.6% of GDP and record levels of international reserves equivalent to two years of imports offer protection against external shocks.
- 1.5 Bolivia's fiscal position strengthened considerably during the 2006-2009 period on rising fiscal revenues from international hydrocarbon sales and cyclical improvements in tax collection. With the fiscal revenues available following the nationalization of the natural gas sector, Bolivia's public sector posted surpluses for four consecutive years. The overall position of the nonfinancial public sector showed an average surplus of 2.5% of GDP for the period 2006-2009, with a primary surplus of 4.5% of GDP for the same period. The key role of natural gas exports in this outcome is reflected in the non-hydrocarbon deficit, which is calculated without natural gas revenues and averaged 11% of GDP during this period.
- 1.6 Despite the upward trends in fiscal revenues, fiscal management during the upswing was relatively conservative, with real expenditure growth rates far below revenue growth. This fiscal policy stance enabled authorities to steadily lower public sector debt and also to amass significant fiscal reserves in the government vaults at the Central Bank of Bolivia. Due to both of these factors, there are no major risks to Bolivia's fiscal position in the short or medium term. Official deposits at the Central Bank of Bolivia went from 7.6% of GDP in 2003 to 18.6% of GDP at the close of 2009.
- 1.7 Total public debt has trended downward over the past five years, propelled by forgiveness of a significant portion of the country's external debt between 2006 and 2007. Under the framework of the HIPC Initiative,¹ the World Bank, the International Monetary Fund, and the IDB forgave a total of US\$3 billion, which

¹ Heavily Indebted Poor Countries

constituted approximately 60% of the debt owed at the close of 2005. Of that amount, the IDB forgave US\$1.171 billion, thereby assuming a decisive role in establishing the current trend in the debt. At the close of 2009, total public debt represented 31.6% of GDP, with 14.4% attributed to foreign debt and 17.2% to domestic debt. A Bank debt sustainability study found that Bolivia does not face significant sustainability risks in the medium term, a conclusion that points to a robust economy even in the face of more negative shocks.

- 1.8 Execution of the public investment plan, “Bolivia: Living Well,” a compendium of plans and programs to be executed by the Government of Bolivia through 2029, will have a decisive role to play in the medium-term fiscal outlook. The plan calls for US\$34.7 billion in public sector investment. Despite significant increases projected for public spending, short and medium-term forecasts for fiscal balances are at -0.3% and 0.2% of GDP for 2010 and 2011, respectively, and financing needs are projected at 1.2% and 0.5% of GDP for 2010 and 2011, respectively.
- 1.9 **Risks.** Bolivia does face some medium- and long-term risks. First, the country’s fiscal and external accounts continue to be highly dependent on international commodities markets, an intrinsic vulnerability of the Bolivian economy to external volatilities. The process of transferring resources and responsibilities to autonomous subnational entities entails the fiscal risk of those tasks not being performed in a balanced and fiscally neutral manner for the central government.

2. Advances in the fiscal decentralization process

- 1.10 During the 1990s, Bolivia moved forward with political, administrative, and fiscal decentralization, focusing initially on municipios. With the passage of the Popular Participation Law of 1994, public spending and tax collection responsibilities were transferred to the municipios, and a revenue-sharing regime was also established. Subsequently, with the Administrative Decentralization Law of 1995, administrative decentralization at the department level began. Since then, reforms have aimed to strengthen municipios and departments and establish new transfers of fiscal resources.² The Bank has provided technical and financial assistance for the fiscal decentralization process through the Local Development and Fiscal Responsibility Program (1075/SF-BO), which supported development strategies for the municipal sector, helping to establish and implement reforms and direct activities with municipios.
- 1.11 The fiscal decentralization process acquired fresh momentum in February 2009 with the approval of the new Constitution, which laid the groundwork for a system of autonomy and decentralization whereby, in addition to municipal autonomy, there is departmental, regional, and native indigenous-campesino autonomy. The new system of autonomy significantly expands the roles of subnational

² Zapata, Juan Antonio, Decentralization in Bolivia, Inter-American Development Bank, August 2007.

governments, giving them exclusive, concurrent, and shared powers.³ The Constitution also establishes certain responsibilities exclusive to the central government that could potentially be delegated to autonomous governments.

