

## Message Text

CONFIDENTIAL

PAGE 01 LA PAZ 07471 01 OF 02 011300Z  
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C O N F I D E N T I A L SECTION 1 OF 2 LA PAZ 7471

EXDIS

E.O. 12065: GDS 8/31/85 (THOMPSON, STEPHEN H.) OR-P

TAGS: EFIN, ECON, BL

SUBJECT: GOB DISCUSSIONS WITH IMF

1. (CONFIDENTIAL ENTIRE TEXT.)

2. SUMMARY: CONVINCED BY THE AUGUST 22-25 VISIT OF THE IMF'S MARCELO CAIOLA, PRESIDENT WALTER GUEVARA AND THE GOB'S ECONOMIC LEADERSHIP NOW SUPPORT NEGOTIATIONS WITH THE IMF AND REALIZE THAT ECONOMIC MEASURES MUST BE TAKEN. THE IMF AND THE GOB AGREED THAT THE PACKAGE OF ECONOMIC MEASURES MUST INCLUDE AN IMMEDIATE INCREASE IN THE DOMESTIC PRICE OF PETROLEUM PRODUCTS AND SOME FORM OF DEVALUATION. THE IMF HAS STATED THAT IT CAN SEND A MISSION TO BOLIVIA WITHIN A FEW DAYS OF RECEIPT OF THE GOB'S INVITATION. POSSIBLE OBSTACLES ARE THE GOB'S INSISTENCE THAT IT NEEDS ABOUT \$US 50 MILLION PRIOR TO THE NEGOTIATIONS, SO IT WILL NOT BE NEGOTIATING UNDER THE GUN OF IMMINENT RESERVE EXHAUSTION, AND THE RISK THAT WAGE PRESSURES WILL SURGE BEYOND WHAT THE GOB CAN OFFER IN THE CONTEXT OF A COHERENT PROGRAM.  
END SUMMARY.

3. AT HIS OWN INITIATIVE, RETURNING FROM URUGUAY, MARCELO CAIOLA OF THE WESTERN HEMISPHERE DIVISION OF THE IMF, ARRIVED IN LA PAZ AUGUST 22 AND SPENT THREE DAYS DISCREETLY VISITING WITH GOB OFFICIALS. CAIOLA HELD THE FOLLOWING MEETINGS:

CONFIDENTIAL

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PAGE 02 LA PAZ 07471 01 OF 02 011300Z

A. ENRIQUE GARCIA, PRESIDENT OF THE CENTRAL BANK;

B. GUIDO HINOJOSA, MINISTER OF FINANCE AND CARLOS MIRANDA,  
MINISTER OF PLANNING AND COORDINATION;

C. THE PRESIDENT'S ECONOMIC CABINET--CARLOS MIRANDA, GUIDAO

HINOJOSA, TOMMAS GUILLERMO ELIO (MINISTER OF INDUSTRY AND COMMERCE), GUSTAVO FERNANDEZ (MINISTER OF FOREIGN RELATIONS).

D. PRESIDENT WALTER GUEVARA. THE PRESIDENT, WHO WOULD NORMALLY HAVE ATTENDED THE ECONOMIC CABINET MEETING, WAS SICK SO CAIOLA AND JORGE SOL PEREZ, THE RESIDENT IMF REPRESENTATIVE, VISITED HIM AT HIS HOME.

4. ACCORDING TO SOL PEREZ, THE MEETINGS WERE MOST PRODUCTIVE BUT WERE CHARACTERIZED BY A DEGREE OF IGNORANCE OF INTERNATIONAL FINANCE ON THE PART OF THE GOB OFFICIALS. THE ECONOMIC LEADERSHIP IS MADE UP OF PEOPLE WELL EXPERIENCED IN RURAL DEVELOPMENT, PROJECT FINANCING, AND INTEGRATION BUT NOT INTERNATIONAL FINANCE. AFTER THE CANDID DISCUSSION, THE GOB DECIDED IN FAVOR OF ECONOMIC MEASURES AND NEGOTIATIONS WITH THE IMF. PRESIDENT GUEVARA ARZE, IN CONSONANCE WITH WHAT HE TERMED HIS IMPLICIT MANDATE FROM CONGRESS TO ADDRESS THE ECONOMIC SITUATION, FOLLOWED THE DISCUSSIONS CLOSELY AND ULTIMATELY AGREED THAT THE GOB MUST NEGOTIATE WITH THE IMF.

