

# STRUCTURAL REFORMS AND CAPITALIZATION

(BO-0094)

## EXECUTIVE SUMMARY

<b>BORROWER AND GUARANTOR:</b>	The Republic of Bolivia		
<b>EXECUTING AGENCY:</b>	Ministry of Capitalization		
<b>AMOUNT AND SOURCE:</b>	IDB (FOE):	US\$ 70,000,000	
	Tranches:	Board approval	- \$14,000,000
	3 floating - General		- \$14,000,000
		Hydrocarbons	- \$28,000,000
		Legal/Financial	- \$14,000,000
	Cofinancing (IDA):	US\$ 50,000,000	
	Tranches:	Board approval	- \$10,000,000
	3 floating - General		- \$10,000,000
		Hydrocarbons	- \$20,000,000
		Legal/Financial	- \$10,000,000
	Total:	US\$120,000,000	
	Technical Cooperation (FOE):	US\$ 12,000,000	
<b>FINANCIAL TERMS AND CONDITIONS:</b>	Amortization period:	40 years	
	Grace period:	10 years	
	Disbursement periods:		
	Loan	2 years	
	Technical Cooperation	3 years	
	Interest rate:	1% for grace period, 2% thereafter	
	Inspection and supervision:	1%	
<b>COFINANCING:</b>	International Development Association (IDA)		
	Amortization period:	40 years	
	Grace period:	10 years	
	Disbursement period:	2 years	
	Service charge:	0.75%	
	Commitment charge:	0.5%	
<b>ENVIRONMENTAL CLASSIFICATION:</b>	The Environmental Management Committee, at its meeting of November 8, 1994, classified this as a Category III operation and approved the corresponding Environmental Report on May 16, 1995.		

**EXCEPTIONS**

**TO BANK**

None

**POLICY:**

**PRESENTATION**

**OF LOAN**

**PROPOSAL:**

The Bank and IDA project teams have worked jointly since October, 1994 in finalizing the Program's structure with the Bolivian authorities and have jointly negotiated the loan contract provisions. The Bank joined in the final stages of the preparation of this Program, which was been under study by the International Development Association project team for over a year, with the understanding that the IDA loan analysis would also be used by the Bank for the operation. The conclusions and results from prior sectorial adjustment operations, as well as two Bank financed technical cooperation operations and several IDA technical assistance loans have served as the basis for the Program presented in this document. As necessitated by entering the program in an advanced stage of analysis, the Bank project team has reviewed, revised and ultimately found acceptable all aspects of the operation that the various IDA project teams had developed.

The draft Bank loan contract contains all of the standard Bank conditions for procurement and disbursement of sector lending operations. The conditions for release of disbursements are identical between the Bank and IDA loans. The Plan of Operations for the Bank's Technical Cooperation for the registering of all Bolivians is presented in Annex 3. The principles for the Hydrocarbons Law and the Pensions Law which were negotiated by the project teams are attached to the document.

**OBJECTIVES:**

The centerpiece of the government's reform program "Plan de Todos" is a bold program of privatization of six major public enterprises through a process called capitalization. The goal of the Capitalization Program is to improve the efficiency of public services removing the government from ownership and management of public enterprises, provide for private-sector management and resources to meet present and future demands for services and, in the process, free up for deficit reduction and investment in the social sectors and infrastructure 25-30% of the national budget that had previously been dedicated to investment requirements of these companies. This program involves transferring management control and up to 50% of the ownership of the state-owned enterprises to strategic investors. Unlike traditional privatizations, the Bolivian treasury will not receive funds from these transactions. Investors will not buy existing assets, but rather will make an equity investment into the company approximately equivalent to its book value. This investment will be used to increase each company's capital and provide new liquidity for expansion. The state's

share of the new companies, representing the value of the existing assets, will be transferred to the Bolivian people through the establishment of deferred distribution accounts to be managed by private pension funds.

The proposed adjustment operation will support establishing an appropriate enabling environment so that: (i) private investment is forthcoming as the Government withdraws from the sectors served by the state-owned enterprises; (ii) such private investment spurs growth in an efficient manner; and (iii) competition is promoted wherever possible. The specifics of how each large public enterprise will be capitalized are being developed on the basis of sector-specific restructuring plans, the present capital structure of the enterprise and estimates of investment needs in the short-to-medium term.

**DESCRIPTION:** Specific action is proposed in three areas, as detailed in the conditionality matrix, included as Annex 2:

(i) Sectoral reform and the capitalization of public enterprises, in which the Government will: (a) enact general legislation to enable key public enterprises to be capitalized and to establish a general regulatory framework for those sectors to be capitalized; (b) enact sector-specific legislation and promulgate regulations to promote investment and a competitive, efficient environment in the hydrocarbons, telecommunications, electricity, mining, railway and aviation sectors; and (c) begin the capitalization of six large public enterprises that dominate the above sectors. In addition, the Government will complete the divestiture of over 100 small and medium enterprises (average value of about US\$1 million) and the restructuring of the mining sector.

(ii) Institutional and Legal reforms to strengthen Bolivia's regulatory and judicial institutions and establish administrative mechanisms for fair and swift adjudication of regulatory and commercial disputes. These reforms will include the: (a) establishment of an independent regulatory agency with sectoral departments and developing its capacity to implement regulations; (b) passage of an administrative procedures law for regulatory disputes between the state and private parties; and (c) ratification of an international convention on arbitration and passage of an arbitration law. The Government also plans to further improve the enabling environment for private sector development through the implementation of a secured transactions law and the improvement of commercial and property registries. In addition, the Government has committed itself to support fully the initiatives undertaken by the Judiciary to improve justice administration in Bolivia.

(iii) Financial sector reforms to develop long-term financial markets. The first phase of financial reform, was assisted by previous Bank (628/OC-BO) and IDA-supported adjustment programs, and aimed at reforming the existing banking system. This phase will focus on improving the regulation of securities and insurance institutions, as well as strengthening contractual savings and pension mechanisms. In addition, the Government plans to further strengthen the financial system through restructuring the Central Bank and the passage of the Organic Central Bank Law, and the Superintendency of Banks and Financial Entities Law.

**ACTIONS  
ALREADY  
TAKEN:**

The Capitalization Law was approved by Congress in March, 1994 and established the framework for the program and the political decisions have been taken to implement the various aspects of the program. The Conditions for presentation of the operation to the Board of Directors have been agreed and fulfilled and are summarized in the Policy Matrix (Annex 2).

**SPECIAL  
CONTRACTUAL  
CONDITIONS:**

The conditions for each of the three floating tranche disbursements have been agreed with the governmental authorities and appear in paragraphs 4.9 through 4.12 of the Loan Proposal. All conditions are summarized in the Policy Matrix, which appears as Annex 2 and are detailed in the Letter of Development Policy (Annex 1).

Up to US\$14,000,000 of the resources of the loan may be used to compensate Bolivia for the cost of imports acquired within six months prior to the signature of the loan contract (¶ 4.13). Also, it is proposed that up to US\$4,000,000 of expenditures made after January 1, 1995 but prior to the signature of the reimbursable technical cooperation agreement for financing the registry of Bolivians (see Annex 3, ¶ ?) may be reimbursed from the resources of the credit.

**SUPPORTING  
TECHNICAL  
ASSISTANCE:**

The process of registering all adult Bolivians for eligibility for participation in the Capitalization program will be achieved through the universal registering of all Bolivians called the "Registro Unico Nacional (RUN)", which is to be carried out with assistance from the technical cooperation from the Bank of US\$12,000,000, as well as US\$2,000,000 from IDA and the equivalent of US\$2,000,000 from the Bolivian Government. The project proposes to register all of the approximately 3.3 million Bolivians during a period of two years, and to prepare a data base from which the civil register and voter registers will be maintained. Two consultants have already begun assisting in the first phase of the project.

Three comprehensive IDA technical assistance operations totaling more than US\$32 million are scheduled to follow later this year to accompany the capitalization process (see paragraphs 4.16 through 4.26).

**POVERTY POLICY CRITERIA:** Although not a "Poverty Target Investment", the Program should have a positive impact on poverty as indicated in paragraph 5.3 in that public resources will be freed for increasing essential social services for the poor, a massive redistribution of income will occur by the transfer of the State's share of major state enterprises to all adult Bolivians, the proceeds from the privatization of small and medium public enterprises are being allocated towards social projects, and certain legal reforms will encourage credit expansion to small entrepreneurs.

**BENEFITS:** The economic benefits of the policies supported by this credit are substantial. Comprehensive reform and the development of an appropriate regulatory framework for the hydrocarbons, telecommunications, electricity and mining sectors, together with the legal reforms aimed at promoting efficient methods of dispute resolution, such as the recent ratification of the New York convention on International Arbitration, should have a positive effect on private sector investment in general and should propitiate private investment and technology transfer. These reforms--especially accelerated development of Bolivia's hydrocarbons resources--should have an important impact on GDP growth. They are expected to reduce the deficit and permit the Government to increase expenditures for investment in human capital and basic infrastructure in line with GDP. The overall government expenditures are expected to be reduced in absolute terms.

**RISKS:** Despite the measures being taken in the environmental assessment of this operation, particularly in the mining sector, the social problems related to the relocation of independent miners and members of cooperatives, if not properly addressed, could result in additional risks and delays in the capitalization process. Within the context of the environmental preparation of the Program, the Bank has provided consultants to outline the scope of a Plan for Social Development and Rehabilitation in the mining regions. Currently the Bank is processing a technical cooperation for US\$200,000 to provide consultants to help the task force that has been established in the "Secretaria de Minería" develop the Plan. Also, the absence of experience in managing clear and proper environmental emissions standards for the sectors to be capitalized, may cause difficulties for bidders in accepting the provisional standards, uncertainties in assessing the related costs for compliance with

regulations and delays in the bidding process. Furthermore, although provisions that should be adequate are being taken, if the liabilities of the existing pollution stock and pollution flows in the facilities to be capitalized are not properly identified before the bidding process, the results could not meet expectations. The IDA technical assistance operations will assist in the environmental activity, as will the continuing execution of the Bank's Environmental Institutional Strengthening Project (Loan 929/SF-BO).

The financial crisis affecting Latin America which began in December, 1994 has limited the normal flows of private capital into Bolivia. The planned privatization (via an international public stock offering) of the electric company of the city of Cochabamba (ELFEC) was canceled and replaced with a directly-negotiated sale. There could be delays in the accompanying privatization program, but the main Capitalization Program should remain on schedule. It is expected that the offering prices by the strategic investors for the capitalized companies could be somewhat less than what might have been realized last year. However, the magnitude of the reduction is estimated to be such that it is not seen to justify delaying the Capitalization process. The benefits of prompt implementation of the Program should outweigh any possible increases in offers by the strategic investors by delaying the process.

If the necessary legislation for the reforms is significantly weakened before passage by Congress or is delayed, then the private sector will continue to withhold investment resources. Also, the operation involves a complex set of legislative and regulatory reforms that must be carefully sequenced to secure the desired outcome. Achievements thus far and up-front conditionality are designed to mitigate a risk of failure; however, non-compliance in a single area might derail the disbursement of credit tranches. To avoid stalling the entire program if certain difficult and important sector-specific reforms are delayed, it is proposed to divide the second tranche into three floating tranches to be disbursed as soon as their specific conditions are met.

**THE BANK'S  
COUNTRY AND  
SECTOR  
STRATEGY:**

The strategy of the Bank for the Country supports the program and focuses on projects and programs which would: (i) contribute to resolving the problems which are delaying structural reforms; (ii) strengthen the country's productive and export capacity; and (iii) support solutions for the basic needs of the population.

## I. INTRODUCTION

### A. Background

- 1.1 In August, 1994, at the request of the Bolivian authorities, the Bank joined in the final stages of the financing of this Program, which had been under study by the International Development Association project team for over a year, with the understanding that the IDA loan appraisal would also be used by the Bank for the operation. The Bank and IDA project teams carried out two joint missions (October, 1994 and March, 1995), worked together in finalizing the Program's structure with the Bolivian authorities and jointly negotiated the loan contract provisions.
- 1.2 Although the Bank had an ongoing investment sector loan and had provided two technical assistance operations for the preparation of aspects of the Capitalization Program and related privatizations (discussed below), the World Bank/IDA teams had been providing the majority of the resources for preparation of the program to be financed with a US\$50 million IDA credit. The IDA appraisal mission for the credit had been carried out at the end of 1993. At the time the Bank agreed to participate in the financing, the Program was in its final stages of preparation.
- 1.3 The IDA credit approval document is in the final processing stages and will be presented for IDA Board approval at the first opening (currently expected to be in mid July, 1995).
- 1.4 To maintain current per capita income levels, Bolivia needs to achieve a sustained GDP growth rate which will require annual gross domestic investment in real terms above 16% of GDP, and private investment to grow at a rate of 20% per year. Therefore, promotion of private investment is a main priority for the country. Consistent with this priority the campaign platform of the new Government, "El Plan de Todos", emphasized as the first of the seven pillars on which the plan is based "a substantial increase in resources targeted for investment" which includes: (i) capitalization/privatization of public enterprises, (ii) encouragement for private investment and (iii) increasing public sector savings. Additionally, expanded investment flows need to be matched by commensurate growth of saving instruments and institutions, such as pension and mutual funds, and security markets.
- 1.5 To date, the public enterprise reform program has resulted in: (i) the elimination of budgetary transfers to public enterprises, and the imposition of tight discipline on their borrowing, saving and procurement activities; (ii) the sale of about 30 small/medium state-owned enterprises; and (iii) opening up the mining sector to promote private investment. Despite this progress, public investment in the larger public enterprise sectors (hydrocarbons, long distance telecommunications, electricity, mining and transport) has accounted for about 33% of the public investment

budget. Past attempts to improve efficiency in monopolistic state enterprises through performance contracts have largely failed.

- 1.6 **Capitalization of public enterprises.** The Government is developing a comprehensive initiative to associate private capital with public capital in state enterprises through its Capitalization Program. To carry out the Program, the Ministry of Capitalization was created in March, 1994 and will be dissolved when the process is completed. The Program includes six public enterprises: YPFB, ENTEL, ENDE, EMV, ENFE and LAB. The Government's approach to raise private capital for these enterprises includes, as a first step, the transformation of these companies into mixed public-private entities (Sociedades Anónimas Mixtas - SAMs) where the private partners will be the current employees receiving a capital participation up to the amount of the "social benefits" that they have accrued with the company. The next phase will consist of an offering of up to 50% of shares (capitalization) to be subscribed by private investors, and it would involve the transformation of the "Sociedades Anónimas Mixtas" into regular corporations (Sociedades Anónimas). With the assistance of specialized consulting firms in each sector, the Ministry of Capitalization will determine the valuation of the new companies as to the target capital investment and the floor capital investments for each. It is generally expected that the new investment would double the net worth of each company. This new capital injection shall be applied to new investment, rehabilitation, and restructuring programs. As a last phase, the Government intends to distribute its remaining shares among all adult Bolivian citizens through a pension funds mechanism.
- 1.7 In the Capitalization Program the Government receives no proceeds from the share issue, but the equity contribution to the companies and the new management brought in by private investors enable the implementation of modernization and investment plans, increasing the value of the company's shares, half of which would be in the accounts of Bolivian citizens.
- 1.8 Capitalization is taking place in the context of Bolivia developing a new regulatory framework for key sectors of the economy. The System of Sectoral Regulation (SIRESE) Law, passed by Congress in October 1994, establishes a broad regulatory framework for the hydrocarbons, communications, electricity, transport and water sectors. The system elaborated in the law comprises a General Superintendency and sector-specific Superintendencies. While Sectoral Superintendents will be responsible for day-to-day regulation in their respective sectors, the General Superintendent will be responsible for oversight of the regulatory system as a whole, approval of staffing and human resources policies and internal operating norms, preparation of a consolidated budget for the regulatory system, and hearing appeals from decisions of the Sectoral Superintendents. The Superintendencies are autonomous and will be funded through levies on the regulated industries. The law

includes a number of measures to protect the Superintendencias from political interference, including protection of the Superintendents from arbitrary removal. The law also elaborates certain cross sectoral norms, including transparency requirements and Bolivia's first set of anti-trust rules.

B. Macroeconomic considerations

- 1.9 Bolivia was one of the first countries in Latin America to adopt a far-reaching economic program aimed at restoring price stability and structurally reforming the economy to achieve sustainable growth. Since 1985 the reform program has been supported by arrangements under the Enhanced Structural Adjustment Facility (ESAF) with the International Monetary Fund (IMF) and by adjustment credits and other assistance from the Bank, the World Bank and bilateral donors.
- 1.10 The program was designed to ensure macro stability while implementing structural reforms to reduce state participation in the economy, improve public sector finances, foster private investment and enhance productivity and competitiveness. The reforms have included: (i) liberalization of prices; (ii) unification of the exchange rate and liberalization of capital flows; (iii) simplification of the tax regime and improvements in tax administration; (iv) trade liberalization and customs reform; (v) privatization of small commercial public enterprises; and (vi) financial sector reform (including freeing interest rates, eliminating credit subsidies, liquidating state-owned financial intermediaries and strengthening bank supervision and regulation). This program has been complemented by successfully reducing debt and the debt service burden through concessional rescheduling with bilateral creditors (including five Paris Club reschedulings) and a comprehensive program to eliminate commercial bank debt.
- 1.11 Despite the achievements attained, two main factors explain the disappointing performance of the economy in attracting private investment. First, public enterprises dominate key sectors of the economy that present strong growth potential--hydrocarbons, mining, telecommunications, electricity and transport. Second, Bolivia lacks an institutional framework to ensure private agents clarity, predictability and enforceability of the legal and regulatory principles governing their activities.
- 1.12 The new Government assumed office in August 1993 with the pledge to continue to reduce and rationalize the role of the state and to move the social agenda forward. The Government's program "Plan de Todos" includes: (i) reform of the executive branch; (ii) the Capitalization program; (iii) education reform; (iv) pension reform; and (v) the "popular participation" program of decentralization to the Provinces, Municipalities and neighborhood groups for prioritizing and fiscalization of investments in roads, sanitation and education.

- 1.13 Immediately after taking office the new Government accelerated discussions with the International Development Association (IDA) of the World Bank Group for financing of the reform programs. An IDA pre-appraisal mission for the Capitalization Program Adjustment Credit was carried out in September, 1993 and the IDA Appraisal took place in December, 1993. Since then there have been several follow-up missions, with full participation of the Bank since October, 1994, to advance the preparation of the documentation for the conditions which should be met prior to presentation to the IDA and Bank Boards of Directors.

C. Strategy of the Bank and related operations

1. Bank strategy for Bolivia

- 1.14 Bolivia continues to face considerable difficulties in achieving sustained growth, despite eight years of economic adjustment and substantial debt relief. The large share of export revenues from primary commodities and the low level of domestic savings have limited the ability of the economy to respond flexibly to external and internal shocks. Since these constraints are likely to remain in the foreseeable future, the country must preserve macroeconomic stability, maintain an appropriate exchange rate, improve public sector efficiency, and increase incentives for private sector investment. Bolivia's economic program, as reflected in the recent Economic Policy Framework paper (PEP) with the IMF, is designed to achieve these objectives. The program promotes stable economic growth, along with poverty alleviation and ecological conservation.
- 1.15 As shown in Table 1, implementation and maintenance of the economic program pursued by the Government will require annual inflows of approximately US\$844 million of assistance (net of donations) and debt relief in the 1995-97 period to supplement the country's domestic savings. These resources would continue to be provided largely by donors and Paris Club reschedulings. As per programmed disbursements it is expected that an average of US\$337 million per annum will be derived from net capital flows and foreign investment; US\$340 per year from multilateral institutions (US\$165 million from IDB); and another US\$60 million from bilateral credits. The gap of US\$108 million will be closed by a reduction in bilateral debt or debt service.
- 1.16 To achieve growth targets, the Government must attract substantial additional foreign and domestic resources. Private investment as a share of GDP will have to more than double by the end of the decade. To attract these levels of private investment, the Government plans to: (i) open up key sectors - especially hydrocarbons, mining, telecommunications and electricity - still dominated by the public sector; and (ii) establish an enabling legal and regulatory framework. The reforms supported by this proposed adjustment operation are critical to achieving these objectives.

- 1.17 The strategy of the Bank supports the program and focuses on projects and programs which would: (i) contribute to resolving the problems which are delaying structural reforms; (ii) strengthen the productive and export capacity of the country; and (iii) support solutions for the basic needs of the population.

**Table 1**  
**External Financing Requirements, 1995-97**  
(US\$ millions)

	1995	1996	1997
Financing Requirements	770	872	891
Current Account Deficit	411	547	596
Amortization Due	296	263	256
Net Change in Reserves;			
(+) increase	63	62	39
Financing Sources	770	872	891
Net Private Capital	171	384	455
Gross Disbursements 1/	455	388	355
Multilateral	375	339	305
IDB	175	160	160
IDA	99	90	80
IMF	48	48	24
Other	53	41	41
Bilateral	80	49	50
Reprogrammed debt service and debt reduction 2/	144	100	81

2. Prior related Bank loans Source: IMF.

- 1.18 The reforms instituted by the prior Bolivian Government established the framework for this program and made its execution possible. The Government, with support from the Bank's Financial Sector Reform and Investment Sector Loan and companion Global Multisectoral Credit Program (628 and 629/OC-BO, respectively), along with the parallel Structural Adjustment Credit from IDA and other international institutions, all of which were approved in September of 1991, was largely successful in fulfilling the policy requirements. In both the Bank and IDA sector loans, first tranche conditionality was met at the time of Board approval and first tranche was released in January, 1992. Among the key conditionality requirements fulfilled at that time were the promulgation of the various decrees which initiated the closing of the three public banks, the presentation of a Draft Law to Congress for the sound regulation and supervision of the financial system, and agreement on a detailed strategy for the privatization of public enterprises.
- 1.19 When the Government elected in August of 1993 subsequently announced its "Plan de Todos" which contained among its pillars the proposed capitalization program, a modification of 628/OC-BO was approved by the Board in March of 1994 to revise conditionality requirements for the second tranche release, in order to keep these in line with the thrust of the Government's new program. At that time, the remaining conditionality was deemed by the Board to have been substantially met, and second tranche was released in April, 1994. Under the financial sector reforms, in broad terms, this conditionality included the public banks, development credit, improvements in the regulation and supervision of financial intermediaries and in the functioning of the Central Bank, capital

1/ Only long term (includes capitalized interest).

2/ The Paris Club accord of March, 1995 granted a reduction of debt service of US\$344 million in the period 1995-97. This reduction is US\$19 million more than the amount indicated in the ESAF amounts indicated on this line.

markets development, and improvements in the efficiency of the financial system; under the investment sector, it included private capital activities associated with public capital, improvement in public enterprise efficiency, privatization, business infrastructure and trade procedures, and small and medium enterprise.