- 1.12 This constitutionally stipulated change in subnational organization places Bolivia in a transitional period during which it will be imperative to establish the laws and regulations and the coordination mechanisms necessary to fulfill new constitutional mandates. A key element in this process has been preparation of the Framework Law on Autonomy and Decentralization (LMAD). As set forth in the Constitution, the LMAD regulates the transfer and delegation of authority, the economic financial system, and coordination between the central government and the decentralized and autonomous subnational entities. The LMAD chapter on the economic and financial systems of autonomous entities covers own revenue, fiscal transfers, public debt, planning and budgeting, and fiscal control and oversight.
- 1.13 In this context, the Bolivian government's main challenge is to advance the decentralization process by designing a regulatory framework that does not jeopardize the fiscal stability obtained in recent years. This also involves establishing the right timelines and sequencing for the reforms sought.
- 1.14 This program will provide technical and financial assistance to support the government's efforts to introduce into the fiscal decentralization process the structural reforms that are required under the new Constitution. Consequently, the program will focus on moving the process forward, striking a good balance in the intergovernmental fiscal structure and establishing rules that will provide resources consistent with the responsibilities transferred to the subnational governments, all under a framework of medium- and long-term fiscal sustainability. This will require sound criteria and mechanisms for defining the transfer of responsibilities and resources to the autonomous entities and for promoting fiscal responsibility among the subnational governments as they take on their new duties. In addition, debt monitoring and oversight systems should be improved so autonomous entities can detect potential imbalances early on and avoid the need for fiscal bailouts by the central government.

B. Government commitment

- 1.15 The Bolivian government has acknowledged the importance of prudent fiscal policy in maintaining sustainable public accounts as the premise for the process of fiscal decentralization. The central government's goal is to design a coherent regulatory framework that will allow it to move the process forward while ensuring fiscal

³ The Constitution establishes four types of jurisdictional authority: (i) reserved, whereby authority rests with the central government alone; (ii) exclusive, in which executive, regulatory, and legislative functions reside with the subnational government, which can transfer the former two; (iii) concurrent, whereby the central government is responsible for legislation, and the central and subnational governments both have enforcement and regulation responsibilities; and (iv) shared, whereby basic legislation comes from the central government, with enabling legislation and the power to enforce and regulate left to the subnational government.

sustainability in the central and subnational governments. The government has stated the need for a gradual transfer of responsibilities to autonomous entities consistent with the constitutional mandate and the evolving implementation capacities of the subnational entities.

- 1.16 In order to preserve fiscal balance at all levels of government, the Constitution stipulates that any delegation or transfer of responsibility to the subnational governments should be accompanied by identification of the source of economic and financial resources necessary for performing the corresponding tasks. In the area of taxation, the Constitution requires the Plurinational Legislative Assembly to enact a law delineating the responsibilities of the different levels of government in this regard.
- 1.17 The LMAD is gradually advancing the process of fiscal decentralization. As its name suggests, it establishes certain basic principles with a view to bringing about an orderly and harmonious decentralization process. It does not seek to define, in a comprehensive manner, the distribution of autonomous entities' responsibilities in terms of expenditures and resources. Once the overall framework is established, the central government will then debate and develop four sets of regulations implementing the aforementioned law in fiscal matters: (i) borrowing; (ii) fiscal responsibility; (iii) municipal treasuries; and (iv) trust funds. As regards tax revenue distribution, and pursuant to the Constitution, the LMAD provides that one year after its enactment, through a tax classification law, the legislature will classify and identify which taxes pertain to the national, departmental, and municipal treasuries. The LMAD also (i) clarifies the distribution of powers until such point as the aforementioned law on tax categories is enacted, and (ii) stipulates that the tax classification law and implementing regulations should be enacted, at most, within one year of the LMAD being enacted.
- 1.18 The central government has created the Ministry of Autonomy in order to strengthen and deepen the process of political and administrative decentralization. The Ministry of Autonomy is tasked, among other things, with designing and proposing policies and mechanisms to ensure the financial fiscal sustainability of the autonomous and decentralized subnational entities; coordinating between these entities, the Ministry of Development Planning, and the Ministry of Economy and Public Finance (MEFP); and developing a system to monitor and evaluate the subnational performance in institutional, jurisdictional and fiscal financial public management.