5. CURRENT SITUATION: BOLIVIA'S FINANCIAL SITUATION GROWS MORE SERIOUS EACH DAY. ON AUGUST 29, THE CENTRAL BANK'S NET RESERVES TOTALLED \$US 49 MILLION. APPARENTLY, THIS INCLUDED ABOUT \$US 10 MILLION IN GERMAN CREDITS FOR THE KARACHIPAMPA LEAD AND SILVER SMELTER PROJECT. IN ADDITION, THE CENTRAL BANK HAS ABOUT \$US 100 MILLION IN THE "

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PAGE 03 LA PAZ 07471 01 OF 02 011300Z

DEPOSITOS AL TERCEROS," WHICH ARE FOREIGN EXCHANGE DEPOSITS OF THE STATE ENTERPRISES AND COMMERCIAL BANKS HELD IN THE CENTRAL BANK. NORMALLY, WITH GOOD MONETARY MANAGEMENT, THE CENTRAL BANK WOULD NOT USE THESE DEPOSITS, BUT RECENTLY THE BOLIVIAN CENTRAL BANK HAS DIPPED INTO THEM TO MEET THEIR FOREIGN EXCHANGE DEMANDS. THE CENTRAL BANK ALSO HAS ABOUT \$US 50 MILLION IN CREDIT LINES WITH NEW YORK BANKS WHICH HAVE NOT BEEN USED. IF NECESSARY, BOTH THE "DEPOSITOS AL TERCEROS" AND THE BANK CREDIT LINES COULD BE DRAWN DOWN.

A. PRESENTLY, BOLIVIA'S AVERAGE DAILY FOREIGN EXCHANGE TRANSACTION LOSS IS RUNNING ABOUT \$US 2 MILLION. SOME DAY'S LOSSES HAVE BEEN MUCH HIGHER. ON MONDAY, AUGUST 27, TRIGGERED BY AN INTERVIEW WITH CENTRAL BANK PRESIDENT ENRIQUE GARCIA PUBLISHED IN SATURDAY'S NEWSPAPERS, LOSSES APPROACHED \$US 8 MILLION. EVEN ASSUMING MINIMUM RESERVE LOSSES OF \$US 2 MILLION DAILY, THE CENTRAL BANK'S NET RESERVE POSITION WOULD TURN NEGATIVE BEFORE THE END OF SEPTEMBER.

B. FROM NOW THROUGH THE END OF THE YEAR, BOLIVIA MUST PAY ABOUT \$US 244 MILLION IN DEBT SERVICE, ACCORDING TO SOL PEREZ.

THIS INCLUDES \$US 100 MILLION IN AMORTIZATION AND INTEREST FOR VARIOUS LOANS TO THE GOB AND \$US 144 MILLION TO REPAY THE CENTRAL BANK SWAPS OBTAINED BY THE GOB IN JUNE.

C. GROSS CENTRAL BANK RESERVES TOTLED \$US 236.7 MILLION ON AUGUST 20 AS COMPARED WITH \$US 215.2 MILLION ON JUNE 30. NET RESERVES ON JUNE 40 WERE \$US 82.04 MILLION. NET DOMESTIC CREDIT EXPANDED FROM \$US 440.86 MILLION ON JUNE 30 TO \$US 509.3 MILLION ON AUGUST 20. THE MONEY SUPPLY INCREASED BY 7 PERCENT TO \$US 321.3 MILLION FROM JUNE 30 TO AUGUST 20. THROUGH JULY, IMPORTS WERE INCREASING AT A RATE ALMOST 40 PERCENT OVER THAT OF LAST YEAR.

D. SOL PEREZ STATES THAT BOLIVIA'S CONSOLIDATED PUBLIC SECTOR  
CONFIDENTIAL

CONFIDENTIAL

PAGE 04 LA PAZ 07471 01 OF 02 011300Z

DEFICIT IS ENORMOUS AND WITHOUT ANY MEASURES WILL APPROACH \$US 580 MILLION BY THE END OF THE YEAR. EVEN IF PUBLIC SECTOR REVENUEW WERE INCREASED VIA TAX INCREASES, BETTER CUSTOMS ENFORCEMENT, AND PRICE INCREASES OF STATE ENTERPRISE PRODUCED GOODS, THE FISCAL GAP COULD NOT BE CLOSED. THE GOB CURRENTLY FINANCES ABOUT ONE-HALF OF THIS DEFICIT WITH SHORT-TERM CREDITS.