- 1.20 Strong ties and mutual support existed between the loans of the IDB and IDA, given their linkages through a common Policy Matrix and Policy Letter. However, the Bank's Policy Matrix, in particular, contained additional conditionality over and beyond that required by IDA. In many respects, it included additional third tranche requirements and allowed for a deepening of activities in certain sectors not covered by the IDA matrix. As a result, much of the progress achieved through the Government's financial sector and structural adjustment reforms as supported by Loans 628 and 629/OC-BO, now forms the basis for this new program which is intended to build on prior achievements and deepen the results attained to date.
- 1.21 Past reforms also brought about considerable investment in the hydrocarbons area. Presently there are about 16 companies exploring and exploiting concessions, although they account for only about 20% of national production. Through its competitive business practices and control of the concession-granting process for the Government, YPFB continues to dominate the market as well as controls exploration and production. It became apparent that only through the elimination of the State from its dominant, monopolistic role in activities in the principle sectors of the economy would the efforts at privatization and efficiency be successful. Under these circumstances the Government's realization that the State could not afford to make the required investments in the critical companies to ensure adequate services by them, and, at the same time, make the investments in infrastructure and social services needed in the country, prompted a review of the reform programs that resulted in the new program.
- 1.22 The borrower has given substantial compliance with regard to the conditions for release of the third tranche of the ISL (628/OC-BO) and the corresponding authorization is in process. This Capitalization Program would complete the actions developed by the conditions in the ISL. The studies and reforms in the ISL regarding the legal structure and the operation and supervision of the insurance industry, pensions and securities will reach fruition in this Program. The capitalization process will create the needed critical mass of shares to be traded in the market and the need to manage these same shares for the Bolivian people until retirement age could give the needed boost to the operation of the reformed pension system.
- 1.23 It should also be pointed out that several features originally contemplated under the ISL, such as the investment law, have been superseded by the deepening reforms brought about with the

Capitalization Program. The Capitalization Law and related measures that have been approved in the past year have given all investors, domestic and foreign, equal rights and privileges and together with the various sectorial laws guarantee the free movement of capital and remission of profits abroad. Other measures intended to stimulate foreign investment are being taken to propitiate the capitalization process. The consultants and investment bankers working with the mining sector have concluded that there needs to be a more integrated approach than previously contemplated for the privatization of the various mining assets, in order to achieve commercially viable enterprises; the implementation of which also requires some further modification to the mining laws. At such time as the new sectorial laws for hydrocarbons, telecommunications, insurance and securities are passed and reglamented and the reglamentation of SIRESE and the new electricity law is completed, it would be feasible to consider provisions for a comprehensive investment law as previously contemplated.

- 1.24 In spite of its experience in the prior reform programs, originally the IDB had not intended to participate in the financing of the capitalization program, having commitments to undertake other projects in Bolivia. However, given that the scope of the program had substantially increased and exceeded the financing requirements that had been anticipated earlier, the Government of Bolivia sought the financial support of the IDB in order to cofinance the program with IDA.

3. Financial sector reimbursable technical cooperation - 879/SF-BO

- 1.25 The objectives of the technical cooperation (which was signed in March, 1992 and eligible for disbursements in January, 1993) are to collaborate with the Ministry of Capitalization in the process of redefining and rationalizing the business activities of the government to prepare for the "privatization" process. Specifically, the loan seeks to continue with the strengthening of the capacity of the principal public enterprises to negotiate, administer and proceed to their capitalization; support the capacity of the government secretariats charged with the administration of the public enterprises to better meld the objectives and goals of these public enterprises with the sectorial policies of the government; and assist the government in defining and evaluating a strategy for the privatization of the various mixed-capital companies. The original program included assistance to the government in creating an executing unit to support the corresponding institutions in the formulation, negotiation, administration and evaluation of the performance contracts that they would be signing; but this aspect was deleted when the performance contracts were discontinued.
- 1.26 The activities of the operation were advanced with a bridge financing from UNDP and are presently in full execution with above 50% disbursed.

4. Capitalization Program supporting technical cooperation - MIF - ATN/MT-4451-BO

- 1.27 In June, 1994 an agreement was signed with the Bank for a non-reimbursable technical cooperation of US\$2,336,000 from the Multilateral Investment Fund to assist the Bolivian government, through the Secretaría de Capitalización e Inversión (SENACI) of the Ministry of Capitalization, in the process of preparation of the Capitalization Program. The program is progressing satisfactorily to adequately accompany the capitalization cronology, having disbursed over 25% of the funds.
- 1.28 The objectives during the first phase of the program are:
- (a) the institutional strengthening of the "Secretaría", which will be responsible for the design and implementation of the program;
  - (b) transforming the six enterprises into "Sociedades Anónimas Mixtas";
  - (c) developing and then implementing the legal modifications required to establish an appropriate legal framework for private sector investment in the six sectors, in particular electricity, hydrocarbons and telecommunications;
  - (d) completion of the design of the capitalization/privatization strategy for each of the six companies, in particular ENDE, YPFB and ENTEL;
  - (e) preparation of ENDE, YPFB and ENTEL for capitalization/privatization;
  - (f) designing a privatization strategy for companies controlled by the Regional Development Corporations.

5. Projects under execution - ENDE (BO-0116) and YPFB (BO-0150)

- 1.29 In the Bank's project BO-0116, being financed with loan 598/OC-BO, several components remain to be completed. Some of these components, related primarily with the transmission network, will remain with the residual ENDE. The main unfinished project is the Carrasco generating unit. As has been reviewed with the potential investors and is indicated in the documentation for the capitalization bidding process, the completion of this project will continue to be supervised and executed by ENDE, with transfer to the newly capitalized company upon completion (scheduled for January, 1997).
- 1.30 The YPFB hydrocarbons exploration and production project (BO-0150), financed with loans 816/SF-BO (59% disbursed) and 542/OC-BO (98% disbursed), is expected to be completed by YPFB prior to the capitalization of the respective new companies and would not cause

any repercussions either in the bidding process or the subsequent operation by the strategic partners.

## II. PROGRAM DESCRIPTION

- 2.1 The centerpiece of the government's reform program "Plan de Todos" is a bold program of privatization of six major public enterprises through a process called capitalization. The goal of the Capitalization Program is to improve the efficiency of public services remove the government from ownership and management of public enterprises, provide for private-sector management and resources to meet present and future demands for services and, in the process, free up government resources for deficit reduction and investment in the social sectors and infrastructure the part of the national budget that had previously been dedicated to investment requirements of these companies. This program involves transferring management control and up to 50% of the ownership of these state-owned enterprises to strategic investors. Investors will not buy existing assets, but rather will make an equity investment into the company approximately equivalent to its book value. This investment will be used to increase each company's capital and provide new liquidity for expansion.

A. Program structure and policy components

- 2.2 The proposed adjustment operation will support establishing an appropriate enabling environment so that: (i) private investment is forthcoming as the Government withdraws from these sectors; (ii) such investment spurs growth in an efficient manner; and (iii) competition is promoted wherever possible. The specifics of how each large public enterprise will be capitalized are being developed on the basis of sector-specific restructuring plans, the present capital structure of the enterprise and estimates of investment needs in the short- to medium-term future. The State's present ownership will be transferred to adult Bolivians through the establishment of deferred distribution retirement accounts to be privately managed by pension funds. The development of long-term financial markets and an appropriate regulatory framework for this sector, thus, is fundamental to the success of the capitalization plan.
- 2.3 The process of custody of the shares for the Bolivian people will be entrusted to a global trustee/fiduciary which is in the process of being hired from among a short list of the largest international private sector firms specialized in this area. This firm will be contracted prior to the first capitalization (ENDE) and will manage the shares and select the directors for the Boards of the various capitalized companies to represent the shares held in custody. Once the private pension management of the accounts of the Bolivian people has been determined and the registry of eligible Bolivians completed, the firm will transfer the value of the respective shares to the designated pension administrator. The global custodian/fiduciary will not only provide for the immediate custody

of the shares, but will help to develop the custodial capability in Bolivia to support a more extensive securities market.

- 2.4 Criteria used to determine what sectoral coverage and conditionality to include in this operation include: (i) the importance of the sector to Government revenues, employment and the country's potential for growth; (ii) the magnitude of fresh private investment needed to develop the sector; (iii) aspects of the enabling environment that are critical to stimulating efficient private sector investment as the Government withdraws from areas that it used to dominate; and (iv) financial sector reforms that are fundamental to the success of the Government's capitalization strategy.
- 2.5 The policy components are presented in the Letter of Development Policy (Annex 1) and are summarized in the Policy Matrix (Annex 2). The specific activities and regulations to be accomplished for compliance with each condition are detailed in the draft Bank and IDA loan contracts and appear in paragraphs 4.9 through 4.12.
- 2.6 The operation involves a complex set of legislative and regulatory reforms that must be carefully sequenced to secure the desired outcome. Achievements thus far and up-front conditionality are designed to mitigate a risk of failure; however, non-compliance in a single area might derail the disbursement of credit tranches. It is proposed to divide the second tranche into three floating tranches to be disbursed as soon as their specific conditions are met to avoid stalling the entire program if certain difficult and important sector-specific reforms are delayed. For two key companies, ENTEL and YPFB, the conditionality for second tranche release requires issuance of tender documents for capitalization of ENTEL and of at least 30% of the assets of YPFB. For all companies, the contract with each strategic investor will contain specific performance objectives, which must be met and which will serve as adequate follow-up measures to the conditionality reflected in the Policy Matrix. Furthermore, the directors on the boards of each company who represent the shares of the Bolivian people will seek to maximize the return for those shares, which will best be obtained through the expansion of each company's activities, as envisioned in the plans developed by the advisors and investment bankers for each industry.

B. Hydrocarbons Sector Reform

- 2.7 The oil and gas industry is vital to Bolivia, representing about 40% of Treasury revenues and 10% of export revenues. Although efforts have been made to increase private participation in the sector, it is still dominated by Yacimientos Petrolíferos Fiscales Bolivianos (YPFB). The sector suffers from inadequate investment to develop existing fields or new discoveries, YPFB's inefficient operations and heavy debt burden, as well as declining prices of gas exports to Argentina. While the 1990 Hydrocarbons Law expanded

possibilities for private sector involvement in the sector and eliminated some tax disincentives, the response has been poor.

- 2.8 The hydrocarbons sector offers perhaps the greatest potential for increasing efficiency and attracting foreign direct investment to the country. As well as large unexplored sedimentary basins, it is estimated that Bolivia has 880 million barrels of oil equivalent (boe) of proven reserves and 4.8 billion boe of potential reserves. Investment requirements between 1994 and 2000 are estimated at US\$700 million for exploration and development alone. The projects to export natural gas to Brazil and Chile currently being negotiated represent the most important commercial opportunities for Bolivia during this decade. However, many hurdles still must be surmounted. For these projects to be a success, exploration and production activity far in excess of public sector capabilities will be required to find and develop adequate reserves of oil and gas to meet domestic and export demands. And, substantial private investment will have to be found to finance the necessary pipeline and other infrastructure required to implement such projects.
- 2.9 On the basis of the "Plan de Todos", the Government has established clear objectives for the sector. These are to: (i) maximize long-term economic benefits from all activities of the sector; (ii) eliminate YPFB's monopoly position and foster competition; (iii) capitalize YPFB; (iv) redefine the role of the Government in the sector; (v) ensure that revenues and hard currency earnings continue to flow from the hydrocarbons sector; (vi) attract substantial private sector investment in all phases of the sector, particularly for exploration and production; (vii) promote greater effectiveness and efficiency throughout the sector; (viii) protect consumers through effective regulation; and (ix) protect the environment from damage that could be caused by petroleum operations.
- 2.10 The Government is committed to an ambitious reform of the legal, institutional and regulatory framework which presently governs Bolivia's hydrocarbons sector in order to attract foreign investment and promote efficiency. This legislation as well as regulations and guidelines for contracts are being designed to be competitive in fiscal and other aspects with those of neighboring countries and the rest of the world. The first stage of legislative reform agenda has been met with the passage of the amendment to Tax Law 843, described earlier, which establishes a new excise tax regime for liquid fuels in downstream operations. This is a necessary precondition to deregulating petroleum product prices, restoring price transparency and thereby creating conditions to stimulate competition.
- 2.11 In the short-term, the greater difficulty of administering hydrocarbons' tax collection combined with the loss of YPFB transfer payments may result in a fiscal shortfall. The short-term budgetary impact of implementing reforms in the hydrocarbons sector would be partially cushioned by this Credit. In the medium term,

the fiscal impact of these reforms will be positive, as increased taxes are collected from a more dynamic sector and the short-term costs have been incurred. Future reforms in the hydrocarbons sector include:

- (a) Passage by Congress of a new Hydrocarbons Law and the promulgation of key regulations to implement the law. The current draft law includes the: (i) the right of free disposition, export and import of crude oil, petroleum products and natural gas; (ii) rationalization of taxation on upstream operations and petroleum products, other than those established in Law 843, amended by Law 1606 including a national tax at a sliding scale related to production level on value or as a function of a ratio of accumulated income and accumulated expenditure ("R" factor); (iii) deregulation of petroleum products prices; (iv) introduction of more flexibility on contractual arrangements for exploration, production and transport by pipeline; (v) establishment of an appropriate institutional mechanism with sufficient independence and autonomy to promote exploration investments, negotiate exploration and production contracts, manage the data bank, fulfill obligations of the State vis-a-vis the operating companies and control their compliance with contractual obligations, in accordance with international practices and standards; (vi) the jurisdiction of the Superintendent for Hydrocarbons within SIRESE, the multisectoral regulatory framework; 1/ (vii) introduction of regulatory provisions for ensuring open third party access to gas, oil and products pipelines, with tariffs based upon common carrier principles; (viii) elimination of direct and indirect barriers to entry in the downstream hydrocarbons activities; and (ix) provisions enabling the capitalization of YPF. (See Annex 4 for a description of the basic principles of this law.)
- (b) Promulgation of key regulation(s) to implement the new Hydrocarbons Law. Regulations to the law will cover the following subjects: (i) the process for awarding exploration areas; (ii) pipeline rights of way, access and tariffs; (iii) environmental, technical and safety standards and norms; (iv) definition of institutional arrangements for granting and monitoring of existing and future contracts for exploration and production; and (v) taxation of upstream production. In addition, the Government has committed itself to establishing a separate environmental unit and issuing environmental regulations, standards and norms related to hydrocarbon sector activities.

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1/ These responsibilities would include, among others, the regulation of natural gas distribution, supervision of access obligations to pipelines and enforcement of anti-trust rules.

- (c) Promulgation of key regulation(s) to implement the new excise taxes on petroleum products established in the amendment to Tax Law 843. Regulations on the level of excise taxes are needed to implement the new tax system to accompany the deregulation of petroleum product prices.
- (d) Establishment and staffing of regulatory and other agencies to award and supervise concessions and monitor compliance with regulations. Several Bolivian Government institutions must be strengthened to enable enforcement of hydrocarbons regulations and the new tax policy. A Superintendency for Hydrocarbons will be established within SIRESE with staff qualified to enforce tariff regulations for gas distribution, monitor compliance with gas distribution concession contracts, supervise open access and/or common carrier arrangements where required and enforce transport tariffs, and monitor the market for anti-competitive practices. In addition, an independent, financially autonomous institution will be established to negotiate exploration and production contracts, assume the management of existing exploration contracts between YPFB and private oil companies and monitor strategic investors' compliance with a minimum investment program defined for the capitalized YPFB(s). The National Secretariat of Finance's administrative capacity to collect the new taxes in the hydrocarbons sector must be significantly strengthened to ensure that the Government's single-most important source of revenue is maintained. Finally, the National Secretariat of Energy's capacity will be strengthened to enable it to prepare norms, monitor safety, technical and environmental standards and regulations, conduct environmental assessments and audits and enforce--in association with the National Secretariat of Natural Resource and Environment--compliance with environmental laws and regulations.
- (e) Capitalization of YPFB. The Government's adjustment program aims to establish a sound legal and regulatory framework for the hydrocarbons sector in tandem with the capitalization of YPFB into several companies. The Government has formulated the principles for the capitalization of YPFB which include the new companies' ability to: (i) attract investment capital, technology and managerial skills; (ii) increase shareholder value; and (iii) gain a competitive position in the regional gas market. Another critical factor will be to organize the new companies in a way that reduces concerns over the misuse of market power to the detriment of domestic consumers. The Government intends that the resulting private companies will compete in an equal basis in all areas of the sector and that all exploration acreage presently held by YPFB will be opened to exploration by private companies. Existing operations contracts between YPFB and private producers will be transferred to the Government prior to capitalization. The Government plans to complete the capitalization of YPFB by early 1996.

C. Telecommunications Sector Reform

- 2.12 Bolivia has one of the worst telecommunications systems in Latin America. The Government has concluded that telecommunications service and penetration levels in Bolivia will not significantly improve without wide-ranging reforms in the regulation of the sector and the management of the long distance and local companies. While Empresa Nacional de Telecomunicaciones (ENTEL), the long distance public enterprise that is part of the capitalization plan, requires no new capital and little investment, the local service cooperatives cannot meet investment and service requirements. Thus, the Government plans to require that the newly-capitalized ENTEL use most of its new investment resources to improve local service.
- 2.13 The Government has stated in its Letter of Development Policy that it wishes to attract private investment capital to the sector in order to provide better and more services to the population. The Government has committed itself to achieving this by: (i) establishing a new legal and regulatory framework for the telecommunications sector which stimulates fair and open competition for the provision of telecommunications services; and (ii) capitalizing ENTEL in such a way that investment flows to the local service, where it is needed.
- 2.14 Key actions in the telecommunications reform program include:
- (a) Passage by Congress of a new Telecommunications Law. The current draft law, which has been presented to Congress: (i) delineates the specific responsibilities of the Superintendency of Telecommunications within SIRESE; (ii) defines the principles for new tariff structures and interconnection charges to promote efficient development of the sector; and (iii) specifies that where there is no competition, tariffs will be regulated by the Superintendency using methods which incorporate an automatic adjustment formula; and (v) envisages obligatory interconnection of public telecommunications networks, in a way that will permit equal and nondiscriminatory interconnection. The law submitted to Congress authorizes both the long distance and local telephone operators to retain monopoly privileges in their concessions for six years, all value-added services (data transmission, cellular, leased private lines, etc.) will be open to free competition. And, the draft law authorizes the Superintendency to remove this exclusivity if concession expansion and quality service targets are not met. With the effective growth of competition in the sector and the completion of the exclusivity period, the necessity for regulation will gradually disappear until finally competition will freely determine the variety, quality and price of telecommunications services.
  - (b) The promulgation of key regulations to implement the Law. The Government has begun to prepare the concomitant regulations to

implement the law. Within three months of passage of the Telecommunications Law, regulations will be issued which will cover: (i) procedures and formulae for tariff adjustment; and (ii) rules for interconnection of operators (technical standards and access charges).

- (c) The capitalization of ENTEL. The strategy to capitalize the entire sector involves requiring the capitalized ENTEL to expand local service--including that in rural areas--according to specifications to be incorporated in its concession agreement. To enable the company to earn a reasonable return on these investment requirements, the Government plans to give the private ENTEL exclusive rights to provide long distance and international basic voice services in Bolivia for six years. The level of coverage, maintenance, quality of service, areas of operation and sanctions will be specified in its concession agreement. The capitalized ENTEL will be required to provide at least one public telephone to about 1,500 rural communities with more than 1,000 inhabitants as well as install public telephones in urban areas. In addition, during this time existing cooperatives will be required to expand and improve their service within their concession areas. If the local providers do not meet these targets, the Superintendent will allow other entrants to enter the market to do so. Initial tariffs during the transition period will be calculated based on the cost for each class of service with a reasonable profit margin. Adjustments will be based on price cap methodology. The Government intends to invite bids for the new shares of ENTEL by mid-1995. An international investment banking firm has been hired to perform this transaction.

- (d) Establishment and staffing of the Superintendency of Telecommunications within SIRESE. The Superintendency of Telecommunications, which will award and supervise concessions and monitor compliance with regulations, is expected to be established within ninety days after the Telecommunications Law is passed. The staffing of this unit should be completed during 1995.

#### D. Electricity Sector Reform

- 2.15 Although the national electricity public enterprise, Empresa Nacional de Electricidad (ENDE), has been effective in developing a generation and transmission system that offers technically reliable service, the organization of Bolivia's electricity sector as a whole is not well-suited to ensure operational efficiency, promote competition, attract private investment to substitute for Government support and expand the system efficiently. To address these issues, the Government is committed to undertake the sectoral restructuring strategy that is supported by the proposed loan.
- 2.16 The main objectives of the electricity sector reform are to provide an economic and reliable service to the greatest number of

consumers, with little Government intervention, and due regard to the environment. This objective will be reached by promoting quality and efficiency through competition and autonomous effective regulation, and attracting new sources of private capital to support its development. To address the sector problems, and achieve a level of efficiency necessary to support the economic and social development of the country, the Government proposes to undertake a sectoral restructuring strategy.

- 2.17 One of the critical first steps in the reform process for this sector was the passage by Congress of a new Electricity Law. This Law established: the responsibilities of the Superintendency of Electricity within SIRESE, including the granting and monitoring of concessions; principles for tariff-setting; requirements for the separation of generation, transmission and distribution functions into different companies, including a prohibition on direct cross-ownership (for utilities integrated to the National Interconnected System); open access to transmission and distribution; the principle that future investment needs will be supplied by the private sector; and anti-trust provisions so that competition in the wholesale contract market is not undermined.
- 2.18 The Government has hired international investment bankers and lawyers to prepare the capitalization of ENDE and the privatization of ELFEC (a Cochabamba electricity distribution company). Further electricity sector reform measures include:
- (a) Promulgation of key regulations to implement the Electricity law. Regulations to apply this law are expected to be issued by mid-1995. Key regulations will cover: (i) quality of service norms; (ii) clear and specific rules for tariff-setting; (iii) economic dispatch of the power system; and (iv) the conditions for granting concessions and licenses, and monitoring performance standards.
  - (b) Establishment and staffing of the Superintendency of Electricity within SIRESE. Since the Electricity Law already has been passed, the Government has started to hire Superintendency staff which will award and supervise concessions and monitor compliance with regulations, and has begun their training.
- 2.19 Capitalization of ENDE. The Government plans to capitalize ENDE by mid-1995 in a manner to foster competition among private generation suppliers in the future and ensure open access to the grid. ENDE's assets have been separated between generation and transmission. The resulting ENDE-Generation has been divided into three generation companies to be capitalized, so that new investment in the sector spurs efficient competition rather than the creation of a quasi-monopoly. These private capitalized companies will have obligations to invest in new generation capacity during a specified period of time to meet growing demand. Entrance to the sector by new operators will be restricted for three years after

capitalization of the generators. The isolated systems of ENDE serving rural areas, as well as the Regional Distribution Systems, Empresa de Luz y Fuerza Eléctrica Cochabamba (ELFEC), Servicios Eléctricos de Potosí (SEPSA), and Compañía Eléctrica de Sucre (CESSA), will be divested in accordance with the Privatization Law of 1992. Finally, the transmission company will be capitalized after the dispatch system is functioning in a satisfactory manner.