C. The Bank's country and sector strategy

- 1.19 The Bank's country strategy with Bolivia (2008-2010) seeks to support the Government of Bolivia in its efforts to develop four strategic pillars: (i) productivity, competitiveness, and productive infrastructure; (ii) development of the water and sanitation sector, and socially productive development; (iii) creation of opportunities for the majority and development with identity; and (iv) strengthening of the State apparatus through institutional development at the

national and decentralized level. The strategy calls for attention to subnational levels of management, complemented with institutional strengthening programs to promote consistency and coordination among different levels of government. This operation will support this last pillar of the country strategy by contributing to the sustainability of public finances while strengthening the legal and institutional framework for fiscal matters at the subnational level and subnational coordination with the central government.

- 1.20 The proposed operation complements the Effectiveness in Public Administration Support Program II (BO-L1010 – 2317/BL-BO), which supports enhancements to the country's system for budget management and control of public expenditures, concentrating on: (i) the comprehensiveness and quality of the budget cycle; (ii) integration of financial management systems, extending the coverage of the Integrated Management and Administrative Modernization System (SIGMA); (iii) control of public expenditure, with a focus on the payrolls of State-owned companies and the pension system; and (iv) measures for enhancing transparency and combating corruption, using accountability instruments.
- 1.21 To support the government's efforts to update the regulatory framework for fiscal decentralization, the Bank will provide technical assistance under the framework of the proposed program, partially financed with funds from the operational input for the preparation phase.

D. Program objectives and structure

- 1.22 The objective of the program is to support the process of fiscal decentralization by designing and updating the regulatory framework and strengthening the institutional framework in a way that helps ensure the sustainability of public finances.
- 1.23 The proposed program is structured in consecutive, single-tranche operations that will be financed independently under the programmatic policy-based loan (PBL) modality. The operations are technically linked through three policy areas to ensure consistency over time and are subject to verification of measures to tailor and revamp the regulatory framework in order to strengthen fiscal policy and enhance processes for public finance management. As a whole, the measures set forth in the policy matrix will lead to the development of a new regulatory framework for autonomous entities that is in line with the medium-term fiscal balance target and subnational fiscal responsibility, in addition to more efficient and effective coordination between the central government and subnational governments on fiscal matters.
- 1.24 The first operation under the program, in the amount of US\$20 million, will support reforms in the design of the regulatory framework for public finance management by autonomous entities and support the central government in its relationship with subnational governments, by developing a suitable action plan to make public finance management more effective, efficient, and transparent. The second operation under the program, in an amount to be determined in accordance with the country programming process, will focus on providing support to the central

government to: (i) review, update, and establish regulations for the fiscal framework as mandated in the LMAD, including executive branch approval of the draft Law on Tax Classification and the draft Law on Public Sector Borrowing, which will include the subnational autonomous entities; (ii) implement actions to enhance coordination mechanisms between the central and subnational governments; and (iii) develop a policy for training MEFP, Ministry of Development Planning, and Ministry of Autonomy personnel on subnational fiscal policy.