6. MEASURES: AFTER TALKING WITH IMF OFFICIALS, THE GOB OPTED FOR THE EXTENDED FUND FACILITY(EFF) INSTEAD OF A ONE YEAR STANDBY AGREEMENT, WHICH WOULD PROVIDE LESS THAN \$US 100 MILLION IN FINANCING

CONFIDENTIAL

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CONFIDENTIAL

PAGE 01 LA PAZ 07471 02 OF 02 011310Z  
ACTION SS-25

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CONFIDENTIAL SECTION 2 OF 2 LA PAZ 7471

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FROM THE IMF.

UNDER THE EFF, BOLIVIA COULD BORROW UP TO \$US 250 MILLION OVER THE LIFE OF THE PROGRAM AND WITH NEXT YEAR'S QUOTE INCREASE UP TO \$US 450 MILLION.

A. THE IMF AND THE GOB TENTATIVELY AGREED TO SEVERAL ECONOMIC MEASURES TO BE TAKEN AS PART OF THE IMF PACKAGE UNDER THE EFF. THE MOST IMPORTANT ACCORDING TO THE IMF WOULD BE AN INCREASE OF ABOUT 140 PERCENT IN HYDROCARBON PRICES SINCE THE IMF BELIEVES THAT THE AVERAGE PRICE PER BARREL OF PETROLEUM MUST APPROACH WORLD LEVELS.

THE DISTRIBUTION OF THE PRICE INCREASE WOULD BE LEFT TO THE GOB SINCE IT IS A POLITICAL DECISION WITH NUMEROUS SOCIAL COSTS AND IMPLICATIONS.

B. YPFB, THE STATE OIL COMPANY, HAS ASKED FOR HIKES IN DOMESTIC HYDROCARBON PRICES WHILE AT THE SAME TIME DEMANDING FORGIVENESS OF PAST TAX PAYMENTS STILL OWED TO THE CENTRAL BANK FOR 1977, 1978 AND 1979. THROUGH JUNE OF THIS YEAR, YPDB HAS PAID ONLY \$US 1.2 MILLION OF THE \$US 55.3 MILLION OWED TO THE GOB. ACCORDING TO SOL PEREZ, THE IMF MAY RECOMMEND FORGIVING TAX PAYMENTS FOR 1977 AND 1978 BUT NOT FOR 1979 SINCE THE REVENUES ARE TOO IMPORTANT FOR THE NATIONAL TREASURY.

C. THE QUESTION OF DEVALUATION WAS PRESENTED TO GOB OFFICIALS AS CONFIDENTIAL

CONFIDENTIAL

PAGE 02 LA PAZ 07471 02 OF 02 011310Z

A TRADE-OFF BETWEEN EXCHANGE MOVEMENT AND UNEMPLOYMENT. THE IMF WOULD NOT PERMIT THE GOB TO CONTINUE BORROWING SHORT-TERM TO FINANCE THE PUBLIC SECTOR DEFICIT: A DEVALUATION WOULD GENERATE SUFFICIENT REVENUES TO NARROW THE FISCAL GAP WITHOUT A DRASIC REDUCTION IN EXPENDITURES AND EMPLOYMENT. THE DEVALUATION WOULD BE CARRIED OUT ACCORDING TO THE FOLLOWING SCENARIO: THERE WOULD BE A SMALL DEVALUATION OF ONLY SEVERAL PERCENT TO BE FOLLOWED BY ELIMINATION OF DOLLAR-GUARANTEED ACCOUNTS. SUBSEQUENTLY THE EXCHANGE RATE WOULD BE ALLOWED TO FLOAT LOWER UNTIL ACHIEVING THE LEVEL OF PEOPLE'S EXPECTATIONS. THE GOB WOULD THEN ANNOUNCE THAT SUBSEQUENT EXCHANGE MOVEMENT WOULD BE LINKED TO THE RATE OF INFLATION AND WOULD OCCUR PERIODICALLY.

7. PROBLEMS AND FURTHER RECOMMENDATIONS. THE IMF WOULD ACCEPT A SALARY ADJUSTMENT ONLY AS PART OF AN ECONOMIC PACKAGE AND POSSIBLY LINKED TO HYDROCARBON PRICE INCREASES. IN THEIR MEETINGS WITH GOB OFFICIALS, CAIOLA AND SOL PEREZ SUGGESTED THAT THE GOB POSTPONE ACTION ON WAGE INCREASES AS LONG AS POSSIBLE AND PREFERABLY FOR AS LONG AS SIX TO 12 MONTHS. THIS WILL CLEARLY NOT BE POSSIBLE. IN FACT, THE REASON THAT PRESIDENT

GUEVARA IS WILLING TO DEVALUE IS THAT THIS WOULD ALLOW ROOM FOR WAGE INCREASES WITHIN A COHERENT ECONOMIC PROGRAM.