E. Mining Sector Reform

- 2.20 The role of mining in the Bolivian economy has been diminishing steadily since the mid-1980s. While falling world mineral prices have contributed to this decline, until 1994 the national mining company's Corporación Minera de Bolivia (COMIBOL) poor management, continued operation of non-profitable mines and serious overstaffing contributed to huge losses. In addition, lack of stability in certain government tax and leasing policies related to the mining sector place Bolivia at a comparative disadvantage to other countries when trying to attract investors. Between 1986 and 1994, the Government undertook a program of rationalization of COMIBOL, drastically reducing excess personnel and resulting in the elimination of non-viable mining operations. To improve this sector's performance, COMIBOL has begun to transfer to the private sector through joint ventures the operational and management responsibilities for all potentially profitable operations. In the future COMIBOL will limit its role to that of a holding company.
- 2.21 The adjustments to be made to COMIBOL need to be complemented with the modernization of the legal and institutional framework of the sector to ensure: open access to mineral resources; adequate administration of the sector, particularly with respect to mining rights; and the provision of a reliable technical data base. The leasing policies incorporated in the existing Bolivian Mining Code, which place Bolivia at a comparative disadvantage to other countries when trying to attract investors, will be modified. IDA has been assisting this reform process through the on-going Mining Sector Rehabilitation Project.
- 2.22 The Government has: (i) prepared a draft of the proposed amendment to the Mining Law; (ii) developed a strategy to capitalize the Vinto smelter, Empresa Metalúrgica Vinto (EMV); and (iii) hired financial advisors/investment bankers to prepare EMV for capitalization and increase private participation in the operation of COMIBOL's assets. Future proposed actions include:
- (a) Passage of an amendment to the Mining Law. This amendment is expected to include the following provisions to increase the attractiveness of the sector to long-term investors: define the role of COMIBOL as that of a holding company and derogate provisions of laws which specified its role as that of an operating mining company; permit mining leases that exceed 10 years; introduce tax options for investors; eliminate the optional royalty, presently operating concurrently with the

result-based taxation system; improve mining rights administration; define the attributions and responsibilities of sector institutions to facilitate their modernization, improve their administration and maintain a reliable data base; and update the existing environmental provisions to be consistent with Government policy.

- (b) Capitalization of EMV. A package of assets that will ensure an adequate long term supply of tin ore to the Vinto smelter will substantially increase EMV's attractiveness to potential investors. To this effect, the Government intends to offer a package which includes the Vinto smelter plus the long-term leasing of a number of mines from COMIBOL. The capital gained through this capitalization would be used to develop the mines.

#### F. Railways Sector Reform

- 2.23 The Empresa Nacional de Ferrocarriles (ENFE), the national railroad, was formed in 1964 from the combination of several Andean lines in western Bolivia belonging to the State and certain private companies. A few years later the lines of Eastern Bolivia radiating from Santa Cruz were added. In total, the system comprises 3,500 km of lines, with 4,000 employees. While the eastern network is profitable (after taking into account Government subsidies to compensate for below-cost passenger and freight tariffs), the losses of the Andean line absorb almost all of these profits. Moreover, the profitability of the Andean lines has been reduced in recent years due to the decline of Bolivia's minerals sector and rapidly escalating costs. Both networks suffer from inefficient practices, overstaffing, and severe lack of reinvestment. This situation has been improved through significant lay-offs which occurred in late 1993. But, without fundamental change, the entire railway faces continued decline.
- 2.24 The adoption of Bolivia's new economic policies offer the potential for fundamental reform of the railways. The Government's objectives include: (a) non-discriminatory access to railway services; (b) tariffs which reflect market conditions free from monopolistic distortions; (c) adoption by the railway of the most efficient and appropriate technologies and practices; and (d) constitution of the railway as commercial private sector enterprises through the process of capitalization. If the Government decides that the private sector should continue to operate unprofitable lines due to important social reasons, the railway(s) will be compensated through a system of transparent Public Service Obligation payments by the Government.
- 2.25 The Government plans to present a new Railways Law to Congress by mid-1995. This law will enable the new capitalized railway company(s) to provide an integrated rail service. ENFE's assets, excluding tracks, would be included as part of the capitalization package. The law will delineate the responsibilities of the Superintendent of Transport within SIRESE in the railways sector.

A new regulatory framework will guarantee that the railway will function as a "common carrier" offering its services to all parties. To eliminate monopolistic abuses, the tariffs, freight contracts or other prices set for such services as well as the conditions of such services shall be subject to appropriate regulation to be monitored by SIRESE. The law will set the principles for a mechanism of payment under transparent circumstances for non-remunerative public services which the Government or any other duly constituted entity wishes to purchase from the railway.

- 2.26 The Government has contracted consultants and investment bankers to advise on the strategy for ENFE's capitalization and investment bankers were hired in April 1995. In addition, an analysis of the extent and value of ENFE's properties is being made according to whether they are required for railway use or are excess to needs. The advisors will specify a recommended form of transaction or transactions which will then become the subject of a marketing effort.

G. Aviation Sector Reform

- 2.27 The proper organization of the aviation sector is crucial for the development and integration of Bolivia, as well as for assuring the safety of air travelers. Bolivia's aviation sector is characterized by relatively high State intervention and lacks a clear and effective regulatory framework. This has translated into inefficiencies in the provision of air traffic and airport-related services. As part of its reform agenda, the Government has already passed Supreme Decree 21060 which deregulated domestic air traffic tariffs. The impact of this ruling has already created stronger private competition in the market.
- 2.28 The Government wishes to restructure the sector to promote private sector participation, make domestic and international air service more efficient and reduce government involvement when inappropriate. The three basic tenets of the reform program are dealing with the: (i) international and domestic airline sectors; (ii) airports sector; and (iii) adaptation of the institutional and regulatory framework.
- 2.29 The Government plans to capitalize Lloyd Aéreo Boliviano (LAB) in a manner that fosters competition in the domestic airline sector. It has hired a technical advisor, an international investment bank and a legal firm to help with the capitalization of LAB. Since 1994, the Government has eliminated implicit subsidies to Transportes Aéreos Militares (TAM) and Transportes Aéreos Bolivianos (TAB), which have suspended operations. The Government wishes to develop a level playing field by eliminating implicit subsidies to individual airlines, particularly in the case of the two military airlines--TAM and TAB. Domestic routes to non-commercial destinations will be auctioned to the domestic airline that requires the lowest compensation. The Government will either

convert TAM and TAB into commercial enterprises that function within the competitive market or they will discontinue commercial services and be integrated into the military sector.

- 2.30 Concerning the airports sector, the Government intends to restructure the Administración de Aeropuertos y Servicios Auxiliares a la Navegación Aérea (AASANA), the airport services public enterprise, so that: (i) most of the airport-related activities, excluding air traffic control services, are transferred to the private sector; (ii) a redimensioned AASANA (most probably a new entity) will retain responsibility only for operating air traffic control services; (iii) airport administration is decentralized through the creation of regional airport authorities, with private sector and regional entities involvement and; (iv) airport tariffs and rates are established more in line with neighboring countries. The Government has retained specialized airport consultants to assist in the restructuring and privatization of AASANA and intends to contract an internationally recognized investment bank to help manage this transaction.
- 2.31 Concerning the institutional and regulatory framework of the aviation sector, the Government intends to: (i) adapt the current aeronautical legislation to the new organization in the aviation sector, as well as to the SIRESE Law; (ii) adjust the general aviation policy as well as the international aviation policy, to conform to the changes in the aviation sector; and (iii) create a civil aviation authority (regulatory body) for aviation-related matters. The Superintendency of Transport within SIRESE will be responsible for monitoring compliance with economic regulations, such as airsite charges.

#### H. Privatization of Small and Medium Public Enterprises

- 2.32 The Government has some 72 publicly-owned, small and medium enterprises, which remain to be privatized by the end of 1996. These are under the control of the Regional Development Corporations, the military, local prefectures (mostly hotels), municipalities, and a variety of other ministries, secretariats, state enterprises (as subsidiaries) and other agencies. Their total value is estimated at US\$100 million. For about half of this group, consultants have already conducted individual pre-privatization assessments and evaluations.
- 2.33 The process of privatization for small and medium enterprises was fully elaborated in the Privatization Law of May 1992 and accompanying regulations, and was used under the previous administration for privatizing or otherwise disposing of about 30 enterprises with a total value of \$12 million. The Government has issued a Supreme Decree adapting procedures to the new Executive branch structure. Proceeds from the sales are to be used exclusively for socially-oriented activities, selected by the agency which had responsibility for the enterprise when it was in the state sector, and with oversight from the Ministry of Finance.

To date, about US\$5 million of funds has been disbursed for over 100 social projects.

I. Institutional framework reforms

- 2.34 The capitalization program described above aims at removing the State as owner and operator of strategic enterprises in key economic sectors. The Government is undertaking various efforts to develop an institutional framework conducive to private sector participation. As mentioned earlier, it is developing private sector-oriented institutional frameworks, opening market structures and establishing transparent regulations and independent regulators in key sectors currently dominated by public enterprises. In addition, it is: (i) establishing effective and impartial dispute resolution mechanisms to deal with conflicts between the Government and private parties that arise from the application of sector regulations; (ii) establishing dispute resolution mechanisms between private parties that arise from commercial and financial exchanges, including the proposed capitalization transactions; (iii) supporting the Judiciary's efforts to improve the opportunity and soundness of judicial dispute resolution by means of a Judicial Reform Program; and (iv) seeking to overcome legal restrictions and deficiencies in the registration and enforcement of security on movable assets that unduly restrict access to credit.

1. Adjudication of Disputes Legal Framework

- 2.35 The availability of speedy and fair mechanisms of dispute resolution between private parties is another important consideration for investors. Existing legislation is deficient in providing for alternative dispute mechanisms. Major constraints exist on the eligibility of parties, scope of application and the possibility of obtaining swift decisions and their enforcement.
- 2.36 In August 1994, the Bolivian Congress ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the corresponding Panama arbitration convention and the treaty of the International Center for the Settlement of Investment Disputes. This enables the enforcement in Bolivia of foreign arbitral awards concerning private parties. It is also the Government's intention to promote the utilization of alternative dispute resolution mechanisms--arbitration, conciliation and mediation--as means to respond effectively to investors' dispute resolution needs within the domestic context. A draft Law on Arbitration, Conciliation and Mediation has already been completed and reviewed by the Ministry of Justice and will be presented to Congress for enactment.

2. Judicial Reform

- 2.37 The Judiciary, with the support of the Executive, is working together to improve justice administration for civil and commercial cases in Bolivia. The judicial system has been recognized as a

critical constraint to private sector development and the efficient operation of a market-based economy in Bolivia. Failure of the judiciary to provide a reliable and predictable environment for enforcement of rights related to commercial transactions is a key factor hindering the emergence of modern business practices and efficient markets. The deficient performance of the judiciary has also hampered the development of alternative dispute resolution mechanisms, such as commercial arbitration.

- 2.38 The Government intends to coordinate with the judiciary's effort to modernize justice administration in Bolivia. This involves converting the judiciary into an organization driven by the objectives of ensuring: (i) judicial disputes are resolved expeditiously; (ii) judicial rulings are based on sound and uniform jurisprudence consistent with legislative and equity principles; (iii) efficiency in the use of judicial resources; and (iv) accountability and responsiveness of the judiciary to society's justice administration needs. Improving the judiciary's poor performance will require introducing reforms in the judiciary's human resource management policies to rectify the incentive framework governing staff recruitment, promotions and compensation as well as to build up a strategic management function together with appropriate management information systems. Reforms are also needed to process disputes in a manner to deal effectively with the public's demand for swift, fair and predictable justice administration.

### 3. Secured Transaction Development

- 2.39 Access to credit in Bolivia is limited to those who can offer real estate as collateral. Inventory, accounts receivable or industrial equipment cannot serve as collateral without a supplemental real or personal guarantee. The dominant role of real estate as collateral derives from deficiencies in the legal and institutional framework for secured transactions. The current legal framework limits the assets that can serve as collateral and makes uncertain the priority of creditors' claims and the registry where the claims should be filed. In addition, the law does not permit any type of private enforcement of rights, an alternative that is critical for an effective secured transaction system. These legal constraints materially obstruct the ability of private parties to utilize movable assets as collateral.
- 2.40 Inadequacies in the registries' operation also constitute a serious obstacle to a well-functioning, secured transactions system. The Real Estate and Commercial Registries do not apply adequate procedures to ensure the efficient filing, retrieval and publicity of security. Thus, they defeat their main objective of providing secured creditors certainty regarding their priority interest on debtors' assets.
- 2.41 It is the Government's intention to seek Congressional approval either of relevant amendments to the Commercial Code or of a

comprehensive secured transactions law in order to remove the prevailing legal constraints. This legislative initiative would seek to facilitate, modernize, and clarify the creation, perfection, and enforcement of security interests and liens on personal property. Banking regulations shall be redrafted to conform to this new law.

- 2.42 Because record information is essential to ensure an efficient business environment, the Government is committed to the improvement of commercial and property registries. The Government has commissioned assessments of the technical needs of each registry office. Based on these studies, the Government plans to promote and undertake a program aimed at improving the operation and management of the registries through computerization and performance monitoring. The Government is also investigating the possibility of contracting out the management of commercial registries to the private sector.

J. Financial sector reforms

- 2.43 While the efficiency of banking financial intermediation has improved in recent years, Bolivia's long-term financial markets remain undeveloped, with contractual savings mechanisms weak and poorly regulated and securities markets thin and poorly supervised. Deepening of long-term financial markets is fundamental to the success of the Government's capitalization strategy which involves distributing shares to the Bolivian people through a private-sector pension fund mechanism. Development of a well-regulated secondary market for distributed shares will be critical to promoting a competitive market and ensuring the highest possible return both to investors and beneficiaries of share distributions. In addition, the management and supervision of the distribution system is critical for public credibility of the capitalization process--individuals must be assured of having such holdings efficiently managed and receiving what they are entitled to in a timely and efficient manner. Finally, development of a better regulated insurance market will enable individuals to use distributions through annuity contracts to ensure the highest income in retirement, open up a channel for institutional investment in a secondary market for shares, and facilitate improved coverage of risks.
- 2.44 The Government also hopes to develop long-term financial markets to mobilize long-term savings for investment. Fixed income and equity markets could serve as important vehicles for raising investment finance as well as a means of matching financing mechanisms to business risks. Moreover, improved insurance markets could both increase the vehicles for covering personal, property and business risks as well as stimulate institutional investment.

## 1. Development of Securities Markets

- 2.45 A formally regulated securities market has been operating since 1989. The two exchanges in La Paz and Santa Cruz offer primarily fixed-income Government and private securities. Three mutual funds operate in the market and there are 18 members of the La Paz exchange (of which 10 firms are subsidiaries of banks). The exchange does not offer any custodial arrangements and securities are physically moved between safe boxes. Similarly, clearing and settlement is done on a manual basis for the securities and through funds transfers from banks to brokers and vice versa. The Comisión Nacional de Valores (CNV) regulates securities issues and trading. Turnover on the La Paz stock exchange has just regained the level of 1990, after having declined by 50% to a low in 1992. Turnover currently is running at an average rate of US\$60 million a month. The range of instruments traded in purchase or sale transactions on the La Paz stock exchange has steadily evolved and diversified since 1990, including both bond, certificates of deposit and repurchase transactions. Approximately 60% of turnover is accounted for by purchases or sales of securities, and 40% by sale and repurchase transactions covering periods ranging from one to 45 days. The majority of trades are for short-term debt instruments, and most transactions are the secondary market for certificates of deposit, with repurchase agreements. Dealing is by open outcry five days a week at a call-over of listed securities.
- 2.46 Government is committed to establishing a transparent and efficient market as a necessary prerequisite to the success of its capitalization program as well as to accelerate the mobilization of long-term savings. A well-regulated securities market with adequate disclosure mechanisms will facilitate secondary market trading so as to promote competition and ensure the greatest price and liquidity for shareholders and pension and mutual fund members. Deeper and more efficient stock and bond markets would stimulate the development of long-term corporate financing and offer a mechanism to hedge financial risks. Indeed, given the large volume of shares which would enter the Bolivian (and international) market through the capitalization scheme, the existence and transparency of a secondary share market is fundamental to promoting a competitive market among pension funds and ensuring that the 3.2 million estimated holders of deferred distribution accounts are able to realize the greatest return and liquidity on their portfolio assets.
- 2.47 The Government proposes to establish a secure legal, institutional and regulatory framework to govern Bolivia's securities markets. This includes measures to improve securities regulation, operation and supervision, which are fundamental to capitalization and pension reform. A Securities Law was initially drafted in 1991 and is currently under review by a designated Congressional Commission. The law is expected to be presented to Congress by early 1996. The law is a major advance towards meeting most of the requirements which may be anticipated for the next few years.

2.48 Key further actions of the reform program include:

- (a) Passage by Congress of a Securities Law and the promulgation of regulations to implement the Law. The draft law deals with: ensuring investor protection (prevention of illegal transactions, price manipulation and fraud, minimum capital requirement for market operators, etc.); maintaining orderly markets through proper supervision of stock market practices; promoting market development by allowing mechanisms to broaden the range of financial instruments and institutions; and fostering openness to foreign investment and market participants. Key regulations to the law will cover: (i) issuance and handling of securities; and (ii) registration and listing requirements.
- (b) Institutional strengthening of the Superintendency of Securities. Measures would include establishing stronger regulatory hardware, software and monitoring procedures, disclosure guidelines and staff training. The Government also plans to establish a funding mechanism to ensure the proper functioning of this Superintendency.

## 2. Pension Reform

- 2.49 Bolivia's current social security system includes benefits for retirement, survivorship and disability pensions and medical insurance. Pension insurance is mandatory for selected workers only. Bank employees, police and military and university teachers have their own pension insurance regimes. For other employees, mandatory pension insurance operates through: (i) a national fund that covers basic pensions, and (ii) 22 complementary funds organized on a sectoral or industrial basis. A January 1994 Supreme Decree created the National Institute of Pensions to supervise the basic and complementary pension funds. Contributors account for approximately 12% of the economically active population. Of the 276,000 contributors to the system, about 69% are public sector employees (including teachers, police force and employees of public sectors enterprises and decentralized entities).
- 2.50 The government plans a reform of the pension system as part of the "Plan de Todos", the main objectives of which include: (i) financial and operational restructuring of the existing basic and complementary pensions to increase the operational efficiency, solvency and equity of contributions and benefits; (ii) development of a new system of privately-managed, defined contribution pension funds to gradually replace the current one; and (iii) distribution of the capitalization shares into individual deferred distribution accounts managed by new, private pension funds. Prerequisites for the reform are the passage of a Pensions Law and accompanying regulations and the establishment of a Superintendency of Pensions.

- 2.51 The Government has committed itself to an overhaul of the existing pension system. Agreement was reached with the government on the basic principles of a revised pensions system (see Annex 5), but the only aspect of that reform which will be required by the Bank for the disbursement of the financial sector second tranche is the establishment of non-contributory accounts for share distribution from capitalization, the promulgation of key regulations and the establishment and staffing of a regulatory authority to supervise compliance with the regulations.

### 3. Insurance Sector Reform

- 2.52 Bolivia's insurance market has yet to recover from the severe disintermediation which occurred during the hyperinflation of the 1980's. Annual premium income is only US\$40 million, derived mainly from property, casualty, motor vehicle, and a very small amount of life insurance. Moreover, many operating insurance companies lack an adequate technical, financial and capital base for their operations. Limits on the lending activities of insurance companies have restricted them from investing in mortgages, private bonds or commercial paper. A substantial proportion of technical reserves must be invested in fixed capital, such as buildings. The Superintendency of Insurance is very weak, with limited technically specialized staff and prudential control procedures. A draft Insurance Law to strengthen this industry and its supervisory arrangements (under preparation since 1992) is currently under consideration before a Review Committee and is expected to be presented to Congress by early-1996.
- 2.53 Reform of the insurance sector is needed to increase the options for coverage of multiple business risks, help develop a vehicle for long-term savings, and ensure that retirees, the disabled and survivors can efficiently invest pension benefits. Improving insurance regulation and supervision reinforces the objectives of capitalization and pensions reform as an efficient regulated insurance system is critical to death and disability coverage as well as for providing a system of annuities in retirement. In addition, insurance reform is needed to allow insurance companies to invest in a more diverse set of investments--including shares of capitalized companies. Thus, reform in this area is viewed as a fundamental complement to the capitalization process.
- 2.54 Critical reforms needed to develop the insurance industry are:
- (a) Passage by Congress of an Insurance Law and enactment of regulations. This law, which was originally presented to Congress in 1992 includes: strengthening the parameters for operation of the insurance companies (their functioning, solvency and capital requirements, solvency and technical margins, technical reserves, investments, reinsurance, governance, administration, accounting, mergers, transformations and closure, and liquidations); establishing rules for the functioning of intermediaries and auxiliaries

(agents, insurance and reinsurance brokers, loss adjusters and claims settlement agents, accident investigators, and damage inspectors); broadening the range of assets in which insurance companies can invest while ensuring that prudential considerations are respected; and establishing regulatory controls of insurance companies, intermediaries and auxiliaries through the Superintendency of Insurance, prudential measures and sanctions. Key regulations will be promulgated to cover: (i) entry of local and foreign insurers and reinsurers; (ii) supervision procedures; and (iii) investment parameters.

- (b) Strengthening of the Superintendency of Insurance to supervise compliance with the Insurance Law and regulations, which includes: (i) revising the organizational structure as necessary; (ii) strengthening off-site hardware, procedures and staff capability; (iii) improving on-site procedures and staff skills; and (iv) establishing a common form of accounts, an inspection manual, uniform norms for portfolio investments and systems for better and quicker evaluation of monitoring information.

### III. SPECIAL ASPECTS OF THE PROGRAM

#### A. Upstream taxation for hydrocarbons

- 3.1 The Government has indicated in the Letter of Development Policy that it intends to have legislation, regulations and guidelines for contracts which are competitive in fiscal and other aspects with those of neighboring countries.
- 3.2 The draft hydrocarbons sector law seeks to establish a competitive, stable and equitable fiscal regime that will also satisfy Bolivia's fiscal needs. This regime includes taxes outlined in law 1606 which modified Tax Law 843, the current departmental royalties of 12.5% and a national tax at a sliding scale related to production level or value, or as a function of a ratio of accumulated income over accumulated expenditures ("R" factor). These three aspects will permit the Bolivian Government to maximize revenue from the Hydrocarbons sector without jeopardizing their competitiveness in the region.