E. Program components

- 1.25 **Component I. Macroeconomic stability.** As a general condition for disbursement, the program requires that a stable macroeconomic environment be maintained, consistent with the program objectives and guidelines established in the country's policy letter on the sector.
- 1.26 **Component II. Support for fiscal decentralization.** This component provided support for developing the economic, fiscal, and financial system described in the LMAD and presenting it to the Plurinational Assembly in order to achieve: (i) responsibility and sustainability in subnational public finances; (ii) incentives for own revenue generation; (iii) delegation of expenditure and taxation responsibilities among the different levels of autonomous entities; (iv) subnational equity (to ensure a balanced distribution of resources among the autonomous entities); (v) mechanisms for coordination between the central government and the autonomous subnational entities; and (vi) incentives for transparency and accountability in subnational use of public resources. Since preparations began for the proposed operation, the Banks' project team has provided technical assistance to help the Bolivian government draft the LMAD.⁴
- 1.27 **Component III. Strengthening of public finance management.** This component will support the development of an action plan based on the Public Expenditure and Financial Accountability (PEFA) assessment of public finances that was completed in October 2009 with the support of the IDB and the World Bank. The PEFA report provides a diagnostic assessment of public finance management, focusing on the central government's policy on public revenues and expenditures and considering the transfers the central government makes to subnational governments. Based on this assessment, the government has identified opportunities for improvement and is attempting to establish reform priorities in a comprehensive medium-term action plan whose main objective is to strengthen public finance management and build the State's capacity to manage its fiscal policy.
- 1.28 This component will support the government in identifying and setting priorities that may be incorporated into the action plan (2011-2015) to increase the

⁴ The Plurinational Legislative Assembly passed the LMAD and the government enacted it on 20 July 2010. The law adheres to the principles established for this program; thus the objective of this component has been met.

transparency of the fiscal relationships between the different levels of government and improve central government oversight of the aggregate fiscal risk produced by subnational entities. It will also assist the Bolivian government in establishing an appropriate timeline and the sequencing of the reforms to pursue in these areas. The action plan will be approved in a ministerial resolution issued by the MEFP.

- 1.29 This component will work in a coordinated fashion with loan 2317/BL-BO (paragraph 1.20), which concentrates on four budget-related activities: (i) presentation of a draft Framework Law on the Budget to the Plurinational Legislative Assembly, with an emphasis on quality expenditure and integration of the different phases of the budgetary cycle; (ii) design of a medium-term macro fiscal framework that can serve as a reference for planning and budgetary processes; (iii) development of a SIGMA module to generate management data and pilot implementation in the MEFP, the Ministry of Development Planning, and the Ministry of the Presidency; and (iv) the signing of management agreements between the MEFP and at least three entities for the current year, and substantial progress in executing the agreements.
- 1.30 An action plan is being designed with technical and financial assistance from the European Union. The Bank's project team will provide technical assistance in the review of action plan proposals.
- 1.31 **Policies expected for the second operation.** The second operation of the program will focus on supporting policy actions that enable the decentralization process to bring about a neutral net intergovernmental fiscal outcome, and it will continue to help strengthen the government's fiscal policy with three lines of action: (i) development of LMAD fiscal principles, including the executive branch's presentation to the Plurinational Assembly of draft laws on Tax Classification and Public Sector Borrowing, which would apply to the central government and subnational autonomous entities; (ii) strengthening of fiscal policy through the executive branch's presentation to the Plurinational Assembly of a draft Law on the Treasury; and (iii) support for capacity-building in the design and implementation of fiscal policy for the central and subnational governments.

F. Main outcomes and indicators

- 1.32 Disbursement of proceeds for the first operation of the program will be contingent upon fulfillment of the conditions established in the policy matrix (Annex II). As a complement to this, the expected outcomes of the program are indicated in the results matrix ([see electronic link](#)). The policy matrix includes: (i) contribution to economic stability and sustainable fiscal balances; (ii) update of the regulatory framework to ensure that subnational entities approve balanced budgets; (iii) increases in the own revenue streams of autonomous governments; (iv) increases in the capital expenditures of autonomous governments; (v) improvements in the transparency and rules for the horizontal distribution of central government transfers among subnational governments; (vi) improvements in the reliability of information provided to subnational governments on the transfers