#### B. YPFB capitalization strategy and exports of gas

- 3.3 The preliminary strategy for capitalization of YPFB, which is a floating tranche condition, has been presented by the Bolivian authorities and seeks to support the general capitalization objectives with particular emphasis on the following: (a) sustainable economic growth through the creation of a dynamic private sector, with improvement in productivity and efficiency and export growth; (b) removal of governmental involvement in the management of business enterprises; and (c) a process that is sustainable and irreversible. The government's objectives are to strive to attract capital and technology, preserve YPFB as a long-term source of tax revenue, foster competition, improve oil and gas services to the Bolivian people, monetize petroleum resources, use environmentally sound practices, and position Bolivia to become a significant natural gas supplier in the Southern Cone.
- 3.4 Regarding this last objective, the strategy points to successfully concluding and implementing the natural gas project with Brazil, which is seen by Bolivia as determining to a large degree whether or not there is an affluence of foreign investment to develop the hydrocarbons sector. The importance of this project is due to the high gas bearing hydrocarbons geological structures in Bolivia, the limited export markets, of which Brazil has the most significant potential and the gas volumes to be supplied to Brazil and the price will determine the economics for foreign investors to explore for gas and oil in Bolivia.
- 3.5 The Bolivian government has presented the elements of its strategy for capitalization of YPFB with two alternatives, which only differ

with regard to the integration or separation of the gas transmission pipelines from the Exploration and Production companies. The refineries would be capitalized as a separate entity, current operating contracts passed directly to the government, marketing assets privatized, and residual assets, such as drilling operations, grouped into a company to be subsequently privatized.

- 3.6 In both of the alternatives being considered for capitalization of YPFB, in the gas pipelines and existing production areas, contracts and concessions will be awarded subject to fulfilling the contractual obligations which are negotiated with Brazil.

C. Environmental considerations

- 3.7 The major environmental issues which are addressed in the Environmental Report are: (i) the coordination of the process of issuing regulations to the environmental law, "Ley General del Medio Ambiente", with the schedule of the capitalization program, as well as, the need to review such regulations; (ii) the need to carry out in a timely manner, environmental audits for all facilities to be included in the program, defining beforehand what is pollution stock and what is pollution flow, and the resulting responsibilities for the clean-up measures; (iii) the need to ensure that the bidding documents for the capitalization program include emission standards with which the new owners must comply; (iv) the estimation of the costs and likely financing sources for the clean-up of the most critically polluted sites uncovered by the environmental audits; and (v) the social costs of the capitalization process, particularly in the mining areas.
- 3.8 In order to prepare the environmental assessment of the program, consultants were contracted by the Bank to assist in the preparation of the Environmental Report and to assist in the coordination and preparation of the most urgent environmental regulations for the sectors to be capitalized, as well as the measures to be taken regarding social impacts of the operation. The three IDA individual technical assistance credits (programmed for 1995 - see paragraphs 4.16 through 4.26) have corresponding environmental components to support the Government's programs, particularly in the energy and hydrocarbons sectors, in complement to the Bank's ongoing Environmental Institutional Strengthening Program (Loan 929/SF-B0).
- 3.9 With the exception of the mining sector, all identified existing stocks of environmental liabilities will be the responsibility of the corresponding capitalized companies. The Government will remain responsible for any unidentified current liabilities which may arise in the future.

D. Social aspects in mining regions

- 3.10 The mining areas (western part) of Bolivia have been adversely affected in recent years by declining mineral prices as well as continued operation of inefficient mines by COMIBOL. Under government programs supported by the Bank loan 628/OC-B0 the inefficient mining operations were closed and the displaced miners were indemnified. Unfortunately, the earlier programs had not contemplated retraining nor development of alternative employment possibilities. As economic conditions in the mining areas continued to worsen, new employment opportunities have not arisen and are not generally available throughout the country.
- 3.11 The unemployed miners have resorted to various schemes for subsistence, including exploitation in very precarious conditions of abandoned mines, unauthorized use of ore mined from active COMIBOL mining operations, which would form part of the capitalization of the sector.
- 3.12 It is expected that considerable social unrest could result from the transfer of the mining and smelting operations to the private sector, unless these chronic problems are addressed, beginning with the areas involved in the capitalization.
- 3.13 As agreed with the Government and reflected in the Letter of Development Policy a task force has been formed under the auspices of the Secretaria Nacional de Minería (SNM) to direct the preparation of a Plan for Social Development and Rehabilitation of the mining region of Bolivia and coordinate the actions of the various governmental programs for rehabilitation and social development in the mining regions, which will support the activities of the Capitalization Program. Although it is expected that very few miners will need to be resettled, the Bank will ensure that the Plan adheres to all pertinent Bank policies and guidelines regarding resettlement. The Plan is expected to be completed within the next nine months.
- 3.14 The Bank will monitor the progress of the Plan in accordance with the corresponding schedule of activities as developed in the Plan and as part of the review of the compliance with the conditions contained in the Letter of Development Policy as is indicated in the Policy Matrix (Annex 2, Part A).
- 3.15 The Bank is preparing additional technical assistance funding for US\$200,000 to assist the Secretariat of Mining's task force in developing this economic and social development plan in the mining areas. The summarized terms of reference for the preparation of the Plan are attached as Annex 6. Also, various financing options for investments and retraining to implement that Plan, including an additional loan and further technical assistance, are being discussed by the Bank with the Bolivian authorities, as well as with potential donors and co-financiers.

E. IDB technical cooperation subprogram

- 3.16 One of the most important factors which distinguishes the Bolivian program from other privatization programs is the distribution to the Bolivian adults of approximately half of the value of the capital in the capitalized companies. In order for this feature to become effective it is necessary to carry out (at a cost of approximately US\$16 million - see Annex 3) a complete census and registry of the adult Bolivian population, since only some 35% of the urban population and less than 15% of the rural population are currently incorporated into the existing Civil Register.
- 3.17 The Bank proposes to provide a technical cooperation of US\$12 million, parallel to the sector loan, to finance 75% of this project during the next three years. The majority of the activity regarding the registering of the population will take place in the first year. In the subsequent two years a complete data base and systems for maintaining the civil register (births, deaths, marriages, etc.) and elaborating the election rolls will be implemented.
- 3.18 One of the IDA technical assistance projects (financial sector, see ¶ 4.22) will cofinance US\$2 million of the cost and the government will cover the equivalent of US\$2 million, primarily in personnel costs.
- 3.19 The execution of the technical cooperation for the "RUN" will be coordinated with a technical cooperation that the Bank expects to approve during 1995 for delimiting and demarcation of the provincial and municipal boundaries in the country, which will be executed by the Inter-ministerial Boundaries Commission (COMLIT). The "Ley de Participación Popular" mandates reassignment of 20% of fiscal rents to the jurisdictions based on their number of inhabitants in each, as well as delegation of administration of other government services. The parallel activities of the "RUN" and the COMLIT boundaries definition will enable Bolivia to greatly improve the efficiency of its civil and electoral registries and to equitably implement the "Plan de Todos".

#### IV. PROGRAM IMPLEMENTATION

##### A. Execution

- 4.1 The agency primarily responsible for the implementation of the conditionality will be the Ministry of Capitalization in coordination with both the Ministry of Finance and the Ministry of Economic Development. The disbursement execution will be carried out through the Central Bank using the Bank's standard procedures for sector lending.
- 4.2 Each of the six state enterprises to be capitalized has had ongoing, parallel activities to prepare it to be capitalized. The current Capitalization chronogram is based on the relative degree of readiness of each enterprise at this time, as well as the legislation required for each. The main enterprises, all requiring legislation, will be capitalized in sequence of ENDE, ENTEL and YPFB, based on the agenda with Congress. The railroads (ENFE), mining operations (EMV) and airline (LAB) will proceed in parallel as they are prepared.

##### B. Enforcement of investment requirements

- 4.3 The initial investments in each company will either be fully realized at the time of award or will be backed by bank guarantees. The investment and expansion requirements for the strategic investors in each of the capitalized companies will be specified in the respective contract with each strategic investor. The new regulatory structure (SIRESE) will be responsible for supervising the compliance with the requirements. The companies will be required to register on national and international stock exchanges and comply with all of corresponding disclosure requirements. The ultimate penalty for non-compliance with expansion requirements would be the removal of the strategic partner from the company.
- 4.4 The first three companies to be capitalized are in the energy sector (ENDE). The initial investment in the electrical sector will be made 100% at the time of award. Each of the three companies created from ENDE have specific investment requirements for expansion of generation in terms of KW of generating capacity to be installed, as well as the proviso that at least 90% of the additional capital be invested in generating capacity. The distribution companies are required to provide necessary service and must demonstrate that they have contracted with generators at least 80% of their anticipated demand for the next 5 years. To establish the domestic demand for energy upon which the majority of the investment requirements will be based, the SIRESE regulator will issue an annual calculation of the demand increases that have occurred in the country. It is expected that the competitive private sector will provide for the increases in demand.

- 4.5 The Superintendent will have specific remedies available to enforce these requirements, which include: (i) retention in escrow of the shares of the strategic investor until such time as the investment requirements have been met; (ii) formulas to be included in the contract with each strategic investor specifying monetary damages to be assessed for non-compliance or late compliance with investment requirements; (iii) replacement of management of the company by the regulators (SIRESE); (iv) reduction of the company's period of exclusivity; and, in the final instance, (v) revocation of the contract with the strategic investor. In the event that the generating companies do not respond to a distributor's needs for service, the Superintendent can require the distribution company to secure the necessary energy through international competitive bidding for installation of the needed capacity.
- 4.6 For ENTEL, the telecommunications company, initial equity investment by the strategic investor will be required upon award. Future investment requirements by the company call for expansion of local and rural telephone service, as well as cellular networks in nine cities and public telephones throughout the country. To enforce the investment requirements there are a series of escalating monetary penalties, culminating in the revocation of the concession and forfeit of the equity investment made by the strategic investor.

C. Disbursement schedule

- 4.7 The first tranche of the loan that would be eligible to be disbursed upon board approval is for 20% of the total or US\$14,000,000. There will be three additional sector-specific, non-sequential, "floating" tranches, which will not have common conditionality among them other than the maintenance of a sound macroeconomic framework and compliance with the Letter of Development Policy. The conditionality for these tranches is expected to be fulfilled during 1996, with a final disbursement date of two years after the contract enters into force is proposed for full compliance with conditionality. These floating tranches are General Capitalization tranche for US\$14,000,000, the Hydrocarbons tranche for US\$28,000,000 and the Legal/Financial tranche of US\$14,000,000. All of the specific regulations required for tranche eligibility have been defined in the draft contracts and agreed upon with the Government.

D. First tranche - Conditions prior to Board approval

- 4.8 The conditions for Board presentation have all been met. Agreement on the timing and financing of the capitalization program was a condition of negotiations and (after discussion during the joint IDB/IDA mission in October, 1994) was reached in November, 1994 as part of the IMF/IDA discussions with the Government on the Policy Framework Paper for 1994-97. Conditions for Board presentation (first tranche release) include the maintenance of sound macroeconomic policies that are consistent with the objectives of

the program and compliance with the policy objectives and programs described in the Letter of Development Policy (Annex 1). Other conditions for Board presentation, which have been met, are:

- (a) Capitalization Program: (i) Passage by Congress of the Capitalization Law; (ii) Establishment of a structure to coordinate and direct the capitalization process and (iii) Agreement on a strategy to transfer partial ownership of key public enterprises to the Bolivian people.
- (b) Establishment of General Regulatory Framework: Passage by Congress of the SIRESE Regulatory Framework Law.
- (c) Taxation Regime: Passage by Congress of an amendment (Law 1606) to Tax Law 843 to establish a new corporate tax regime.
- (d) Restructuring and Capitalization of the Telecommunications Sector: (i) Presentation to Congress of a new Telecommunications Law; and (ii) Agreement on plan to recapitalize local service and capitalize ENTEL.
- (e) Restructuring and Capitalization of the Electricity Sector: (i) Passage by Congress of an Electricity Law; (ii) Hiring of financial advisors/investment bankers to prepare ENDE for capitalization; and (iii) Agreement on strategy to capitalize ENDE.
- (f) Restructuring and Capitalization of the Smelter/Mining Sector: (i) Agreement on a draft amendment to the Mining Law to increase the attractiveness of the sector to long-term investors; (ii) Agreement on a strategy to capitalize EMV and other mining assets; and (iii) Hiring of financial advisors/investment bankers to prepare EMV and other mining assets, for capitalization.
- (g) Restructuring and Capitalization of the Hydrocarbons Sector: (i) Agreement on a draft Hydrocarbons Law; (ii) Passage by Congress of an amendment to Tax Law 843 to establish a new tax regime for liquid fuels to restore price transparency and stimulate competition in downstream operations; and (iii) Agreement on principles for the capitalization of YPFB.
- (h) International Adjudication of Disputes: Congressional ratification of the 1958 U.N. New York Convention on the Recognition and Enforcement of International Arbitral Awards.

E. Floating tranches and conditions for approval

- 4.9 Release of any of the three floating tranches of the proposed loan would be conditional upon: the maintenance of a sound macroeconomic framework consistent with the objectives of the program; and compliance with the policy objectives and programs described in the Letter of Development Policy (Annex 1). Compliance with pertinent

audit conditions on prior disbursements will also be required at time of tranche release. In addition, each floating tranche release will be subject to meeting the respective conditions as summarized below and presented in Annex 2.

1. Floating tranche - General capitalization

4.10 The general capitalization tranche includes compliance with the following specific conditions:

- (a) Issuance of regulations for competitive bidding procedures for companies to be capitalized under the Capitalization Law.
- (b) Promulgation of key regulations for the SIRESE Regulatory Framework Law and appointment of the Superintendent General.
- (c) Promulgation of key regulations to implement the new corporate taxation system established in the amendment to Tax Law 843.
- (d) Passage by Congress of the new Telecommunications Law. Promulgation of key regulations to implement the Telecommunications Law, namely new tariff and interconnection structures. (¶ 2.14(a) and ¶ 2.14(b))
- (e) Government to invite bids for the capitalization of ENTEL. (¶ 2.14(c))
- (f) Establishment and staffing of the Superintendency of Telecommunications within SIRESE to award and supervise concessions and monitor compliance with regulations. (¶ 2.14(d))
- (g) Promulgation of key regulations to implement the Electricity Law. (¶ 2.18)
- (h) Establishment and staffing of the Superintendency of Electricity within SIRESE to award and supervise concessions and monitor compliance with regulations. (¶ 2.18)
- (i) Passage by Congress of an amendment to the Mining Law to increase the attractiveness of the sector to long-term investors. (¶ 2.22)

2. Floating tranche - Hydrocarbons sector

4.11 For the Hydrocarbons tranche disbursement the Government will have to comply with the following:

- (a) Passage by Congress of a new Hydrocarbons Law and promulgation of key regulations to implement this law. (¶ 2.11(a) and ¶ 2.11(b))

- (b) Promulgation of key regulations to implement the new excise taxes on petroleum products established in the amendment to Tax Law 843. (§ 2.11(c))
- (c) Establishment and staffing of regulatory and other agencies for the hydrocarbons sector to award and supervise concessions and monitor compliance with regulations. (§ 2.11(d))
- (d) Agreement on a strategy to capitalize YPFB. (§ 2.11(e))
- (e) Issuance of tender documents for capitalization of at least 30% of the book value of YPFB (excluding those parts of YPFB to be privatized). (§ 2.11)

3. Floating tranche - Financial/Legal sector

4.12 The Financial and Legal sector tranche disbursement will require the following:

- (a) Passage of the Securities Law and enactment of key regulations. (§ 2.48(a))
- (b) Strengthening of the Superintendency of Securities to supervise compliance with the Securities Law and regulations. (§ 2.48(b))
- (c) Establishment of non-contributory accounts for share distribution from capitalization. Promulgation of key regulations. (§ 2.51)
- (d) Establishment and staffing of a regulatory authority to supervise compliance with regulations. (§ 2.51)
- (e) Passage of the Insurance Law and enactment of key regulations. (§ 2.54(a))
- (f) Strengthening of the Superintendency of Insurance to supervise compliance with the Insurance Law and regulations. (§ 2.54(b))

F. Reimbursement of expenditures incurred prior to the loan agreement

4.13 Up to US\$14,000,000 of the resources of the loan may be used to compensate Bolivia for the cost of imports acquired within six months prior to the signature of the loan contract.

G. Procurement procedures

4.14 Bank Policy GP-116-4 requires that international public bidding shall be followed for public and private sector purchases in excess of US\$5 million. For lesser amounts, procurement by the public sector shall be done in accordance with the procedures established in local legislation insofar as such legislation is not inconsistent with the Banks procurement policy. The Bank has examined these procedures and found them acceptable.

H. Records, audit and control

- 4.15 For each disbursement, the borrower will provide documentation showing the goods imported during each period, the country of origin and the date and value of the transaction, so that expenses can be reimbursed by the Bank. For purposes of accounting and control of those transactions, the Borrower shall open a special account in the Central Bank, keep accounting records of the program, prepare and forward the application for disbursement, present listing of the transactions considered eligible and maintain all relevant supporting documentation.

I. Implementation support - IDA technical assistance programs

- 4.16 The IDA is accompanying the Capitalization Program with three sector-specific technical assistance operations in the Power, Hydrocarbons and Financial sectors, which will complement and facilitate the implementation of many of the reforms being undertaken.

1. IDA power sector technical assistance

- 4.17 The power sector technical assistance project for approximately US\$12.6 million will be financed by an IDA credit of the equivalent of US\$7.9 million with cofinancing of the remainder from Japanese grant funds and local government contribution. The project will help carry out the power sector reform, capitalization of the state-owned utilities, and regulatory and environmental institution building aimed at ensuring efficient competition and private participation in the sector. The project will support (a) the preparation of the regulations needed to implement the reforms of the new Electricity Law, and establishing and developing the expertise of the regulatory agencies already created under the new Law; (b) the investments needed to maintain the integrity of the electricity service, as well as the reorganization and streamlining costs to be incurred during the reform transition period; and (c) the capitalization of the Government-owned power utilities by (i) assessing options and developing a final capitalization strategy; and (ii) preparing, bidding, and final capitalization and divestiture of the utilities.
- 4.18 The project will consist of: (a) the preparation and execution of Action Plans by a Project Executing Unit staffed with senior local professionals, assisted by consulting firms to: (i) draft, and help approve the Regulations of the Electricity Law; (ii) carry out the legal and regulatory reforms of the power sector - creating the regulatory agencies as stipulated in the Law, and training the staff of the regulatory agencies in the areas of policy making, regulatory, planning, pricing, and establishing environmental regulations; and (iii) assess the environmental and safety liabilities of the sector in general and of the Government-owned power utilities in particular and develop sectoral safety and environmental norms; (b) the implementation of key actions and

investments during the reform transition period required to maintain the reliability and quality of the electricity service, and the reorganization program required to streamline the utilities prior to their capitalization; and (c) the carrying out of the capitalization of the utilities by helping to (i) assess the various options and develop a strategy to unbundle, audit, value and prepare for the utilities for capitalization and divestment with the assistance of a management consultant; and (ii) promote and effect the divestment of the power utilities with the assistance of an investment banker.

## 2. IDA hydrocarbons sector technical assistance

- 4.19 This project for approximately US\$13.8 million (equivalent of US\$11 million from IDA) is in the most advanced stage of processing of the three technical assistance loans. Its objectives are to assist the Government in the analysis, planning, design and execution of: (i) its reform program for the hydrocarbon sector, including the strengthening of the institutions which will be monitoring and regulating the sector; and (ii) the capitalization of YPF. The Project reflects the findings of a diagnosis carried out in February/March 1993, as well as a number of subsequent studies carried out during project preparation. The project is expected to be completed in about 4 years.
- 4.20 The proposed project will include three components for: (i) analytical studies and preliminary activities for the design of the overall legal and regulatory framework for the reform of, and future development in the sector; (ii) YPF's pre-capitalization analytical studies and preliminary activities and preparation for the capitalization of mixed-economy corporations; and (iii) strengthening of the capacity of the National Secretary of Energy (NSoE) to carry out the reform and monitor the sector.
- 4.21 This last component will provide support to DGH for preparatory activities leading to the design and establishment of a new financially independent entity responsible for Exploration and Production (E&P) policies formulation, investment promotion, negotiations with oil and gas companies of concessions and other contracts; administering a Data Bank Unit; enforcing technical and safety standards and norms; monitoring concessions, and operation contracts to ensure compliance of obligations of contractors and strategic partners with regard to minimum investments and training obligations. It will include design of appropriate organizational structures, including initial staffing and start-up needs for: (i) the unit managing the data bank; (ii) the Environmental Unit to be established to monitor activities in the sector and enforce compliance with environmental regulations; and (iii) the Superintendency of Hydrocarbons (SHC) to be established to ensure compliance with already enacted Sistema de Regulación Sectorial (SIRESE) Law and the future Hydrocarbons Law as well as the respective regulations implementing these two laws. In addition, an E&P promotion campaign will be launched to attract private

foreign investment in this area; and training will be provided to NSoE personnel for the staffing of the units referred to above and enforcement of technical, safety and environmental regulations, implementation of promotional campaign, contract negotiations and management, and in general, monitoring all activities in the sector. The credit will finance the acquisition of office and related equipment and material, computers and software.

3. IDA financial sector technical assistance

- 4.22 The technical assistance for the financial sector of approximately US\$13 million is designed to assist in the areas of pension reform, design and implementation of the capitalization distribution system, securities regulation, insurance regulation and supervision, the superintendency of banks and credit administration in the Ministry of Finance.
- 4.23 In the area of pensions the technical assistance would be focused on the (i) establishment of the regulatory structure for the system of individual capitalization pension and deferred-distribution accounts; (ii) assisting in the development of regulatory norms; (iii) design of computerization, regulatory procedures and staffing for the Superintendency of Pensions within SIRESE; and (iv) computerization of the Government's basic pension fund (FOPEBA). For distribution, the credit would provide for the further design of the system, acceleration of the registry system, a public information campaign and office equipment.
- 4.24 The securities component would provide for the strengthening of legislation, review and improvement of Superintendency of Securities rulings, institutional restructuring of the Comisión Nacional de Valores (CNV), upgrading of supervision and inspection procedures, market development and promotion, information systems and training.
- 4.25 Insurance regulation and supervision will be strengthened by an institutional assessment of the Superintendencia Nacional de Seguros y Reaseguros (SNSR), strengthening of off-site analysis, inspection strengthening, establishment of control systems for reinsurance, a capital requirements assessment, public awareness campaign, strengthen of local licensing, and training in insurance techniques school.
- 4.26 The Superintendency of Banks would receive support for strengthening human resources, amendments to the Banking Law, development of norms, update of operational guidelines, and strengthening of information systems. Also, office equipment would be provided for the operation of the Project Unit of the Ministry of Finance.