- they will receive from the central government for the next fiscal period; (vii) improvements in the collection and dissemination of consolidated fiscal data; and (viii) improvements in central government oversight of the fiscal performance of autonomous public agencies, government-owned companies, and subnational governments.
- 1.33 The indicators for measuring expected outcomes are described in the results matrix and include: (i) 2010 inflation and fiscal balance data; (ii) budgets formulated by the autonomous subnational entities; (iii) own revenue of the autonomous municipal governments of department capitals; (iv) capital expenditures made by autonomous departmental governments; (v) transparent systems based on rules governing horizontal distribution of central government transfers among subnational governments; (vi) timely delivery to subnational governments of reliable information on allocations they will receive from the central government for the next fiscal period; (vii) information on the extent to which consolidated, sector-based fiscal data on the government in general (on revenues and expenditures, at a minimum) is collected and published; (viii) information on the extent to which the central government conducts oversight of autonomous public entities and government-owned companies; and (ix) information on the extent to which the central government monitors the fiscal position of the subnational governments.
- 1.34 To achieve expected outcomes, the program envisages the actions described by component in the Policy Matrix, which include: (i) presentation of the LMAD to the Plurinational Legislative Assembly with provisions that develop the principles of fiscal responsibility and sustainability; incentives for the generation of own revenue by the subnational governments; delineation of the responsibilities of different levels of government; measures to guarantee subnational equity; mechanisms for coordination between the central government and autonomous subnational entities; and measures that provide incentives for transparency and accountability in subnational use of public resources, an action that was completed on 20 July 2010, when the LMAD, incorporating the proposed principles, was enacted; and (ii) approval, through an MEFP ministerial resolution, of an action plan for enhancing public finance management, to include actions for improving the transparency of fiscal relationships between different levels of government and for enhancing central government oversight of the aggregate financial risk generated by the subnational entities.

II. FINANCING STRUCTURE AND MANAGEMENT

A. Financial instrument, amount, and currency

- 2.1 This operation, which is structured under the PBL modality based on the guidelines and directives established in the New Lending Framework (document GN-2200-13) and on the Guidelines for preparation and implementation of policy-based loans (document CS-3633), is the first operation in the fiscal reform program, in which

each operation will be financed separately. Use of the programmatic modality is justified by: (i) the nature of the reforms; (ii) the timelines for their implementation; (iii) the coordination of reforms across entities in different sectors; and (iv) the oversight required to implement the reforms in order to monitor and provide feedback on outcomes and mechanisms that trigger subsequent programs.

- 2.2 The amount of the first operation is US\$20 million, which will be disbursed in a single tranche. The Bolivian government and the Bank will determine the amount of subsequent operations in accordance with the country programming process and the anticipated reforms for updating and revamping the regulatory framework and strengthening the institutions in charge of fiscal policy.
- 2.3 For this first programmatic operation, 70% of the funding will come from the Single Currency Facility of the Ordinary Capital and 30% from the Fund for Special Operations (FSO).

B. Environment and social safeguard risks

- 2.4 Given the nature of the program, which involves institutional strengthening activities, there are no associated environmental or social risks. Pursuant to Directive B-13 and based on the findings of the Safeguards Policy Filter Report, this operation does not need to be classified.

C. Other issues and risks

- 2.5 This operation is considered to involve a moderate/high risk. According to the risk assessment performed during the preparation phase, five main risks were identified: (i) the impact of a potential external shock on fiscal and macroeconomic stability; (ii) the fiscal impact of increased public spending due to the investment plan and social program; (iii) inter-agency coordination problems, given that the program involves various entities in the executive branch of the plurinational government, which could lead to lack of coordination and delays in program execution, thereby creating a risk to the program; (iv) weaknesses in governance that could jeopardize the progress of the fiscal decentralization process; and (v) low capacity for implementing and sustaining the reforms planned under the program.
- 2.6 In terms of the macro-fiscal risk, Bolivia had one of the highest growth rates in the region in 2009, in addition to a solid macroeconomic position, and record levels of international reserves. Nonetheless, the “Bolivia, Living Well” public investment plan, which is a compendium of plans and programs that the Bolivian government will execute through 2029, will entail a significant increase in public capital spending, which could weaken Bolivia’s fiscal position. To mitigate this risk, the program seeks to strengthen public finances, providing subnational governments with incentives for fiscal responsibility, while also providing unrestricted resources to the National Treasury, thereby contributing to fiscal balance. The Bolivian government has also shown that the increase in revenues and the availability of financing sources are consistent with the investment plan and the social program.