## V. PROGRAM FEASIBILITY AND RISKS

### A. Justification

- 5.1 The Government's reform program to date has largely succeeded in putting the economy on a positive growth path. Recent economic and sector work has reinforced the conclusion that maintaining economic growth in Bolivia will require a "second generation" of structural reforms. Given that the reforms undertaken thus far have not tackled the large and inefficient monopolistic public enterprises, the proposed second stage of adjustment is aimed at: (i) increasing the efficiency of enterprises operating in key productive sectors, particularly by transferring ownership to the private sector; (ii) attracting private investment; and (iii) freeing public resources for basic infrastructure and social sector investment. An essential element of this program is a reform package to improve the Government's ability to set policy and regulate appropriately. It has long been recognized that these reforms were necessary and the current Government is fully committed to launching them. The proposed loan would provide financial support to implement the reform program.
- 5.2 The proposed operation has been studied by various IDA specialized sectorial teams and by the Bank project team. The proposed adjustment operation will support establishing an appropriate enabling environment so that: (i) private investment is forthcoming as the Government withdraws from these sectors; (ii) such investment spurs growth in an efficient manner; and (iii) competition is promoted wherever possible. The Administration recommends the approval of the proposed operation as necessary and appropriate support for the required reforms being carried out by the Bolivian government.

### B. Economic impact and benefits

#### 1. Impact on Poverty and Incomes

- 5.3 Although not a "Poverty Target Investment", the program supported by the proposed operation is expected to lead to sustained economic growth, and hence, have a positive impact on real per capita income for all Bolivians. In addition, one of the primary objectives of the proposed Credit is to support the reorientation of the State's role away from direct ownership and investment in the productive sector. As a result, public resources will be freed for increasing public services, including improving the provision of essential social services for the poor. Furthermore, the capitalization program itself implies a massive redistribution of income by transferring the State's ownership share of major state enterprises to all adult Bolivians. Also, the proceeds from the privatization of small and medium public enterprises (US\$12 million to date) are being allocated towards social projects. Finally, certain legal

reforms supported by the program will directly benefit small enterprises. For example, the enactment of a secured transactions law will encourage credit expansion to small entrepreneurs through loans made on the basis of movable assets.

## 2. Budgetary Impact

- 5.4 The policies supported by this Credit will improve the fiscal posture of the public sector over the long-term by sustaining growth and expanding the tax base. However, in the short-term, the adverse fiscal impacts of the reform program include: (i) revenue shortfalls as direct transfers from the public enterprises to the Treasury are replaced by deregulated prices and new tax regimes designed to ensure competition in all sectors; (ii) costs of severance payments, unfunded obligations, and some of the external debt of enterprises being capitalized; and (iii) transactions costs and technical assistance costs associated with implementing this reform package.
- 5.5 The total cost of these reforms has been estimated at approximately 2.8% of GDP per year for the next three years. While the proposed Bank loan and IDA credit will partly cover the short-term effects of these policy reforms, additional domestic and external financing will be required. To finance the gap, the Government will pass part of the short-term costs--debt service and, to the extent possible, severance payments--to the new investors. In addition, an amendment to the Tax Law passed in December 1994 is expected to raise revenues through such measures as an increased transactions tax and the introduction of a corporate income tax and excise taxes on petroleum products. It is anticipated that the combination of these fiscal measures, the Bank loan, the IDA Credit and other committed external resources will finance the gap. In the course of the PFP negotiations, agreement was reached between the Government, IDA and the IMF on the timing and financing of the costs of the capitalization program. And, in its Letter of Development Policy, the Government has committed itself to adopt all fiscal measures necessary to ensure that the reform program can be implemented within the annual fiscal program.
- 5.6 The economic benefits of the policies supported by this credit are substantial. Comprehensive reform and the development of an appropriate regulatory framework for the hydrocarbons, telecommunications, electricity and mining sectors will encourage private investment and technology transfer. These reforms--especially accelerated development of Bolivia's hydrocarbons resources--should have an important impact on GDP growth. They are also expected to free up a substantial portion of the Government's annual budget to reduce the current deficit and to invest in human capital and basic infrastructure. The legal reforms aimed at promoting efficient methods of dispute resolution, such as the ratification of the New York convention on International Arbitration, should have a positive effect on private sector investment in general.

C. Principal risks of the operation

- 5.7 Despite the measures being taken in the environmental assessment of this operation, particularly in the mining sector, the social problems related to the development of alternative sources of employment for independent miners and members of cooperatives, if not properly addressed, could result in additional risks and delays in the capitalization process. Within the context of the environmental preparation of the Program, the Bank has provided consultants to outline the scope of a Plan for Social Development and Rehabilitation in the mining region. Currently the Bank is processing a technical cooperation for US\$200,000 to provide consultants to help the task force that has been established in the "Secretaria de Minería" develop the Plan and will continue to pursue available options to assist the Governemnt in the implementation of the Plan.
- 5.8 Also, although the activities planned for each sector include adequate provisions for remedying the current situation, the absence of clear and proper existing environmental emissions standards for the sectors to be capitalized, may cause difficulties for bidders in accepting the provisional standards, uncertainties in assessing the related costs for compliance with regulations and delay the bidding process. Furthermore, if the liabilities of the existing pollution stock and pollution flows in the facilities to be capitalized are not properly identified before the bidding process, the results could not meet expectations.
- 5.9 The financial crisis affecting Latin America which began in December, 1994 has limited the normal flows of private capital into Bolivia. The planned privatization (via an international public stock offering) of the electric company of the city of Cochabamba (ELFEC) was canceled and replaced with a directly-negotiated sale. There could be delays in the accompanying privatization program, but the main Capitalization Program should remain on schedule. It is expected that the offering prices by the strategic investors for the capitalized companies could be somewhat less than what might have been realized last year. However, the magnitude of the reduction is such that it is not seen to justify delaying the Capitalization process. The benefits of prompt implementation of the Program should outweigh any possible increases in offers by the strategic investors by delaying the process.
- 5.10 The main risk is that vested interests may seek to undermine the content and timing of the reform program if they see themselves as being adversely affected. Second, if necessary legislation is significantly weakened before passage by Congress, then the private sector will continue to withhold investment resources. Finally, the operation involves a complex set of legislative and regulatory reforms that must be carefully sequenced to secure the desired outcome.

- 5.11 Weak implementation capacity is another risk which several IDB and IDA technical assistance operations seek to mitigate. Achievements thus far and up-front conditionality are designed to mitigate a risk of failure; however, non-compliance in a single area might derail the disbursement of credit tranches. The proposal to divide the second tranche into three floating tranches to be disbursed as soon as their specific conditions are met is designed to partially provide for these eventualities and avoid stalling the entire program if certain difficult and important reforms are delayed in a given sector.

**BOLIVIA****CAPITALIZATION PROGRAM ADJUSTMENT CREDIT****LETTER OF DEVELOPMENT POLICY**

Mr. Lewis Preston  
President  
International Development Association  
1818 H Street NW  
Washington, DC 20433  
USA

March 27, 1995

Mr. Enrique Iglesias  
President  
Inter-American Development Bank  
1300 New York Avenue NW  
Washington, DC 20577  
USA

Dear Mr. Preston and Mr. Iglesias:

1. The Government of Bolivia hereby requests a credit from the International Development Association (IDA) and a loan from the Inter-American Development Bank to support further implementation of its structural reform program. Previous phases of the program have begun the process of public enterprise reform including privatizing some small and medium enterprises, restoring the integrity of the banking system and the initial development of capital markets. The principal theme of the present operation is support for the capitalization of a number of major public enterprises through the program described in the Government's Plan de Todos. In addition, the operation would further ease constraints to private sector development by strengthening the regulatory framework and improving the efficiency of financial markets. At the same time, the Government institutions for policy formulation and implementation will be strengthened to ensure that the program can be carried out in a timely and efficient manner.

2. The assistance requested is needed to finance imports that would release counterpart funds which would be used to finance partially the costs of adjustment associated with the proposed reform program. These include, in particular: (i) costs of severance payments, unfunded pension obligations, environmental liabilities and some debt obligations of enterprises to be capitalized; (ii) compensation for short-term revenue shortfalls as direct government transfers from key public enterprises are substituted by a tax-based system; (iii) technical assistance costs associated with implementing the program of reform described herein; and (iv) incremental costs associated with the pension reform program that may be incurred during the life of this program.

**I. The Macroeconomic Reform Program**

3. Since 1985, Bolivia has adopted a far-reaching economic program aimed at restoring price stability and structurally reforming the economy in order to achieve sustainable growth. The program has been supported by arrangements under the Enhanced Structural Adjustment Facility of the

International Monetary Fund (IMF) and by adjustment credits and other assistance from the International Development Association, the Inter-American Development Bank, and bilateral donors. The program has improved macroeconomic stability. Its impact on economic growth has been less effective--real GDP growth averaged 2.7% in 1987-89--partially due to large and inefficient public sector presence in key sectors which has restricted private sector access and private investment. However, since 1990, real GDP growth has accelerated, averaging 4%, and there have been significant increases in per capita GDP. The Government maintains its strong commitment to the structural reform program and intends to accelerate its implementation to further reduce constraints to private investment.

4. The underpinnings of the program for 1994-97 are stated in the Economic Policy Framework Paper prepared by the Government in collaboration with the staffs of the IMF and IDA in October 1994. The program for 1994-97 aims at an average annual growth of real GDP of at least 4.5 percent, a reduction in inflation to industrial country levels, and continued progress toward viability in the balance of payments. The program also includes as integral elements an improvement in the efficiency of the public sector, the development of human capital, the alleviation of poverty, and the conservation of the country's ecological balance. Our Government will continue to support key policies to achieve these goals, including: (i) maintenance of macroeconomic stability through prudent fiscal and monetary management; (ii) maintenance of market determined pricing policies, including the exchange rate and interest rates; (iii) elimination of barriers to entry in key economic sectors; (iv) consolidation of the structural reform program initiated in 1985, including an acceleration of public enterprise reform and private sector development efforts; (v) increasing the supply of basic economic infrastructure and other public goods; and (vi) designing well-targeted social programs to increase services to Bolivia's poorest groups.

5. The achievement of this program will depend largely on the successful implementation of the capitalization program. This program will be implemented in the context of a prudent fiscal management and complemented by an enabling legal and regulatory environment which encourages both foreign and domestic investment. In this context, the reforms supported by the proposed adjustment operation are critical to sustain growth.

6. These reforms will improve the fiscal posture of the public sector over the long-term by sustaining growth and expanding the tax base. However, in the short-term, the adverse fiscal impacts of the reform program include: (i) revenue shortfalls as direct transfers from the public enterprises to the Treasury are replaced by deregulated prices and new tax regimes designed to ensure competition in all sectors; (ii) costs of severance payments, unfunded obligations (e.g. pensions), and some of the external debt of enterprises being capitalized; and (iii) transactions costs and technical assistance costs associated with implementing this reform package.

7. The total cost of these reforms has been estimated at approximately 2.8 percent of GDP per year for the next three years. During negotiations of the PFP, we reached agreement with IDA and the IMF on the timing and financing of the costs of the capitalization program. In order to minimize the costs to the extent possible, the Government will pass part of the short-term costs--debt service and, to the extent possible, severance payments--to the new investors. The Government will adopt all fiscal measures necessary to insure that the reform program--particularly in the hydrocarbons and pension systems--can be implemented within the annual fiscal program. In addition, an amendment to the Tax Law passed in December 1994 will raise revenues through such measures as an increased transactions tax and the introduction of a corporate income tax and excise taxes on petroleum products.

8. As a result of this program, we expect to increase private sector participation in key sectors of the economy and improve the Government's ability to set policy and regulate. This will include restructuring and capitalizing the hydrocarbons, telecommunications, electricity, mining/smelting and transport sectors, which will have a critical impact on income growth, employment and revenues. In December 1994, the Bolivian Congress passed an amendment to the Tax Law which reformed the tax system to provide a uniform and stable tax environment applicable also to the major public enterprises that will be capitalized. Except for royalties, the revised tax law eliminates existing special regimes for the hydrocarbons, electricity and mining sectors. The tax on business net worth (IRPE) was replaced by a uniform corporate income tax of 25 percent, to be applied on a wider base including independent professional activities and most other non-wage income. The current efforts to improve the efficiency of tax administration will continue with technical assistance from the IMF and the IDB. Regulations to the amendment will be promulgated to cover the following subjects: (i) the level of excise taxes applicable to petroleum taxes; (ii) deductions under Article 47 (2) of the law for purposes of the corporate income tax; and (iii) collection procedures for this tax.

9. To further reduce the role of the State and increase its efficiency, we will undertake a reform of the pension fund system. To complement the pension fund reform and develop financial markets, we will define a legal framework for securities markets and undertake reforms in the insurance sector. To improve our efficiency to conduct monetary policy and to ensure stability in the financial system, Central Bank reform will be undertaken. To remove barriers to entry and to improve the climate for efficient expansion of the private sector, we will also begin to overhaul the civil and commercial legal systems.

## **II. Capitalization and Public Enterprise Reform**

### **The Capitalization Program**

10. The Government's capitalization program is a bold initiative and the centerpiece of the Government's reform agenda. The Capitalization Law, passed by Congress in March 1994, authorizes the capitalization of five public enterprises<sup>1</sup>. It states that the Government will: (i) transfer the management control and up to 50% of the ownership of the new private enterprises derived from these public enterprises to strategic investors; (ii) require private investors not to buy existing assets, but rather to invest in the company itself, increasing the capital of the company by the purchase price of the new shares and providing it with liquidity for new investments for expansion; and (iii) transfer the shares corresponding to the State's present ownership to all adult Bolivians. These shares will not be given directly to Bolivians, but be transferred to individual deferred distribution accounts within privately-managed pension funds until withdrawal. The mechanics of this system will be specified in other legislation and regulations. This law also states that regulatory responsibility for the communications, power, hydrocarbons and transport sector will be vested at the national rather than the municipal level.

11. From the moment of capitalization of each company until these new private pension funds are established, the Bolivian people's shares will be transferred to a trust managed by an international trustee and global custodian. This trustee will transfer the shares to the privately managed pension funds for individual accounts. These accounts will be distributed amongst pension funds on a competitive basis.

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The Law specifically mentions YPFB, ENDE, ENTEL, ENFE and EMV. Since the national airline, LAB, is a mixed public/private corporation, it does not require any legal transformation prior to capitalization and thus, is not explicitly mentioned in this law.

12. The establishment of a structure to coordinate and direct the capitalization process has been accomplished. The Government has established a Ministry for Capitalization which is authorized to manage the process of sector reform, capitalization and share distribution to the Bolivian people. A working group composed of Government representatives and sector experts has been established for each of the six sectors involved to draft the necessary legislation and regulations, devise the capitalization strategy for the enterprise involved and help implement the strategy. Working groups have also been established to implement financial sector reforms. Substantial progress has been made on designing a strategy to transfer the state's ownership of key public enterprises to the Bolivian people. In addition, the recently introduced System of Sectoral Regulation (SIRESE) Law establishes a regulatory framework for the electricity, telecommunications, hydrocarbons and transport sectors, including the establishment of independent regulators and the elaboration of certain cross-sectoral regulatory norms. (See Section III on the proposed regulatory framework.)

### **The Hydrocarbons Sector**

13. Background: The hydrocarbons sector provides about 40 percent of Government revenues and 10 percent of export revenues. Although the 1990 Hydrocarbons Law expanded possibilities for private sector involvement in the sector, the response has been poor. We estimate that between 1994 and 2000, US\$700 million will be required for investment in exploration and development alone - an amount well beyond public sector capacity.

14. General Objectives: On the basis of the Plan de Todos, the Government has established clear objectives for the sector to: (i) maximize long term economic benefits of Bolivia from all activities of the sector; (ii) eliminate YPF's monopoly position and to foster competition; (iii) capitalize YPF; (iv) define clearly the role of the Government in the sector; (v) ensure that revenues and hard currency earnings continue to flow from the hydrocarbons sector; (vi) attract substantial private sector investments in all phases of the sector, particularly for exploration and production; (vii) to promote greater effectiveness and efficiency throughout the sector; (viii) protect consumers through effective regulation; and (ix) protect the environment from damage that could be caused by petroleum operations. To achieve these objectives, we are proposing a number of strategic actions.

15. Laws and Regulations and Petroleum Products Price Deregulation: The Government intends to prepare legislation, regulations and guidelines for contracts which are competitive in fiscal and other aspects with those of neighboring countries. The Government intends to present to the National Congress a new Hydrocarbons Law by August 1995, and it is expected that the law will be enacted shortly thereafter. In particular, said law will include: (i) the right of free disposition, export and import of crude oil, petroleum products and natural gas; (ii) rationalization of taxation on upstream operations and petroleum products, other than those established in Law 843, amended by Law 1606; (iii) deregulation of petroleum products prices; (iv) introduction of more flexibility on contractual arrangements for exploration, production and transport by pipeline; (v) establishment of an appropriate institutional mechanism with sufficient independence and autonomy to promote exploration investments, negotiate exploration and production contracts, manage the data bank, fulfill obligations of the state vis-a-vis the operating companies and control their compliance with contractual obligations, in accordance with international practices and standards; (vi) the jurisdiction of the Superintendent for Hydrocarbons within SIRESE, the multisectoral regulatory framework;<sup>2</sup> (vii) introduction of regulatory provisions for ensuring

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<sup>2/</sup> These responsibilities would include, among others, the regulation of natural gas distribution, supervision of access obligations to pipelines and enforcement of anti-trust rules.

open third party access to gas, oil and products pipelines, with tariffs based upon common carrier principles; (viii) elimination of direct and indirect barriers to entry in the downstream hydrocarbons activities; and (ix) provisions enabling the capitalization of YPFB. Given the importance of revenues from this sector, these changes, in particular those related to the deregulation of prices, will be designed so that they will either be revenue neutral or increase resources to the Treasury over the medium term.

16. Immediately after enactment of the law, work on implementing regulations to the law will proceed. These will be promulgated during 1995 and will cover the following subjects: (i) the process for awarding exploration areas (ii) pipeline rights of way, access and tariffs; (iii) environmental, technical and safety standards and norms; (iv) definition of institutional arrangement for granting and monitoring of existing and future contracts for exploration and production; and (v) taxation of upstream production. As mentioned earlier, the Congress has passed an amendment to Law 843 that establishes a new tax regime for petroleum product prices and key regulations will be issued shortly.

17. Institutional and Regulatory Framework: In addition, the Government intends to staff and put into operation the Superintendency of Hydrocarbons within SIRESE and other agencies to award and supervise concessions and monitor compliance with regulations. This will include the following actions to be taken by early 1996: (i) appointment of the Hydrocarbons Superintendent and head of any other relevant agency; (ii) the start of technical assistance activities; (iii) hiring of key staff; and (iv) definition of action plans for implementation of organizational and administrative policies. In addition, the Government plans to: (i) strengthen the implementation capacity of the Secretaria Nacional de Energia to monitor all activities in the sector and supervise environmental aspects of the sector activities in coordination with the Ministerio de Desarrollo Sostenible y Medio Ambiente; (ii) strengthen the Secretaria Nacional de Hacienda to implement the new taxation regime and collect taxes; and (iii) strengthen the Secretaria Nacional de Recursos Naturales y Medio Ambiente to undertake all necessary actions and enforce legislation to protect the environment and mitigate any environmental damages that may be identified by in-depth environment audits of YPFB operations.

18. YPFB Capitalization: With respect to YPFB, the Government intends to implement the capitalization and participation program which it has announced in its Plan de Todos. Important objectives that are being taken into consideration in designing YPFB's capitalization strategy include the new company or companies' ability to: (i) attract investment capital, technology and managerial skills; (ii) increase shareholder value; and (iii) gain a competitive position in the regional gas market. Another critical factor will be to organize the new company/companies in a way that reduces concerns over the misuse of market power to the detriment of domestic consumers. The Government has agreed that the resulting private company or companies will compete on an equal basis in all areas of the sector and that all exploration acreage not retained by the capitalized YPFB will be opened to exploration by private companies. The Government will maintain its rights under the existing operations contracts, and thereby revenues will continue to flow to the Treasury. The mechanisms for collection of these revenues as well as administration of the contracts have yet to be defined.

### **The Telecommunications Sector**

19. Background: The Bolivian telecommunications sector has low telephone density, poor quality of service, low rates of growth, and a lack of an adequate regulatory framework. Key indicators of the state of the sector reveal the need for significant improvement. Telephone density of less than 4 telephones per 100 inhabitants places Bolivia in the bottom rank of Latin American countries. Unsatisfied demand for telephone service is approximately 50% of existing access lines in service. Further

development of telephone service is significantly limited by the high subscription charge of more than US\$1,500. To maintain and begin the expansion of Bolivia's telephone service will require an investment of more than US\$600 million during the next decade, concentrated almost entirely in the local service network. The Government is proposing a major reform of the sector and has developed a policy framework along the following lines.

20. General Objectives: We believe there is an urgent necessity to develop the telecommunications sector as an essential agent of economic and social development. Private capital must be invested in the sector in order to provide better and more services to the population. Further, to properly regulate the sector, the state shall not participate in the direct provision of services, except for essential emergency services. This can best be achieved by stimulating fair and open competition for the provision of telecommunications services among a group of private agents, working within a framework of effective regulation.

21. New Telecommunications Law: The Government has prepared a new telecommunications law which it expects Congress to pass by the second quarter of 1995. New regulations for the sector will be issued not more than 90 days after its passage. The law will define the responsibilities of the Superintendency of Telecommunications within SIRESE. The primary form of regulation and authorization for the operation of a public telecommunications network will be by means of concessions. The Superintendency will represent the Government in negotiations with concessionaires. Concession agreements will contain the obligations and rights of concessionaires in the provision of a public service, and especially will establish obligations with respect to coverage in urban areas, the provision of public telephones and extension of service to rural zones. The Superintendency will apply sanctions, including possible termination of the concession, if the concessionaires do not meet the obligations and requirements of the concession agreement.

22. The regulatory agency will define the number and area of concessions based on economic factors, the efficiency of service, the promotion of regional development and the efficient interconnection of operators. Where there is no competition, tariffs will be regulated by the Superintendency using methods which incorporate an automatic adjustment formula. Initial tariffs during the transition period will be calculated based on the cost for each class of service, and considering a reasonable profit margin. Adjustments will be based on price cap methodology. The Law envisages obligatory interconnection of public telecommunications networks, in a way which will permit equal and nondiscriminatory interconnection.

23. The spirit of the Law is the promotion of competition in the supply of telecommunications services. With the effective growth of competition in the sector, the necessity for regulation will gradually disappear until finally competition will freely determine the variety, quality and price of telecommunications services. However, to attract sizeable new investment for capitalization of ENTEL and the sector, the law will establish a transition period of about five years during which ENTEL S.A. will be the only authorized provider of long distance and international basic voice services. In addition, during this transition, existing cooperatives will be allowed to expand their service within their concessions areas or to merge with other concessionaires, but no new operators will be permitted to enter the local voice service market. All other services such as cellular, wireless, leased private lines, data transmission and other value added services will be open to competition. ENTEL S.A. will be able to compete in these markets as well as in the provision of local voice services. The purpose of the transition period is to give ENTEL S.A. the opportunity to make necessary adjustments under the new structure, the new regulatory framework, and earn a reasonable return on their new obligations.

24. ENTEL S.A. will have the obligation to offer telecommunications services to rural areas, including those that are now being provided by ENTEL and DITER, either directly or through their specialized subsidiaries. The levels of coverage, maintenance, quality of service, areas of operation and sanctions will be specified in each concession agreement. Regulations to the Telecommunications Law are expected to be issued within three months of passage of the law and will cover: (i) procedures and formulae for tariff adjustment; and (ii) rules for interconnection (technical standards and access charges).

25. Institutional and Regulatory Framework: The Government intends to staff and put into operation the Superintendency of Telecommunications within SIRESE, including the following actions to be taken within 90 days of passage of the Telecommunications Law: (i) appointment of the Telecommunications Superintendent; (ii) the start of technical assistance activities in support of the Superintendency; and within 90 days of the Superintendent's appointment (iii) hiring of key staff for the Superintendency; and (iv) definition of an action plan for implementation of organizational and administrative policies.

26. Transformation and Capitalization of ENTEL : The Government proposes the capitalization of ENTEL and interested local cooperatives. The Government intends to form a corporation, ENTEL S.A.M., by combining ENTEL and workers' shares. Then, it intends to invite bids for its capitalization through a national concession of both local and long distance service, by mid-1995. This concession will entail investment and quality of service obligations, to increase the number of telephone lines in the country and improve service to customers. The cooperatives that decide not to join the capitalization program (or those that decide to form joint ventures with other companies) will continue to have a non-exclusive concession contract for local service in their respective areas.

### **The Electricity Sector**

27. Background: Traditionally the Bolivian power sector has provided a technically reliable service. Its legal and institutional framework, however, has induced economic inefficiencies and financial and operational constraints characterized by four fundamental problems: (i) a weak regulatory system; (ii) lack of incentives for generation and distribution companies to improve efficiency; (iii) distorted tariffs which do not reflect the cost of providing service at the regional level nor at the level of final users; and (iv) the absence of competition and a lack of incentives to encourage private investment.

28. General Objectives: The principal objective in the electricity sector is to provide an economic and reliable service to the greatest number of consumers, with the minimum of government intervention, and due regard to the environment. This objective will be reached by promoting quality and efficiency through competition and autonomous effective regulation, and attracting new sources of private capital to support its development. To address the sector problems, and achieve a level of efficiency necessary to support the economic and social development of the country, the Government proposes to undertake a sectoral restructuring strategy. This will include the passage of a new Electricity Law and accompanying regulations and the capitalization of the Empresa Nacional de Electricidad, ENDE.

29. New Electricity Law: In December 1994, Congress passed a new Electricity Law which includes provisions for: (i) the definition of the responsibilities of the Superintendent of Electricity within SIRESE to be funded by the sector; (ii) national level regulatory functions which will include managing the process for the selection of concessionaires, monitoring concessions and setting of tariffs; (iii) only for the utilities which are integrated to the National Interconnected System, the separation of generation,

transmission and distribution functions into different companies and including a prohibition on cross-ownership; (iv) open access to transmission; and (v) promotion of efficient competition wherever possible and for future investment needs following the transition period to be supplied by the private sector. Regulations of this law are expected to be issued by mid-1995. Key regulations will cover: (i) quality of service norms; (ii) clear and specific rules for tariff-setting; (iii) economic dispatch of the power system; and (iv) the conditions for granting concessions and licenses, and monitoring performance standards.

30. Institutional and Regulatory Framework: The Government intends to staff and put into operation the Superintendency of Electricity within SIRESE, including the following actions to be taken by end-June: (i) appointment of the Electricity Superintendent; (ii) the start of technical assistance activities in support of the Superintendency; and by end-September: (iii) appointment of key staff for the Superintendency; and (iv) definition of an action plan for implementation of organizational and administrative policies.

31. Transition Period: During the implementation of the structural, ownership and regulatory reform of the sector the Government will ensure that ENDE: (i) maintains the reliability and quality of its service; (ii) continues the implementation of ongoing investments, initiates those justified investments which are fully financed, and discontinues those which are unjustified or inviable; and (iii) takes all necessary steps required to adapt to the new law. The Minister of Capitalization in conjunction with the National Secretary of Energy has formed a task force which prepared the law, facilitated its enactment by Congress, and is now preparing the law's regulations and helping to implement the capitalization of ENDE.

32. Capitalization of Sector Utilities: The Ministry of Capitalization is implementing the capitalization strategy for each entity as follows:

- Capitalization of ENDE: The Government intends to capitalize ENDE so that its assets are integrated to the National Interconnected System in such a manner as to foster competition among private generation suppliers in the future and ensure open access to the grid. ENDE's generation and transmission assets will be separated into different companies and capitalized separately. The resulting ENDE-Generation will be further divided into three generation companies to be capitalized so that new investment in the sector spurs efficient competition rather than the creation of a stronger quasi-monopoly. The Isolated Systems of ENDE will be corporatized and privatized separately. The proposed sector reform will require creating a load dispatch committee which all generating and distribution companies that intend to be connected to the grid must join. The unbundling of ENDE into generation and transmission companies is expected to be completed during April 1995 and their capitalization by June 1995. The Government has retained the services of an international investment bank to assist in the capitalization process.
- Divestiture of Regional Distribution Systems: ENDE's 70% shareholding in ELFEC will be floated in local and foreign markets during the second quarter of 1995; the Government has contracted an international investment bank to act as lead manager and coordinator of the flotation. The strategy for divestiture of ENDE's holdings in SEPSA and CESSA will be determined by April 1995.

## The Mining Sector

33. Background: The role of mining in the Bolivian economy has been diminishing steadily since the mid-1980s. While falling world mineral prices have contributed to this decline, COMIBOL's past poor management, continued operation of non-profitable mines and serious overstaffing have contributed to huge losses. In addition, lack of stability in certain government tax and leasing policies related to the mining sector place Bolivia at a comparative disadvantage to other countries when trying to attract investors. Between 1986 and 1994, the Government undertook a program of rationalization of COMIBOL's, drastically reducing excess personnel and resulting in the elimination of non-viable mining operations.

34. General Objectives: The strategy for the mining sector will aim at achieving economically sustainable growth and high international competitiveness based on private sector investment. To achieve this objective, the Government will eliminate the remaining barriers to entry into the sector and provide instruments that ensure stability to the mining investors. COMIBOL is being turned into a profitable entity which will generate income for the State. Having closed all unprofitable operations, COMIBOL will limit its role to managing a portfolio of properties and state participation in the sector, by transferring to the private sector through joint ventures or other mechanisms the operational and management responsibilities for all potentially profitable operations.

35. We will continue to support the modernization and strengthening of the sector institutions in order to provide the mining industry with secure and timely issuance and administration of mining rights, and with a modern and reliable technical data base and geologic infrastructure. In addition, in order to transform small scale mining into an economically sustainable activity, it must continue to be subjected to the rigor of the market.

36. We will also take actions to mitigate the negative environmental impact of existing mining operations and minimize the impact of all new investments. The elimination of unsafe conditions and acts in the work place will also be a priority. To this effect, the Government will establish standards and strengthen the Ministerio de Desarrollo Sostenible y Medio Ambiente as well as the environmental office within the Mining Secretariat to ensure follow-up and compliance with norms and standards.

37. Amendment to the Mining Law: This amendment is expected to include the following provisions to increase the attractiveness of the sector to long-term investors: (i) define the role of COMIBOL as the manager of state mining assets and derogate laws which specified its role as that of an operating mining company; (ii) permit mining leases that exceed 10 years; (iii) introduce the option of tax stability for investors which enables investors to choose between adjusting to prevailing tax conditions or subscribing to a contract with fixed tax terms; (iv) eliminate the obsolete, optional royalty, presently operating concurrently with the result-based taxation system; (v) improve mining rights administration; (vi) define the attributions and responsibilities of sector institutions to facilitate their modernization, improve their administration and maintain a reliable data base; and (vii) update the existing environmental provisions to be consistent with government policy. We expect to present this draft to Congress by June 1995 and secure passage shortly thereafter.

38. Capitalization in the Mining Sector: The Bolivian Constitution provides that none of the assets nationalized in 1952 can be transferred outside of COMIBOL. Consequently, COMIBOL cannot be subject to the capitalization scheme, and the participation of private investment in the operations of COMIBOL will be achieved through joint ventures, leases and other mechanisms. However, since the

Vinto smelter was not nationalized in 1952, the public enterprise smelting company, EMV, is not subject to the above limitation and will be capitalized.

39. The presentation of a package that will ensure adequate long-term supply of raw material to the Vinto smelter, in addition to the smelter itself, will substantially increase the attractiveness of EMV to potential investors. To this effect, the Government intends to submit a package including the Vinto smelter and a number of mines from COMIBOL. EMV would be capitalized in the amount agreed for the smelter, and the mines would be leased to the newly capitalized EMV. In principle, the Huanuni mine, and possibly the Colquiri mine, would be considered for inclusion in such package. The final definition of the package of options will be made based on the recommendations of technical consultants who will also prepare the valuation of EMV. This definition will aim at maximizing the value of the assets of the state in the mining sector. To prepare EMV for capitalization and increase private participation in the operation of COMIBOL's assets, the Government has already hired an international investment bank.

### **The Railways Sector**

40. Background: The Empresa Nacional de Ferrocarriles (ENFE) was formed in 1964 by combining several Andean lines in Western Bolivia belonging to the State and certain private companies. A few years later the lines of Eastern Bolivia radiating from Santa Cruz were added. In total the system comprises 3,500 km of lines, with 4,000 employees. While the eastern network is profitable (after taking into account government subsidies to compensate for below-cost passenger and freight tariffs), the losses of the Andean line absorb almost all of these profits. Moreover, the profitability of the Andean lines has been reduced in recent years due to the decline of Bolivia's minerals sector and rapidly escalating costs. Both the Andean and the Oriental networks are suffering from inefficient practices, overstaffing, and severe lack of reinvestment. Without fundamental change, the entire railway will face continued decline.

41. General Objectives: The adoption of Bolivia's new economic policies offers the potential for fundamental reform of the railways. In accord with the precepts of the Plan de Todos, the Government will pursue the following objectives: (i) non-discriminatory access to railway services; (ii) tariffs which reflect market conditions free from monopolistic distortions; (iii) adoption by the railway(s) of the most efficient and appropriate technologies and practices; and (iv) constitution of the railway(s) as commercial private sector enterprises through the process of capitalization. If the Government decides that the private sector should continue to provide unprofitable services due to important social reasons, the railway(s) will be compensated through a system of transparent Public Service Obligation payments by the Government or other entity.

42. Railways Sector Legislation: A new Railways Law will be presented to Congress in mid-1995 to enable the successful capitalization of ENFE. This law will empower the new capitalized railway company(s) to enjoy all powers to provide an integrated rail service under a concession contract. ENFE's assets excluding tracks would be included as part of the capitalization package. The law will reflect the fundamental change in the relationship of the railway to the public. A new regulatory framework will guarantee that the railway(s) will function as a "common carrier" offering its services to all parties. To eliminate monopolistic abuses, the tariffs, freight contracts or other prices set for such services as well as the conditions of such services shall be subject to appropriate regulation by the Superintendent of Transport within SIRESE. The law will set the principles for a mechanism of payment under transparent circumstances for non-remunerative public services which the Government or any other

duly constituted entity wishes to purchase from the railway(s). It will clearly define the responsibilities of the sectoral Superintendent within SIRESE.

43. Capitalization of ENFE: An analysis of railway properties is being conducted to determine their value, and whether they are required for railway use or are excess to needs. The current situation has been diagnosed and financial simulations made of alternative structuring of ENFE resources, taking into account efficiencies which could be applied by using "best world practices" adjusted to Bolivian conditions. Ongoing consulting services have been reoriented toward the objective of capitalization and additional special services obtained. This process will specify a recommended or preferred form of transaction or transactions which will then become the subject of a marketing effort. Proposals have been received from international investment banks interested in advising on the process, and one will be selected shortly.

### **The Aviation Sector**

44. Background: We recognize that Bolivia's aviation sector has been characterized by relatively high state intervention and lacks a clear and effective regulatory framework. This has translated into inefficiencies in the provision of air traffic and airport-related services. As part of its reform agenda, the Government has already passed Supreme Decree 21060 which deregulated domestic air traffic tariffs. The impact of this ruling has already created stronger private competition in the market.

45. General Objectives: The Government wishes to restructure the sector to promote private sector participation, make domestic and international air service more efficient and reduce inappropriate government involvement. The three basic aspects of the reform program are dealing with the: (i) international and domestic airline sectors; (ii) airports sector; and (iii) adaptation of the institutional and regulatory framework.

46. International and Domestic Airline Sectors: The Government intends to capitalize LAB in manner to foster competition in the domestic airline sector. We have hired a technical advisor, an international investment bank and a legal firm to help with the capitalization of LAB. Since 1994, we have eliminated implicit subsidies to Transportes Aereos Militares (TAM) and Transportes Aereos Bolivianos (TAB), which have now suspended operations. Domestic routes to non-commercial destinations will be auctioned to the domestic airline that requires the lowest compensation. The Government will decide upon one of two options for TAM, and TAB. Either these entities will be converted into private enterprises and function within the competitive market or they will discontinue commercial services and be integrated into the military sector.

47. Airport Services: We intend to restructure AASANA, the airport services public enterprise, so that: (i) most of the airport-related activities, excluding air traffic control services, are transferred to the private sector; (ii) a redimensioned AASANA (most probably a new entity) will retain responsibility only for operating air traffic control services; (iii) airport administration is decentralized through the creation of regional airport authorities, with private sector and regional entities involvement and; (iv) airport tariffs and rates are established more in line with neighboring countries. We have retained specialized airport consultants to assist in the restructuring and privatization of AASANA, and intend to contract an internationally recognized investment bank to assist with this transaction.

48. Institutional and Regulatory Framework: We intend to: (i) adapt the current aeronautical legislation to the new organization in the aviation sector, as well as to the SIRESE Law; (ii) adjust the

general aviation policy as well as the international aviation policy, to conform to the changes in the aviation sector; and (iii) create a civil aviation authority (regulatory body) for aviation-related matters. The Government has retained a specialized law firm to assist in the drafting of regulations for this sector. The Superintendency of Transport within SIRESE will be responsible for monitoring compliance with economic regulations, such as airsite charges.

### **Privatization of Small and Medium Public Enterprises**

49. The Government has identified some 72 publicly-owned enterprises to be privatized. These are small and medium enterprises under the control of the Regional Development Corporations, the military, local prefectures (mostly hotels), municipalities, and a variety of other ministries, secretariats, state enterprises (as subsidiaries) and other agencies. Their total value is estimated at US\$100 million. For about half of this group, consultants have already conducted individual pre-privatization assessments and evaluations.

50. The process of privatization for small and medium enterprises was fully elaborated in the Privatization Law of May 1992 and accompanying regulations, and was used under the previous administration for privatizing or otherwise disposing of about 30 enterprises with a total value of \$12 million. In view of recent changes in governmental structures, we will issue in early 1995 a Supreme Decree adapting procedures to the new structure.

51. Proceeds from the sales are to be used exclusively for socially-oriented activities, selected by the agency which had responsibility for the enterprise when it was in the state sector, and with oversight from the Ministry of Finance. To date, about US\$5 million of funds has been disbursed for over 100 social projects. We intend to continue this program. With the exception of the large national public enterprises, almost all of the rest of the stock of public enterprises will be privatized or otherwise disposed of by the end of 1996.

### **Environmental Aspects**

52. Environmental audits have been concluded in the electricity sector, are ongoing in the mining sector, while in the hydrocarbons sector environmental consultants are being hired to carry out this work. In general, taking into account likely values of assets to be capitalized, the capitalized enterprises will assume responsibility for existing environmental liabilities to the extent that they have been quantified in the environmental audits. The Government will assume the majority of the liabilities in the mining sector as well as any contingent liabilities which might occur.

53. The Government has formed a task force under the auspices of the Secretaría Nacional de Minería (SNM) which will be coordinating the actions of the various governmental programs for rehabilitation and social development in the mining regions, which will support the activities of the Capitalization Program. This task force will direct the preparation of a Plan for Social Development and Rehabilitation of the mining region of Bolivia, which is expected to be completed within the next twelve months.

54. The Government has advanced in the preparation of the regulations for the Ley de Medio Ambiente (LMA) and will present the draft to the IDA and IDB in advance of the date for presentation of the loan to the respective Boards of Directors.

55. Prior to the presentation of the economic offers for each of the companies to be capitalized in the Program, the Government will make available to the IDA, IDB and the potential investors the following: (i) conclusions of the pertinent environmental audits; (ii) the environmental clauses to be included in the contract with the strategic investor; (iii) the environmental guidelines with which the capitalized companies will have to comply in their future operations; and (iv) the structure and functions of the corresponding sectorial environmental unit.

### **III. The Institutional Framework**

56. Two main factors explain the disappointing performance of the Bolivian economy in attracting private investment: (i) the dominant role of the public sector in areas where the country presents strong growth opportunities; and (ii) the lack of an institutional framework that ensures private agents clarity, predictability and enforceability of the legal and regulatory principles governing their activities. The Capitalization Program aims at rationalizing the State's role as owner and operator of key economic sectors. However, a parallel effort needs to be undertaken to build up an institutional framework that would provide the private sector with adequate incentives to invest and operate in Bolivia.

57. The Government is undertaking various efforts to develop an institutional framework conducive to private sector participation. We are:

- developing competition-oriented regulatory frameworks for each of the sectors included in the Capitalization Program;
- introducing a system of sectoral regulation (SIRESE Law) which provides a broad regulatory framework for the capitalized sectors, including the creation of a system of independent regulatory agencies;
- establishing effective and impartial dispute resolution mechanisms to deal with conflicts arising from the application of sector regulations and from commercial dealings, including the proposed capitalization transactions;
- supporting the Judiciary's efforts to improve the opportunity and soundness of judicial dispute resolution as part of a comprehensive judicial reform program; and
- seeking to overcome legal restrictions and deficiencies in the registration and enforcement of security on movable assets that unduly restrict access to credit.

#### **The Regulatory Framework**

58. Background: The process of capitalization requires the rationalization of the role of the State in the relevant sectors, the definition by law of the basic rules (i.e. sector structure, pricing, entry and exit requirements) that govern each sector and the establishment of effective dispute resolution mechanisms that safeguard the rights of private investors and consumers. The rationalization of the role of the state consists mainly of eliminating its activities as operator in the sectors and strengthening its regulatory capacity.

59. **System of Sectoral Regulation Law:** The System of Sectoral Regulation ("SIRESE") Law was passed by the Congress in October 1994. The Law establishes a broad regulatory framework for the electricity, telecommunications, hydrocarbons, transport and water sectors, including the creation of a Superintendency General and Sectoral Superintendencies and the elaboration of key cross-sectoral regulatory norms. The Superintendencies are autonomous and will be funded from levies on the regulated industries. The Law includes a number of safeguards against improper political interference in the operation of the regulatory system, including protection of the Superintendents from arbitrary removal. Appeals from decisions of sectoral Superintendents are heard by the Superintendent-General. His decisions are appealed to the Supreme Court, without further involvement of the Executive. Regulations made under the Law will establish a mechanism for managing certain shared resources across the regulatory system.

60. The adoption of a cross-sectoral regulatory framework, including a Superintendency General with oversight, coordination and appeal responsibilities, is intended to: (i) foster coordination and consistency across the regulated sectors; (ii) provide Sectoral Superintendencies with a further layer of insulation from improper political interference; and (iii) allow economies of scale and scope in staffing and other resources to be realized. We plan to establish the Sectoral Superintendencies sequentially with the passage of each sectoral law, and to establish the Superintendency General no later than mid-1995. We will issue regulations to the SIRESE Law by mid-1995 covering the following subjects: (i) the administrative structure and operation of the General Superintendency; (ii) procedures for appeals from decisions of the General and Sectoral Superintendents; and (iii) anti-trust matters.

#### **Improving the Legal Framework for the Adjudication of Disputes Between the Government and Private Parties**

61. **Background:** The implementation of competition-oriented regulatory frameworks generates a potential for controversy between the regulators and private investors. At present, Bolivian law does not provide for effective and impartial dispute resolution mechanisms to deal with such potential conflicts.

62. **Appeals from Administrative Decisions:** In addition to the regulations to be promulgated under the SIRESE Law, the Government is also considering a Law of Administrative Procedures, which would subject a broader range of administrative decisions to judicial review in accordance with clear procedures.

#### **Improving the Legal Framework for the Adjudication of Disputes between Private Parties**

63. **Background:** The Government recognizes the importance of speedy and fair mechanisms of dispute resolution on commercial and financial matters, including the capitalization transactions. Existing legislation is seriously deficient in providing for alternative dispute mechanisms. Major constraints exist on the eligibility of parties, scope of application and the possibility of obtaining swift decisions and having them enforced.

64. **Arbitration Law:** It is the Government's intention to promote the use of alternative dispute resolution mechanisms, i.e., arbitration, conciliation and mediation, as means to respond effectively to investors' dispute resolution needs. Prevailing legislation on alternative mechanisms limits their sphere of application and does not ensure swift decisions and prompt enforcement. The Government will submit to Congress a draft Law on Arbitration, Conciliation and Mediation designed to overcome the

shortcomings of the present legislation. To ensure the use of arbitration in specific capitalization transactions, the draft law will specifically enable the State to submit itself to arbitration in any disputes arising from its role as a private agent. To ensure the international enforceability of arbitral awards the Government has already ratified the New York and Panama Arbitration Conventions and the treaty of the International Center for the Settlement of Investment Disputes.

### **Judicial Reform**

65. In a notable cooperative effort, the Executive and Judicial branches have agreed to embark on a comprehensive reform of the system of justice, particularly with respect to civil and commercial law. The judicial system has been recognized as a critical constraint to private sector development and the efficient operation of a market-based economy in Bolivia. Failure of the judiciary to provide a reliable and predictable environment for enforcement of rights related to commercial transactions is a key factor hindering the emergence of modern business practices and efficient markets. The deficient performance of the judiciary has also hampered the development of alternative dispute resolution mechanisms, such as commercial arbitration.

66. Our reform strategy seeks as a long-term objective to modernize justice administration in Bolivia, i.e., converting the Judicial Branch into an organization driven by the objectives of: (i) resolving judicial disputes expeditiously; (ii) ensuring that judicial rulings are based on sound and uniform jurisprudence consistent with legislative and equity principles; (iii) ensuring efficiency in the use of judicial resources; and (iv) promoting accountability and responsiveness of the judiciary to the society's justice administration needs.

67. The implementation of the first phase has begun with the institutional restructuring of the judicial branch contemplated in the recent reform of the Constitution. Further reforms will focus on three inter-related areas that now contribute to the judiciary's poor performance: (i) reforms in human resource management policies to redress the perverse incentive framework governing staff recruitment, promotions and compensation; (ii) build-up of a strategic management function together with appropriate management information systems; and (iii) reforms in processing disputes to deal effectively with the public's demand for swift, fair and predictable justice administration.