- 2.7 The constitutional mandate and enactment of the LMAD, the will of the highest authorities in the executive branch to see this through, and MEFP leadership in taking on program reforms will mitigate the risks associated with lack of coordination between different governmental entities and implementation of the operation.
- 2.8 As regards the governance risk entailed in the fiscal decentralization process, the proposed program supports the government's strategy of a gradual transfer of responsibilities to the autonomous entities. The transfer will be conducted in accordance with agreements reached with subnational entities and the implementation capacities those entities develop. The Law on Autonomy, as its name implies, is a framework law that establishes certain basic principles with a view to bringing about an orderly and harmonious decentralization process. It does not seek to define, in a comprehensive manner, the distribution of autonomous entities' responsibilities in terms of expenses and resources. Once the overall framework law is enacted, the Bolivian government will debate and develop five pieces of legislation implementing the aforementioned law in fiscal matters.
- 2.9 The MEFP has demonstrated that it has the political will to take on the reforms and the technical capacity to implement and sustain reforms, which are crucial for strengthening the plurinational government's public finances. Additionally, program resources will be used to support the actions called for in the action plan. The technical assistance provided under the proposed program, which is partially financed with funds from the operational input for its preparation, will mitigate the risk of limited capacity for implementing reform. The comprehensive reforms set forth in the medium-term action plan (2011-2015) to improve public finance management following the findings of the PEFA report will mitigate the risk of lack of sustainability in the reforms.
- 2.10 Finally, given the leadership shown by the MEFP, through the Office of the Deputy Minister for Treasury and Public Credit (VTCP), and its willingness to work with the Bank on program preparation provide technical assistance, the program envisages joint monitoring of program risks by the Bank team and the VTCP.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Implementation arrangements

- 3.1 **Borrower and executing agency.** The borrower will be the Plurinational State of Bolivia. The MEFP will be responsible for completing the actions described in the policy matrix. Acting through the VTCP, it will: (i) coordinate between the different institutions entrusted with adopting measures or performing technical activities (Ministry of Autonomy and the Office of the Deputy Minister for Tax Policy); (ii) monitor and promote actions aimed at achieving the policy objectives identified in the program; and (iii) draft and present reports and evidence of fulfillment of conditions precedent for the disbursement of loan proceeds for the

operation, as well as any other reports the Bank might require, within established and agreed upon time periods.

- 3.2 In order to support the country, the Bank's project team will implement a strategy to: (i) provide necessary technical assistance in previously identified areas, partially financed with funds from technical-cooperation operation BO-T1124 – ATN/SF-12303-BO (operational input); (ii) conduct special missions at key points in program implementation; and (iii) conduct close monitoring, together with the government, in order to anticipate and effectively resolve strategic, technical and coordination risks and problems associated with program execution.

B. Summary of arrangements for monitoring and evaluating results

- 3.3 The project team will monitor the program. The borrower and the Bank have agreed to hold monitoring meetings on mutually arranged dates to supervise program execution. Once the first operation has concluded, the project team will conduct an assessment of the status of actions proposed under the program, which will be used as an input for determining the policy conditions for the second operation, including any adjustment that should be made to trigger mechanisms proposed in the policy matrix (Annex I). As part of the evaluation, the program indicators will be used to measure progress and make those modifications necessary for meeting the medium-term program targets. As programmatic operations are designed to produce results in the medium and long term, the Project Completion Report (PCR) will be produced at the end of the second and final operation and will evaluate the impact of the program and the degree to which the objectives of the two operations under the program were met. The PCR will be commissioned within six months following the end of the execution period for the last operation in the programmatic series.
- 3.4 The borrower will be responsible for collecting and processing all data necessary for monitoring and evaluating the operation, including the financial cost of the data collection and processing effort. Consulting services for verifying fulfillment of the indicators included in the results matrix ([see electronic link](#)) and the activities included in the policy matrix (Annex II), will be financed with the Bank's administrative resources ([see electronic link](#)).