68. It is the Government's intention, as part of the actions designed to support this judicial reform initiative, to ensure that, within the overall fiscal constraints, it will assign the resources necessary to enable the Judicial Branch to implement the reform initiatives referred above.

### **Secured Transaction Development**

69. Background: Access to credit in Bolivia is limited to those who can offer real estate as collateral. Inventory, account receivables or industrial equipment cannot serve as collateral without a supplemental real or personal guarantee. The unparalleled role of real estate as collateral is derived from deficiencies in the legal and institutional framework for secured transactions.

70. The current legal framework limits the assets that can serve as collateral and makes uncertain the priority of creditor's claims and the registry where the claims should be filed. In addition, the law does not permit any type of private enforcement of rights, an alternative that is critical for an effective secured transaction system. These legal constraints materially obstruct private parties' ability to utilize movable assets as collateral.

71. The registries' operation also constitutes a serious obstacle to a well-functioning secured transactions system. The Real Estate and Commercial Registries do not apply adequate procedures to ensure the efficient filing, retrieval and publicity of security. Thus, they defeat their main objective of providing secured creditors certainty regarding their priority interest on debtors' assets.

72. Secured Transaction Law: It is the Government's intention to seek approval by Congress either of relevant amendments to the Commercial Code or of a comprehensive secured transactions law in order to remove the prevailing legal constraints. This legislative initiative would seek to facilitate, modernize, and clarify the creation, perfection, and enforcement of security interests and liens on personal property. Banking regulations shall be redrafted to conform to this new law.

73. Improvement of Registries: Because record information is essential to ensure an efficient business environment, the Government is committed to the improvement of commercial and property registries. The Government has commissioned assessments of the technical needs of each registry office. Based on these studies, the Government will promote and undertake a program aimed at improving the operation and management of the registries through computerization and performance monitoring. We will also investigate the possibility of contracting out the management of certain registries to the private sector.

#### **IV. The Financial Sector**

##### **Financial Markets Reform**

74. The Government is dedicated to a significant program to improve the breadth and efficiency of financial intermediation in order to facilitate the capitalization process, mobilize long-term savings and reduce constraints to corporate and individual financing. Our aim is to further develop long-term financial markets through improvement in the regulation of securities, insurance and deposit-taking institutions as well as strengthening of contractual savings and pension mechanisms.

75. Deepening of long-term financial markets is fundamental to the Government's capitalization strategy indicated above. A regulated securities market with adequate disclosure mechanisms will enable secondary market trading so as to promote competition and ensure the greatest price and liquidity for shareholders and pension and mutual fund members. Improved insurance regulation will help to mobilize institutional investment, open an avenue for contractual savings and ensure that retirees, the disabled and survivors can efficiently invest retirement benefits in annuity programs ensuring their continued sustenance. Finally, the establishment of regulation and oversight over the pension system will mitigate the possibility of losses of pension assets and promote efficient investments.

##### **Improvement in the Regulation of Deposit-taking Institutions**

76. Bolivia has in recent years experienced significant improvement in the confidence in, and efficiency of, financial intermediation by commercial banks and savings and loan institutions, in part because of improved regulation and the quality of supervision. Financial institution regulation has been strengthened with the passage and implementation of the Financial Institutions Law and will be further strengthened with the passage of the Organic Central Bank Law and the Financial Institutions Law. With the support of the adjustment program, the Government expects continued improvement in the supervision of deposit-taking institutions (including the application of strong prudential norms) so as to maintain public confidence, further increase savings mobilization and promote efficient financial intermediation.

This will be accomplished by strengthening the Superintendency of Banks to regulate and supervise as well as the Central Bank's capacity to manage monetary, credit and foreign exchange policy.

### **Development of Securities Markets**

77. While to date securities markets have not been highly developed in Bolivia, a transparent and efficient market mechanism is essential, particularly in view of the proposed capitalization program. This would ensure that individuals, companies and pension funds can invest their holdings profitably and prudently, and expand the possibilities in Bolivia for corporate financing and institutional investment. Deeper and more efficient stock and bond markets would stimulate the development of long-term corporate financing and offer a mechanism to hedge financial risks. To this end, the Government will submit to Congress a Securities Law, including revised regulating authority with necessary strengthening provisions, for the sector. We expect that by end-March 1996 the Securities Law will have been passed and begun to be implemented, the institutional strengthening program of the Superintendency of Securities will be underway and a funding mechanism will have been established to ensure the functioning of this Superintendency. Key regulations to the law will cover the following subjects: (i) issuance and handling of securities; and (ii) registration and listing requirements. The strengthening of the Superintendency of Securities will ensure that it has the necessary staff, equipment, systems and budget to enforce the new law and regulations.

### **Pension Reform**

78. The pension system in Bolivia has suffered a series of difficulties including: (i) reductions in benefits due to an inability of the system to fully fund benefits provided, including increasing costs and insolvency of select funds; (ii) high administrative costs; (iii) significant variance between complementary funds in the benefits provided; (iv) a significant decrease in the ratio between contributors and retirees; and (v) coverage of only approximately 12 percent of the economically active population in Bolivia.

79. The Government is committed to pension reform in order to: (i) provide better assurance for the retirement, long-term disability, survivor and other long-term pension benefits of workers and their dependents; (ii) broaden the scope of Bolivian citizens that can be assured of such a benefit; (iii) establish a delivery system that mobilizes long-term contractual savings, invests it efficiently and provides periodic information to contributors and retirees and; (iv) supervise the pension system so that contributors and retirees can be protected against misuse of their funds and invest profitably and prudently their assets through professional administration.

80. The Government will undertake a significant pension reform program consisting of three basic pillars. First, this would entail a thorough overhaul of the existing pay-as-you-go system which includes the reform of the existing Fondos de Pensiones Básicas (FOPEBA) and Fondos Complementarios. The end result of such a reform will be the creation of a system which manages contributions and other resources to provide improved services for those workers who would remain within the existing system after the reform. Second, a new system of privately-managed defined contribution pension funds would be developed to gradually replace the current one. These funds would be supervised by the Superintendency of Pensions. This system will be voluntary for current contributors and mandatory for newcomers into the labor force. Third, all capitalization shares would be placed within individual deferred distribution accounts administered by new private pension fund managers.

81. In order to achieve these objectives, the Government will: (i) issue the required norms and regulations to restructure the current system; (ii) establish mechanisms to use private administrators of pension funds as possible vehicles for share distribution under the capitalization process; (iii) secure passage of a pension fund law by March 1996 which provides for the reform of the pension system; and (iv) undertake a development program for the Superintendency of Pensions. Key regulations to be issued under the law will cover the following subjects: (i) requirements and procedures for entry and operation; (ii) portfolio investment limits, ratings and valuation; and (iii) definition of benefits and technical standards. We will establish a Superintendency of Pensions to enforce compliance with the new legislation, including taking the following measures: (i) appointing the Superintendent and key staff; (ii) undertaking training activities; and (iii) installing necessary equipment and systems.

### **Reform of the Insurance Sector**

82. We believe that improvement in the regulation and supervision of the insurance sector can: (i) increase the options for coverage of individual and commercial property risks; (ii) help develop a vehicle for long-term savings; (iii) ensure that retirees, the disabled and survivors can efficiently invest pension benefits; and (iv) strengthen the institutions participating in the sector. To this end, the Government will resubmit to Congress an Insurance Law. We expect passage of this law and the promulgation of key regulations by March 1996. This law will strengthen the norms under which insurance companies operate as well as the regulatory authority. Key regulations will be promulgated to cover the following subjects: (i) entry of local and foreign insurers and reinsurers; (ii) supervision procedures; and (iii) investment parameters. Measures to strengthen the capacity and improve the efficiency of the Superintendency of Insurance are also underway and will ensure that it has the necessary staff, equipment, systems and budget to enforce the new law and regulations.

### **Central Bank Reform**

83. The Government is committed to improving and strengthening the Central Bank in its role as the principal financial sector authority, including its responsibility for Bolivia's monetary policy program. In order to achieve its goals in this area, an Organic Central Bank Law has been presented to Congress which contains: (i) clear definition of the Central Bank's role; (ii) provision for the independence of the Central Bank Board of Directors and President; (iii) budgetary and financial autonomy; (iv) provision for the means by which the Central Bank can effect monetary policy, including authority to establish reserve requirements and undertake open market operations; (v) provision for the Central Bank to serve as provider of liquidity support within the limits of the monetary program; and (vi) clarification that the Central Bank will promote the orderly function of financial markets using competitive market mechanisms.

84. The Government is also committed to reform the Central Bank financial and organizational structure to effectively carry out the role established in the Central Bank Organic Law. To achieve this, a restructuring program was adopted by its Board of Directors which includes measures to: (i) financially restructure the institution in such a way as to facilitate financial autonomy on a sustainable basis; (ii) modification of the accounting system; (iii) development of an integrated financial and management information system; (iv) strengthening of legal and of internal audit functions; (v) development of job descriptions and entry examinations for most posts in accordance with modifications

to the organizational structure; and (vi) development of revised recruitment and promotion guidelines and procedures.

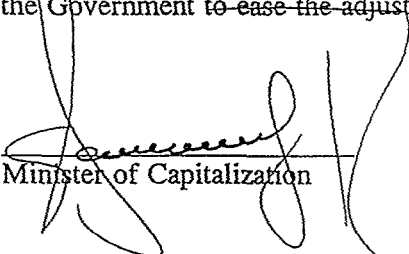
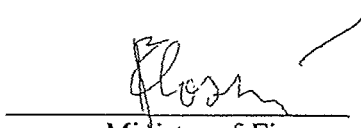
85. Recognizing the importance of the efficient intermediation of development credits provided by foreign institutions for private sector use, the Government will undertake measures to establish an autonomous second-tier financial institution. Such institution will be designated by the Government as the unique form of channeling government-guaranteed commercial credit to the private sector through the financial sector. Further, an institutional development program will be developed and implemented for the second-tier institution. By mid-1995, we expect the second-tier institution to be fully operational, including its organizational structure, staffing, procedures, and management.

### Implementation of the Project

86. A small unit reporting to the Minister of Finance has been designated to administer the loan and coordinate with affected Government agencies. The unit will be in charge of: (i) preparing the information required for certification and supervision of each stage of loan processing; and (ii) ensuring that funds are disbursed according to IDA procedures.

### Conclusion

87. The program described above constitutes a fundamental change in Bolivia's development strategy. The reforms will entail considerable effort in the part of the Bolivian public and will generate significant adjustments as Bolivia modernizes its economy and establishes the basis for future private sector led development. The Government believes that timely support from IDA and the IDB will be critical to help consolidate the reforms and assure its success. The support in the form of a Sector Adjustment Credit as well as technical assistance supported by several IDA and IDB projects will allow the Government to ease the adjustment process and establish strong economic growth.

  
Minister of Capitalization  
Minister of Finance

of the Republic of Bolivia

## Bolivia - Capitalization Program Adjustment Operation Proposed Policy Matrix

Area/Objectives	Measures taken to date	Column One Before Board Presentation	Column Two Floating Tranche Conditions	Part
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### I. MACROECONOMIC POLICY

Macroeconomic Policy	Letter of Development Policy containing the policies to be implemented under the program signed by the Minister of Finance and the Minister of Capitalization	<p>Maintenance of a sound macroeconomic framework consistent with the objectives of the program</p> <p>Compliance with the policy objectives and programs described in the Letter of Development Policy</p>	<p>Maintenance of a sound macroeconomic framework consistent with the objectives of the program</p> <p>Compliance with the policy objectives and programs described in the Letter of Development Policy</p>	A
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#### Note on conditionality for proposed operation:

Compliance with audit conditions would be required before subsequent tranche disbursement

Before Board presentation -- compliance with all conditions in Column One

General Capitalization Floating Tranche: compliance with all conditions in Column Two, Parts A + B

Hydrocarbons Sector Floating Tranche: compliance with all conditions in Column Two, Parts A + C

Financial Sector Floating Tranche: compliance with all conditions in Column Two, Parts A + D

Area/Objectives	Measures taken to date	Column One Before Board Presentation
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Column Two Floating Tranche Conditions	Part
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II. CAPITALIZATION OF PUBLIC ENTERPRISES AND SECTOR REFORMS

A. Capitalization Program		Passage by Congress of the Capitalization Law  Establishment of a structure to coordinate and direct the capitalization process  Agreement on a strategy to transfer partial ownership of key public enterprises to the Bolivian people
B. Establishment of general regulatory framework	Regulations to SIRESE Law drafted	Passage by Congress of a regulatory framework Law (SIRESE)
C. Taxation Regime		Passage by Congress of an amendment to Tax Law 843 to establish a new corporate tax regime
D. Restructuring and Capitalization of the Telecommunications Sector	Sector strategic plan completed  Investment bankers for ENTEL hired	Presentation to Congress of a new Telecommunications Law  Agreement on plan to recapitalize local service and capitalize ENTEL

Issuance of regulations for competitive bidding for companies to be capitalized under the Capitalization Law.	B
Promulgation of key regulations for the SIRESE Law and appointment of Superintendent General	B
Promulgation of key regulation(s) to implement the new corporate taxation system established in the amendment to Tax Law 843	B
Passage by Congress of a new Telecommunications Law. Promulgation of key regulations to implement the law including new tariff and interconnection structures  Government to invite bids for the capitalization of ENTEL  Establishment and staffing of the Superintendency of Telecommunications within SIRESE to award and supervise concessions and monitor compliance with regulations	B

Area/Objectives	Measures taken to date	Column One Before Board Presentation
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Column Two Floating Tranche Conditions	Part
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E. Restructuring and Capitalization of the Electricity Sector	Draft regulations, concession contracts and management contracts prepared	<p>Passage by Congress of Electricity Law</p> <p>Hiring of financial advisors/investment bankers to prepare ENDE for capitalization</p>
	Environmental audit completed	Agreement on strategy to capitalize ENDE
F. Restructuring and Capitalization of the Smelter/Mining Sector	Analysis of key mines performed	<p>Agreement on a draft amendment to the Mining Law to increase the attractiveness of the sector to long-term investors</p> <p>Agreement on a strategy to capitalize EMV and other mining assets</p>
	Environmental audit completed	Hiring of financial advisors/investment bankers to prepare EMV and other mining assets, with long-term leasing rights for mines, for capitalization

Promulgation of key regulations to implement the Electricity Law	B
Establishment and staffing of the Superintendency of Electricity within SIRESE to award and supervise concessions and monitor compliance with regulations	
Passage by Congress of the amendment to the Mining Law	B

Area/Objectives	Measures taken to date	Column One Before Board Presentation
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Column Two Floating Tranche Conditions	Part
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G. Restructuring and Capitalization of the Hydrocarbons Sector	Passage of 1990 law that allowed private entry into all phases (especially downstream)	Agreement on a draft Hydrocarbons Law  Passage by Congress of an amendment to Tax Law 843 to establish a new tax regime for liquid fuels to restore price transparency and stimulate competition in downstream operations  Agreement on principles for the capitalization of YPFB
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Passage by Congress of a new Hydrocarbons Law and promulgation of key regulations to implement this law  Promulgation of key regulation(s) to implement the new excise taxes on petroleum products established in the amendment to Tax Law 843  Establishment and staffing of regulatory and other agencies to award and supervise concessions and monitor compliance with regulations  Agreement on a strategy to capitalize YPFB  Issuance of tender documents for capitalization of at least 30% of YPFB (excluding those parts of YPFB to be privatized)	C
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Area/Objectives	Measures taken to date	Column One Before Board Presentation
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Column Two Floating Tranche Conditions	Part
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### III. FINANCIAL SECTOR FRAMEWORK

A. Development of Securities Markets	Draft Securities Law prepared and technical assistance provided to strengthen Securities and Exchange Commission	
B. Pension Reform	Law drafted to establish a system of individual pension fund accounts  Studies undertaken of existing funds  Agreement on basic principles of a revised pensions system	
C. Reform of the Insurance Sector	Agreement on draft Insurance Law	

Passage of Securities Law and enactment of key regulations  Strengthening of the Superintendency of Securities to supervise compliance with the Securities Law and regulations	D
The establishment of non-contributory accounts for share distribution from capitalization. Promulgation of key regulations.  Establishment and staffing of a regulatory authority to supervise compliance with the regulations	D
Passage of Insurance Law and enactment of key regulations  Strengthening of the Superintendency of Insurance to supervise compliance with the Insurance Law and regulations	D

TECHNICAL COOPERATION PLAN OF OPERATIONS

PROJECT FOR IMPLEMENTATION OF THE NATIONAL UNIVERSAL REGISTRY (RUN) OF  
BOLIVIAN CITIZENS

EXECUTIVE SUMMARY

**BORROWER AND  
GUARANTOR:** The Republic of Bolivia

**EXECUTING  
AGENCY:** The Ministry of the Interior

**AMOUNT AND SOURCE:**

Bank:	US\$12,000,000, from the FSO resources
Local:	US\$ 2,000,000
IDA:	US\$ 2,000,000
Total:	US\$16,000,000

**TERMS AND  
CONDITIONS:**

Amortization period:	40 years
Disbursement period:	3 years
Grace period:	10 years
Interest rate:	1% during the first 10 years and 2% thereafter
Inspection and supervision:	1%

**OBJECTIVES:** Collaborate with the Government of Bolivia in carrying out the National Universal Registry (RUN) of Bolivian citizens. To comply with this objective the specific activities of the Project are:

1. To provide all Bolivian citizens with identity cards.
2. To generate a data base containing civil and social information on all citizens of Bolivia.
3. To establish a system to furnish the information and statistics contained in the data base.

**DESCRIPTION:** The registration of citizens and issuance of identity cards in rural areas will continue until December of 1996.

Preparatory activities are already under way in urban areas. Universal preregistration will take place from July 1995 to May 1996, with registration teams conducting house-to-house interviews. The issuance

of identity cards using modern technology will take place from January to December 1996.

## I. OVERVIEW

### A. Background

- 1.1 The National Universal Registry (RUN) was established by Supreme Decree 22601 of September 20, 1990 and Supreme Decree 22786 of April 25, 1991. Both decrees were enacted by Law 1245 of July 1991.
- 1.2 The RUN project was to take place over a five-year period, concluding on September 19, 1995 but arrangements are being made for a two-year extension. It was instituted with cooperation from the Kingdom of Spain in the form of a US\$3 million credit, which was used to purchase computer equipment and vehicles.
- 1.3 The RUN plays an important role in the capitalization of the six major public enterprises and the pension reform. The RUN data base will be used as the principal source of information for undertaking the distribution of shares to all Bolivians over 21 years of age as of December 1995.

### B. Executing agency

- 1.4 The executing agency for the RUN project will be the Ministry of the Interior. The Ministry will set up an executing unit to operate with members from the Ministry of Capitalization; the Electoral Court, which is responsible for the civil registry office and lists of voters, as well as from the National Statistical Institute (INE). The project is part of the national government's overall plan to improve living conditions for its citizens, starting with capitalization of the six most important state-owned corporations.

## II. OBJECTIVES

### A. General objective

- 2.1 The general objectives of the RUN are:
  - a. To provide an identity card to every Bolivian citizen.
  - b. To generate a data base containing information regarding vital statistics on all Bolivian citizens, in the context of the

National Statistical Institute's definition of rural and urban population.

- c. To furnish information and statistics supplied by the data base.

B. Specific objectives

2.2 The specific objectives are as follows:

a. Universal registration of the urban and rural population:

- (i) Urban population (58%): 4.4 million inhabitants
- (ii) Rural population (42%): 3 million inhabitants

b. Issuance of identity cards to persons over 16 years of age, with different provisional documents for minors:

- (i) Rural population: 45%
- (ii) Urban population: 80%

2.3 The RUN project will prepare a data base that will be used for the civil registry and voters lists. The data base will include birth, marriage, and death records and statistical information for censuses and different government social programs.

### III. PROJECT DESCRIPTION

A. Activities

3.1 The RUN project consists of various activities in rural and urban areas:

1. Rural areas

3.2 It is anticipated that a period of one month will be required to retrain the RUN mobile brigades, provide maintenance for the communications systems, and furnish services to repair the equipment and field materials used by the teams. The work is scheduled to start in accordance with the following operating timetable:

July 1995	start	Beni, Pando
July 1995/ July 1996	start	Cochabamba, Santa Cruz
	finish	Potosí, Chuquisaca, Tarija
January/July 1996	additional work if needed	La Paz, Oruro, Beni, Pando, Santa Cruz, Cochabamba

- 3.3 To date, in the areas covered by the RUN only those over 16 years of age have been registered and provided with cards, so that additional visits will have to be made to the areas covered previously for the universal registration of the population. A period of six months will be necessary for completing the repeat work in rural areas. With universal registration the number of people receiving identity cards would double, although little additional cost will be incurred since the registration of minors would be carried out at the same time as for the other members of the family.

## 2. Urban areas

- 3.4 Plans for the initial stage call for universal preregistration of the population, based on the customary place of residence, and covering name, date of birth, and sex. With the cooperation of the INE, this work could be completed within a period of eleven months.
- 3.5 Publicity campaigns using radio and television announcements and posted notices will be carried out two weeks before starting any activities at the level of each department.
- 3.6 The training, selection and hiring of field personnel – i.e., field supervisors, registrars and administrative support staff – will be completed.
- 3.7 As noted earlier, the preregistration period will last eleven months. The period for issuing identity cards will begin as soon as the equipment is available, which is expected to be in November 1995. Issuance of identity cards is expected to also take approximately 11 months.
- 3.8 As soon as the population registry data are available, the legibility and accuracy of the information gathered in the field will be verified. The forms will then be sent to the central office for transcription at the data processing center, and the data base will be updated on an ongoing basis.

- 3.9 The preregistration data base will then be checked against and supplemented by information contained in the files of the National Directorate of Personal Identification.
- 3.10 The next steps will be installation and testing of the computer equipment network in the department capitals, each of which will be hooked up with the central unit in the city of La Paz.
- 3.11 Having obtained needed information from each individual and checked the same against the existing data bases, a report containing this data will be produced and the interested party will be asked to approve it. The identity card will then be generated by computer and a photograph of the person will be taken and attached immediately drawing on the experience with the issue of identity cards in earlier stages. As a last step, the card will be coated with plastic and handed to the citizen.
- 3.12 Daily reports containing the data of the persons to whom such cards have been issued will be sent by means of the communications network to the central computer. This is to prevent anyone from obtaining more than one proof of identity card in different departments, since the central unit will also send each department a reference file of cards issued to date.

B. Organization and execution

- 3.13 The executing agency of the Project would be the Ministry of the Interior. To carry out its functions the executing agency would establish a Project Executing Unit (UEP), responsible for the administration of the Project, headed by the Director of the RUN, or by a coordinator with appropriate experience and qualifications for this type of function.
- 3.14 The UEP would attend to all of the organization, programming, coordination, follow-up and control of the Project; in particular public bidding, proposals for modification of terms of reference, verification of progress, authorization of payments, production of reports, coordination of consultants, government workers and organizations directly or indirectly with the project. The expenses of the UEP could be included in the local contribution.
- 3.15 Procurement of goods and services and the hiring of consultants would be conducted following the Bank's rules.
- 3.16 In those cases where the Bank's procedures permit following local legislation, plans call for procurement and hiring to be conducted in conformity with Bolivia's Standards for the Goods and Services Administration System. The administrative unit of that system has had experience in application of the corresponding Bank policies and procedures.

- 3.17 Prior to the first disbursement of the financing, the executing agency should have presented to the Bank the following: (a) evidence the UEP has been established; (b) the action plan for the Project, with details for the first year of the consulting services to be hired and remaining activities of the Project, and the corresponding terms of reference and timetables; (c) evidence of extension of the period for carrying out the RUN; and (d) the CPM-type time-line for completing the project.
- 3.18 Registration and issuance of identity cards in rural areas will continue until approximately December 1996. A plan has been drawn up to accelerate the registration work through the use of 50 mobile teams.
- 3.19 Successful completion of the work in rural areas will be contingent on the passing of a law of exception to allow for legal registration of those persons lacking birth certificates. If no such law is passed, there is a risk that the work may have to be extended for more than two years beyond 1995.
- 3.20 Preparatory activities are now being carried out in urban areas. Universal preregistration will be conducted by teams of registrars who will interview citizens directly at their homes. The issue of cards will begin in January 1996 and continue for 11 months.

C. Disbursements

- 3.21 Disbursements will be handled in accordance with the applicable Bank procedures. The period for disbursement of the financing will be three years.

D. Supervision

- 3.22 From the start of the Project the Executing Agency should present semi-annual progress reports to the Bank which would permit it to carry out an effective monitoring of the Project. The reports should contain: (i) the progress of the activities contemplated in the Project; (ii) the progress of disbursements in relation to schedule and the payments made from the local counterpart funds; (iii) a summary of the recommendations of the various consultants hired with resources of the Project; (iv) the proposed changes or adaptations to the Project the Executing Agency considers necessary which may include changes in the periods and in the items contracted; and (v) a summary of the activities that should be carried out in the following semester.
- 3.23 Within six months after the completion of the Project the Executing Agency will present a final report with a summary of the activities accomplished; the destination of the expenditures made with the resources of the Project; the results obtained; the decisions adopted as a consequence of the Project; and the results which are expected based on these decisions. Also, the technical-cooperation

agreement will require the Executing Agency to present the financial statements of the Project, duly audited in accordance with satisfactory standard norms by independent public accountants, acceptable to the Bank.

E. Expenses prior to the signing of the Agreement

- 3.24 Upon approval by the Bank, expenses incurred after January 1, 1995 but before the signing of the financing agreement, may be reimbursed up to the sum of US\$4 million. Likewise, the Bank may recognize as part of the local counterpart, the expenses incurred in the Project from January 1, 1995 to the date of the signing of the agreement up to the amount of US\$1 million.

IV. BENEFITS, RISKS AND JUSTIFICATION

A. Benefits

- 4.1 Once the preregistration of the urban and rural population has been completed, an electronic data base will be available to assist agencies with authorized access in obtaining the information they require.
- 4.2 During the preregistration stage, equipment will be available to perform continuous updating of identity data.

B. Risks

- 4.3 Successful completion of the work in rural areas will be contingent on the passing of a law of exception to allow for legal registration of those persons lacking birth certificates. If no such law is passed, there is a risk that the work may have to be extended for more than two years beyond 1995.
- 4.4 The rate of registration and issuance of identity cards for the rural population could be as low as 50%, in which case the deadline for delivery of the corresponding data bank would have to be extended.
- 4.5 There is a general risk of delays in the procurement process and in project execution. That risk is substantially reduced by the contracting of consultants to organize the process and by applying the new goods and services administration system.

C. Justification

- 4.6 In the event that the RUN objectives are not attained, no data would be available for the distribution of shares to all Bolivian citizens.

- 4.7 Nor would the country have a computerized system to provide information relating to the citizens to whom identity cards have been issued.
- 4.8 In many cases, the scattered populations in Bolivia's rural areas lack an adequate registry facility. Without the RUN, these towns are in danger of being completely excluded from the various government programs.

#### V. BUDGET BY EXPENSE CATEGORY

- 5.1 The total project cost is approximately US\$16 million equivalent, as may be seen in the following table.

#### TOTAL COST

Item	DESCRIPTION	FINANCING			
		BANCO	IDA	LOCAL	TOTAL
1.	Personnel costs			400,00	400,00
2.	Consultants	6,800,00		1,000,00	7,800,00
3.	Equipment & materials	3,600,00	2,000,00	470,00	6,070,00
4.	Financial costs				
	4.1 Commitment fee			120,00	120,00
	4.2 Interest	175,00			175,00
	4.3 Inspection & Supervision			120,00	120,00
5.	Unallocated	1,600,00		130,00	1,730,00
TOTALS		12,000,000	2,000,000	2,000,000	16,000,000

## HYDROCARBONS SECTOR REFORM BASIC PRINCIPLES OF HYDROCARBONS LAW

The Government is committed to comprehensive reform of the legal, institutional and regulatory framework governing Bolivia's hydrocarbons sector. The overall aims are to attract foreign investment to all aspects of the sector in order to increase the hydrocarbons reserve base, promote greater efficiency and maximize long-term economic benefits. To meet these objectives, a new Hydrocarbons Law will be introduced to Congress and will be based on the following key principles:

- a. *Free competition*, including the elimination of all artificial monopolies and preferential treatment, and the appropriate regulation of natural monopolies.
- b. *Rights of free disposition* of crude oil, natural gas and derivatives, including freedom to import and export. (The law should not include treatment of a requirement that contractors satisfy certain gas sale requirements to Brazil.)
- c. *Deregulation of prices*, except in the case of natural monopolies, where regulation may be required (for access prices to pipelines, for example).
- d. *Introduction of a fiscal regime* for upstream operations which is competitive with those of other countries in the region while meeting Bolivia's fiscal needs. Income tax would be calculated to allow qualification for U.S tax credits; country-wide exploration and production activities would be consolidated for purposes of calculating net income; and write-offs would be based on historic U.S. dollar costs.
- e. *Elimination of direct and indirect barriers to entry*, including the limited use of concessions to govern activities in the sector. Almost all activities in the sector will be open to any interested party, subject only to compliance with technical, safety and environmental norms and standards. Concessions will be required only for:
  - (i) exploration and production;
  - (ii) transport by pipeline; and
  - (iii) distribution of natural gas by pipeline.
- f. *Open access to pipelines* for third parties, subject only to payment of a non-discriminatory tariff.
- g. *Flexibility in contractual arrangements* for exploration and production, with contracts to be awarded on basis of technical and financial capacity of investor and minimum work commitments.
- h. *Definition of jurisdiction of Hydrocarbons Superintendency within SIRESE* which shall include: (i) all aspects of distribution of natural gas by pipeline;

(ii) administration of pipeline access and pipeline tariffs; and (iii) monitoring and sanctioning of anti-competitive behavior in the sector.

- i. *Establishment of an appropriate independent institution*, to promote exploration investments, negotiate and administer exploration and production contracts, manage the exploration and production Data Bank Unit, assume the state's rights and obligations under existing and future operations contracts, and monitor strategic investors' minimum investment commitments for the capitalized YPFB.
- j. *No controls on remittance abroad* of proceeds from sales whether local or foreign.
- k. *Stability of tax and exchange regimes* to exploration and production contractors for the duration of the contract, or such changes as the contractor may agree.
- l. *Provisions enabling the capitalization of YPFB*. The capitalized YPFB will receive the same treatment as other investors, entering into contracts with the state for exploration and/or production areas retained by it, if any, and receiving concessions for its pipelines. Exploration areas for which the capitalized YPFB is not awarded contracts will revert to the State, which will reassume responsibility for public sector functions presently carried out by YPFB.
- m. *Existing operations contracts will be honored* and operators will be offered the option of free disposition of natural gas and liquid hydrocarbons.
- n. *Responsibility for environmental standards* will be specified.

## **BOLIVIA: BASIC PRINCIPLES FOR PENSION REFORM**

### **I. Architecture of the system**

- 1.1 The system will be fully funded and based on individual capitalization accounts.
- 1.2 There will be two kinds of funds and accounts. One fund (active) will manage the monthly contributions of its participants. The other fund (passive) will manage the shares of the capitalization for its participants. The managers of the active fund are free to bid for the management of passive funds in addition to that of its active members.
- 1.3 The funds will be privately managed by approved management companies (AFP). The funds will be legally and financially separate from the AFP and their capital.
- 1.4 Membership in an AFP will be on an individual basis and no AFP can reject a member that qualifies according to the law.
- 1.5 Contributors will be able to switch their accounts between AFPs at no cost.
- 1.6 Contributions will be mandatory for all workers with a work contract and voluntary for independent workers. Any participant in the system will not be required to contribute to previous systems.
- 1.7 Participation in the new system will be open to all workers either dependent or independent and will be mandatory for all new workers with a work contract.
- 1.8 Workers who transfer to the new system during the first three years of the new system will qualify for a bond recognizing their contributions to the old system.
- 1.9 AFPs will exclusively manage pension funds. They will be able to freely subcontract the activities required to provide their services.
- 1.10 Workers contributions and the commissions they pay are not counted in their tax base. The pension funds and their returns are not taxable.

### **II. Benefits**

- 2.1 Old age benefits will be calculated on the basis of contributions made.
- 2.2 Disability and survivorship pensions are defined benefits financed through contributions and an insurance.
- 2.3 AFPs will not incur actuarial risk and will reinsure any risk they assume through their insurance products.
- 2.4 Requirements for benefits in terms of age, time of participation, salary base and number of contributions will be harmonized between the different systems. This harmonization will be done in 5 years.

- 2.5 Benefits in the old system will not be increased without increasing contributions to keep an actuarial equilibrium.

### **III. Competition**

- 3.1 AFP management commissions and insurance fees will be set freely by the AFP. Commissions and fees set by an AFP must be uniform and non-discriminatory.
- 3.2 Fund values will be disclosed daily and AFPs will guarantee the liquidity of funds at the quoted rate.
- 3.3 Each pension fund will be composed of personal accounts representing a share in the total fund. Thus, all accounts in an AFP will have the same investment portfolio.
- 3.4 Contributions will be retained by employers and AFPs will have the responsibility of collecting them.

### **IV. Regulation**

- 4.1 AFPs will be regulated and supervised by a single supervisory body (SB) which will be legally and operationally independent.
- 4.2 There will be strict regulation and supervision to ensure that pension funds are invested prudently and profitably. The law will set only maximum limits for investments and the law or the regulations will set prudential limits by type of instrument, issuer and specific issue.
- 4.3 Investment limits should not discriminate against foreign investments by AFPs.
- 4.4 The law will also specify direct, indirect, and cross-ownership relations with AFPs that disqualify investment instruments so as to minimize conflicts of interest. It will also specify the financial sector institutions of which pension funds may not buy shares.
- 4.5 Directors and managers of the AFPs as well as their shareholders may not sell financial instruments of their own portfolio to the pension fund and may not buy instruments from it.
- 4.6 AFPs will be required to co-invest 1 % of the amount of the pension fund. There also will be a nominal minimum capital.
- 4.7 The AFPs investments will be limited to a list of interest bearing instruments set by SB. Investment in shares will be limited to companies necessary for the AFPs activities.
- 4.8 External audits will be required at least semi-annually. Supervision will be delegated to the extent possible to external auditing firms, especially as regards compliance with regulations, adequacy of custodial arrangements and record keeping.
- 4.9 The risk classification of instruments will be done by private companies and their classification will be just accepted or rejected by the SB.

**V. Transition**

- 5.1 There will be a financial incentive to switch to the new system.
- 5.2 AFPs, the pension funds and contributions will not be taxed to fund the old system.
- 5.3 Contributions to the old system will be raised to at least match the expected contributions and commissions to the new system.
- 5.4 Switching to the new system will be irreversible.

**STUDIES FOR THE PREPARATION OF A PLAN FOR  
SOCIAL DEVELOPMENT AND REHABILITATION OF MINING AREAS**

**SUMMARY TERMS OF REFERENCE**

**I. OBJECTIVES AND GUIDELINES**

- 1.1 These terms of reference set forth the terms and conditions to govern the preparation of a plan for social development and the rehabilitation of mining areas. The studies will be conducted by a multidisciplinary team of experts and professionals to be hired and supervised by the Bank using technical-cooperation funding (CT/FONDOS).
- 1.2 The purpose of the studies is to prepare a plan that dovetails with the capitalization process and enables the following objectives to be met:
  - a. Provide an immediate response to the social and economic crisis affecting mining centers.
  - b. Promote economic and social development in depressed mining areas by fostering productive activities in a manner consistent with the structural reforms and the principles of the new country model being put in place by the national government.
  - c. Secure the continuity of cooperative mining activity on an improved technical and economic basis, as a way of ensuring social stability in the region.
  - d. Trace a path for more permanent solutions that will be sustainable from a social, economic and environmental standpoint.
  - e. Create conditions for a successful capitalization process in the mining and metallurgy sector.
- 1.3 The plan is to follow the basic principles set out below, in order to move in the desired direction:
  - a. Establish, in a concerted fashion, ways of ensuring the coexistence of commercial mining operations (large-scale mining now undergoing capitalization) and cooperative activity – in a manner consistent with environmental pollution control – and with small and medium-scale mining companies.

- b. Stimulate business initiatives and the new forms of productive organization that have emerged with the crisis, gradually leaving behind the factors that led to the collapse of the previous model.
- c. Favor a gradual increase in the economic efficiency of small-scale mining operations as the basis of their survival, including in the short term.
- d. Promote accountability, initiative and self-sufficiency on the part of individuals, companies, cooperatives and institutions, avoiding state paternalism.
- e. Foster environmental recovery in mining and bring the sector into compliance with the new regulations.
- f. Ease the transition to the new model by avoiding social and environmental costs and seeking to take advantage of the economic restructuring to make progress in solving problems and disseminate the benefits at the regional and social level.
- g. Maintain appropriate technical underpinnings and political backing to ensure discussion and acceptance by the major sectors concerned.

1.4 More specifically, the plan will obey the following guidelines:

- a. Seek a balance in the allocation of mining development areas between large companies and cooperatives, such that the country's mining assets will serve to leverage overall economic development and provide a livelihood and a means of subsistence for many thousands of families.
- b. Give a realistic focus to the social and economic organization arising spontaneously in mining centers, safeguarding the role of cooperatives in social regulation but promoting business activity (at all levels) as a pillar of sustainable economic development. Idealistic pseudo-solutions are to be avoided, such as forcing the cooperatives to function in a manner at variance with the actual interests of their members.
- c. Direct the capitalization of Empresa Metalúrgica Vinto (EMV) and the companies and mines associated with the capitalization package in order to consolidate an integrated regional system of mining production and marketing that will encompass all aspects of the productive process, including cooperatives (as opposed to an enclave economy).

- d. Confine action by the national state to: (i) in the short term, promoting mining rehabilitation to provide continuity in production; (ii) supporting mining research and the dissemination of information; (iii) promoting the assimilation of technology and the conversion of production; (iv) regulating mining activity and coordinating regional actions by the various governmental agencies.
- e. At the level of the national government, underscore the need to give priority to development and infrastructure projects to benefit depressed mining areas.
- f. Bring social programs within the framework and the limits of the Public Participation Act, speeding up administrative decentralization in the entire area covered by the plan.
- g. Finance the plan with funds derived from: (i) productive mobilization of frozen COMIBOL assets; (ii) private investment directed appropriately to specific projects under the overall plan; (iii) international cooperation, grants and loans from international organizations; and (iv) the Public Participation Act (for social programs).
- h. Set realistic goals for pollution control, differentiating on the basis of the size and features of each activity, based on an active approach to disseminate cleaner technologies and overall (structural) solutions in each mining center.
- i. Promote participation by the population concerned in drawing up the plan, and provide for decentralized mechanisms for implementation and monitoring.
- j. Establish, in a concerted fashion, clear rules for the transition to the new model of private operations by COMIBOL mines and for the subsequent coexistence of the various types of mining activity.

## II. GEOGRAPHICAL COVERAGE

- 2.1 The plan will encompass the mining centers, and their areas of influence, located to the west of the country and stretching to the north, from the gold-mining areas of the department of La Paz to the mining areas of the south in the department of Potosí, as indicated in the table below.

TABLE 1. GEOGRAPHICAL COVERAGE OF THE PLAN

AREA No.	DEPARTMENT	MINING CENTER	AREA OF INFLUENCE
1	Potosí	Catavi	Llallagua, Siglo XX, Uncía, Chayanta
2	Potosí	Cerro Rico	Potosí
3	Potosí	Quechisla	Chorolque, Tasna, Tatasi, Chocaya, Telamayu-Atocha
4	Potosí	Tupiza	Tupiza, Cotagalla
5	Potosí	Pulacayo	Uyuni
6	Oruro	Huanuni	Huanuni
7	Oruro	Santa Fé	Japo, Morococala
8	Oruro	Poopó	Antequera, Pazña, Machacamarca
9	La Paz	Matilde	Chaguaya
10	La Paz	Viloco	Araca
11	La Paz	Caracoles	Quime
12	La Paz	Colquiri	Colquiri
13	La Paz	Corocoro	Corocoro
14	La Paz	Gold-mining areas	Consata, Mapiri, Teoponte, Guanay, Tipuani
15	Cochabamba	Kami	

### III. SCOPE OF STUDIES FOR PREPARATION OF THE PLAN

#### A. Nature of the work

3.1 The plan to be drawn up complements the structural adjustment and capitalization program in the mining and metallurgy sector, and therefore includes all COMIBOL mining and industrial centers where cooperative or small-scale mining activity takes place. There are two kinds of situations:

- a. Mining centers with operations that are to be transferred, fully or in part, to private enterprises. This group, which takes priority because of its greater economic weight and number of population concerned, includes the mining centers of Colquiri, Huanuni, Siglo XX/Catavi, Caracoles and Cerro Rico. In this group, the plan should, among other actions and in a concerted fashion, come up with ways to ease the coexistence of private commercial mining with cooperative activity, in a manner consistent with environmental pollution control.

- b. Mining centers with non-working mines operated by cooperatives and considered unviable for commercial operation. In this group, which includes just over 20 mines, the plan should give priority focus to aspects of technological dissemination and economic and social development.
- 3.2 The work to be undertaken to elaborate the plan includes: (i) technical studies of various kinds; (ii) strategic planning to formulate development strategies and coordinate them with government programs in execution (capitalization, public participation, etc.); and (iii) consultation, discussion and consensus-building with the sectors concerned.
- 3.3 The plan deals with a politically sensitive issue, particularly on the eve of the capitalization. Accordingly, work will be conducted with direction from the National Mining Secretariat as part of a political process of interaction with local communities to prepare the way for and complement capitalization.

B. Principal agents in the process

- 3.4 The problem under consideration, and the plan proposed to deal with it, involve a series of institutional agents that should have a say in drawing up the plan and then take on responsibility for implementing the actions defined. The main participants are as follows:
- a. the national government, encompassing various ministries, national secretariats and agencies, including EMV, and COMIBOL and subsidiaries;
  - b. the departmental governments of Potosí, Oruro and La Paz;
  - c. the municipal governments of Colquiri, Huanuni, Llallagua, Uncía, Chayanta, Potosí, and others that may eventually be involved;
  - d. mining cooperatives and associations of subsidiaries of the mining centers involved;
  - e. marketing enterprises and intermediaries (brokers);
  - f. enterprises that may potentially be interested in capitalization and joint ventures with COMIBOL;
  - g. NGOs and local community leaders (e.g. Radio Pío XII in Llallagua);
  - h. COMIBOL worker unions.

3.5 Other institutions will also take part in the process, such as:

- a. the National Federation of Mining Cooperatives (FENCOMIN);
- b. the National Association of Medium-scale Mining;
- c. trade associations and the business community in the region;
- d. international cooperation agencies providing funding;
- e. the multilateral development banks - IDB and the World Bank - providing financial support for the capitalization program.

C. Other initiatives associated with the plan

3.6 The studies should examine a series of actions, either under way or proposed, that are associated with the proposed plan, and seek to coordinate the programs. The main initiatives are as follows:

- a. environmental audits of COMIBOL operations;
- b. the process of negotiation between the government and the community that began with the seminar on participatory planning in Bustillo Province in October 1994, covering the area of Siglo XX/Catavi;
- c. The Oruro pilot project now under way, which is planned to conclude in December 1995, for preparation of a master environmental plan covering the mining centers of Huanuni, Santa Fe and Poopó; and
- d. the industrial, mining and environmental project now in preparation under the coordination of COMBOL and the World Bank, to begin in 1996.

D. Time frames

3.7 The formulation of the plan should enable the following interim results to be achieved:

- a. an outline of the plan, including the basic technical criteria for reconciling private operation of COMIBOL mines with cooperative activity, should be available within a period of two months, for use in making up a package of information and conditions to be provided to international investors for capitalization;
- b. the consolidation and detailed description of the plan should be concluded around December 1995 so that the most immediate actions can begin to be implemented in parallel to the transfer of mining center management to the new private partners;

- c. funding for the plan should be worked out in the first months of the study so that the initial disbursements may take place in early 1996.

LEGI-0040/95  
BO-0094  
Original: Spanish

APENDICE I

PROPOSED RESOLUTION DE- /95

BOLIVIA. LOAN /SF-BO TO THE REPUBLICA OF BOLIVIA  
Sectorial Reforms for Capitalization Program

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 Republic of Bolivia as Borrower, for the purpose of granting it a loan to cooperate in the financing of the Sectorial Reforms for Capitalization Program. This financing will be for the sum of up to US\$70,000,000 or its equivalent in other currencies, except that of the Republic of Bolivia, which are part of the Fund for Special Operations of the Bank, and shall be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" set forth in the Executive Summary of the Loan Proposal.

LEGI-0042/95  
Original: Spanish

APENDICE II

PROPOSED RESOLUTION DE- /95

BOLIVIA. REIMBURSABLE TECHNICAL COOPERATION /SF-BO FOR THE  
IMPLEMENTATION OF THE THE NATIONAL UNIVERSAL REGISTRY (RUN)  
OF BOLIVIAN CITIZENS PROJECT

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is hereby authorized, in the name and on behalf of the Bank to enter into such agreements as may be necessary with the Republic of Bolivia and to adopt such other measures as may be pertinent for the execution of the plan of operations referred to in Document AT-\_\_\_\_ with respect to the technical cooperation for the execution of the Project for Implementation of the National Universal Registry (RUN) of Bolivian Citizens.

2. That up to the equivalent of US\$12,000,000, is authorized for the purposes of this resolution, chargeable to the resources of the Fund for Special Operations.

3. That the above mentioned sum is to be provided on a reimbursable basis, in accordance with the relevant conditions specified in the Technical Cooperation Agreement.