IV. POLICY LETTER

- 4.1 The Bank has agreed with the Plurinational State of Bolivia on a policy matrix (Annex II) that describes the commitments related to this first operation in the program, the means of verification, and the trigger mechanisms for the second operation. The policy matrix is consistent with the policy letter sent by the Ministry of Economy and Public Finance on 9 August 2010 ([see electronic link](#)).

Development Effectiveness Matrix
Summary

Indicator	Score	Maximum Score
<i>I. Strategic Relevance</i>	Low-High	
1. IDB Strategic Development Objectives	2.5	10
Country Diversification	2.0	2
Corporate Initiatives	0.0	2.5
Harmonization and Alignment	0.5	3.5
Beneficiary Target Population	0.0	2
2. Country Strategy Development Objectives	8.8	10
Country Strategy Sector Diagnosis	6.0	6
Country Strategy sector objective & indicator	2.8	4
<i>II. Development Outcomes - Evaluability</i>	Partial Satisfactory	
3. Evidence-based Assessment & Solution	7.0	10
4. Evaluation & Monitoring Plan	5.3	10
5. Cost-Benefit or Cost-Effectiveness	0.0	10
6. Risks & Mitigation Monitoring Matrix	7.5	10
<i>III. IDB's Role - Additionality</i>		
7. Additionality	7.0	10
Technical Assistance provided prior the project	3.0	3
Improvements in management of financial, procurement, monitoring or statistics internal controls	4.0	4
Improvements in environmental, health and labor performance	0.0	3

I. Strategic Relevance: The program is a Programmatic PBL in Bolivia, a D country group. The PBP has two loans, the first one for US\$20 million and a second for US\$50 million. The project is aligned to the country strategy objectives, and the strategy includes a diagnosis of the sector. There is no outcome indicator for the sector in the country strategy.

II. Evaluability: The project has an evaluation of current deficiencies in the sector provided through a PEFA assessment. The diagnosis has empirical evidence to support a magnitude for each of the factors that contribute to the problem. There is evidence supporting the arguments about the deficiencies in the decentralization process and the need for this intervention. The project impact, outcomes, outputs and vertical logic are clearly stated. The indicators are all SMART. The monitoring plan and outputs to be verified are clear, but the evaluation plan does not have a clear timeline and a budget. There is no cost-benefit or cost-effectiveness analysis. The risk matrix identifies all risks and rates them for magnitude, but no indicators to monitor mitigation measure implementation are presented.

III. Additionality: The Bank has provided technical assistance through an investment loan to support public management (BO-L1060) which complements the conditions in the loan aimed at improving fiscal policy. Additionally, this program and BO-L1060 aim to improve the fiscal framework for the budget and its preparation and execution.

POLICY MATRIX

OBJECTIVE	ACTIONS PRECEDENT TO DISBURSEMENT	INDICATIVE TARGETS FOR THE SECOND OPERATION
General objective of the program The objective of the program is to support the process of fiscal decentralization by designing and updating the regulatory framework and strengthening the institutional framework in a way that helps ensure the sustainability of public finances.		
COMPONENT I. MACROECONOMIC STABILITY		
Macroeconomic stability and sustainable fiscal balance	The macroeconomic framework is consistent with the program objectives and the guidelines established in the policy letter. <i>Means of verification:</i> (i) Independent Macroeconomic Assessment prepared by the Bank and the IMF Assessment Letter.	The macroeconomic framework remains consistent with the program objectives and the guidelines established in the policy letter. <i>Means of verification:</i> Independent Macroeconomic Assessment prepared by the Bank and the IMF Assessment Letter
COMPONENT II. SUPPORT FOR FISCAL DECENTRALIZATION		
Consolidation of the process for autonomy within a framework of economic stability and public finance sustainability	Presentation to the Plurinational Legislative Assembly of a draft Framework Law on Autonomy and Decentralization (LMAD), ¹ with articles that: (i) Establish that autonomous subnational entities must approve their budgets according to the principle of fiscal balance and must guarantee that their duties will be performed in a financially sustainable manner, thereby ensuring the fiscal responsibility and sustainability of the entities. The LMAD must also include provisions establishing that autonomous territorial entities should incur internal or external public debt within the framework of policies and borrowing and concessionality levels, seeking to obtain	(i) Presentation to the Plurinational Legislative Assembly of a draft Law on Tax Classification that clearly defines the taxation responsibilities of Bolivia's central, departmental, and municipal governments. (ii) Presentation to the Plurinational Legislative Assembly of a draft Law on Public Sector Borrowing that establishes rules governing debt incurred by autonomous entities based

¹ The Plurinational Legislative Assembly passed the LMAD and the government enacted it on 20 July 2010. The law adheres to the principles established for this program; thus the objective of this component has been met.

OBJECTIVE	ACTIONS PRECEDENT TO DISBURSEMENT	INDICATIVE TARGETS FOR THE SECOND OPERATION
	<p>the most advantageous conditions possible in terms of rates, terms, and amounts, and that autonomous entities demonstrate their capacity to generate the revenues needed to cover capital and interest payments.</p> <ul style="list-style-type: none"> (ii) Delineate the expenditure responsibilities assigned to the different levels of government, establishing the exclusive, concurrent, and shared responsibilities of autonomous subnational entities. (iii) Grant tax administration duties to autonomous subnational entities. (iv) Recognize the tax jurisdiction of different levels of government. Additionally, LMAD provisions should establish the mechanism for creating new taxes or amending the current tax code. (v) Establish that autonomous subnational resources will be managed in accordance with the principle of subnational equity, through the joint implementation of mechanisms contributing to the most equitable distribution of available resources for financing autonomous entities' respective duties. (vi) Create a technical consulting office as a mechanism for coordinating, proposing, and negotiating agreements between the central government and autonomous subnational entities. (vii) Establish a requirement that autonomous subnational entities publish data related to fiscal and financial performance and institutional management, in order to strengthen transparency and accountability in these areas. <p><i>Means of verification:</i></p> <ul style="list-style-type: none"> (i) Independent consulting report confirming that the draft law sent to the legislature reflects the principles in (i) through (vii). 	<p>on fiscal responsibility and sustainability criteria.</p>

OBJECTIVE	ACTIONS PRECEDENT TO DISBURSEMENT	INDICATIVE TARGETS FOR THE SECOND OPERATION
COMPONENT III. STRENGTHENING OF PUBLIC FINANCE MANAGEMENT		
Improvements in the efficiency and effectiveness of fiscal policy, and in fiscal coordination between the central and subnational governments	<p>Approval by the Ministry of Economy and Public Finance (MEFP) of a comprehensive medium-term action plan based on the PEFA report that calls for the development, execution, and verification of actions to:</p> <ul style="list-style-type: none"> (i) Increase the transparency of intergovernmental fiscal relationships, through explicit regulations governing the distribution of central government transfers among subnational governments at the same level of government. (ii) Improve central government supervision of the aggregate fiscal risk generated by subnational entities in order to facilitate proper documentation, monitoring, and oversight of subnational debt so comprehensive data is available to prepare aggregate reports on fiscal risk. <p><i>Means of verification:</i></p> <ul style="list-style-type: none"> (i) Independent consulting report confirming that the action plan based on the PEFA report incorporates actions to fulfill (i) and (ii). 	<ul style="list-style-type: none"> (i) Presentation to the Plurinational Legislative Assembly of a draft Law on the Treasury, establishing Treasury rules and regulations in order to ensure a healthy policy of government financial flows within the framework of the autonomous government regime established in Bolivia's Constitution.