A. THERE IS A RISK, HOWEVER, THAT THE GOB MAY BE PRESSED INTO A PREMATURE POLITICAL DECISION ON DEMANDS FOR AN INCREASE IN THE MINIMUM SALARY. THE REQUEST WHICH IS CURRENTLY BEING DISCUSSED IN CONGRESS WOULD LIFT THE MINIMUM SALARY FROM ABOUT 2,500 PESOS PER MONTH TO 5,000 PESOS FOR SOME 600,000 WORKERS. THE GOVERNMENT WOULD BE UNABLE TO COPE WITH SUCH AN INJECTION INTO THE ECONOMY. THE MONEY SUPPLY AND AGGREGATE DEMAND WOULD SURGE.

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PAGE 03 LA PAZ 07471 02 OF 02 011310Z

B. ANOTHER PROBLEM IS THAT THE GOB WANTS SOME TYPE OF EMERGENCY CREDIT TO STRENGTHEN RESERVES DURING THE NEGOTIATIONS. REALIZING THAT THEIR RESERVE POSITION IS VERY WEAK, THE GOB FEARS THAT THE PRESENCE OF AN IMF MISSION THE BANKS. RESERVES COULD NOT STAND SUCH PRESSURE FOR LONG AND THE GOB WOULD BE FORCED TO TAKE ALL THE IMF'S CONDITIONS. FOR THIS REASON, THE GOB IS INSISTING THAT IT SHOULD RECEIVE FINANCING OF ABOUT \$US 50 MILLION. THE IMF DOES NOT HAVE SUCH MONEY AVAILABLE; NOR DO THE COMMERCIAL BANKS.

C. THE LAST POSSIBLE PROBLEM SEEN BY SOL PEREZ IS THAT THE GOB WILL SEEK BLACK-MARKET MONEY. HE GIVES THIS A PROBABILITY OF ONLY 10-15 PERCENT BUT HE CANNOT RULE IT OUT. HE BELIEVES THE PROBABILITY IS ABOUT 85 PERCENT THAT THE GOB WILL NEGOTIATE WITH THE IMF.

8. TIMING. TIMING OF THE NEGOTIATIONS IS VERY IMPORTANT NOT ONLY BECAUSE OF BOLIVIA'S FINANCIAL SITUATION BUT ALSO BECAUSE IT WOULD BE ADVANTAGEOUS FOR THE IMF MISSION TO COMPLETE ITS WORK BEFORE THE OCTOBER IMF/IBRD ANNUAL MEETING IN BELGRADE, YUGOSLAVIA. THE GOB WANTED THE IMF MISSION TO ARRIVE AS SOON AS POSSIBLE. WHILE IN BOLIVIA, CAIOLA TOLD THE GOB THAT THE EARLIEST DATE THAT A MISSION COULD ARRIVE WOULD BE SEPTEMBER 15. HOWEVER, SOL PEREZ CALLED WASHINGTON AND WALTER ROBICHEK (HEAD OF THE IMF'S WESTERN HEMISPHERE DEPARTMENT) TOLD HIM THAT A MISSION COULD ARRIVE WITHIN A FEW DAYS. SOL PEREZ RELATED THIS TO THE GOB ON AUGUST 29 AND IS NOW WAITING FOR THEIR INVITATION. THIS IS NOT LIKELY BEFORE THE END OF NEXT WEEK, WHEN THE FOREIGN MINISTER--IRONICALLY THE STRONG MAN OF THE ECONOMIC CABINET--RETURNS FROM THE NAM IN HAVANA (WHERE HE MAY OR MAY NOT BE SEEKING SOME FINANCING FROM FRIENDLY GOVERNMENTS.). IF A MISSION WERE TO ARRIVE IN EARLY SEPTEMBER, ITS RECOMMENDATIONS WOULD BE RECEIVED IN WASHINGTON BEFORE THE END OF THE MONTH. THEN THE IMF WOULD HAVE 72 HOURS TO APPROVE OR REJECT THE RECOMMENDATIONS. A CABLE ACCEPTING THE NEGOTIATING PACKAGE WOULD ARRIVE IN BOLIVIA IN LATE SEPTEMBER OR EARLY OCTOBER.

CONFIDENTIAL

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PAGE 04 LA PAZ 07471 02 OF 02 011310Z

WITH THIS THE GOB WOULD BE IN AN EXCELLENT POSITION TO TALK WITH PRIVATE BANKERS IN BELGRADE.

9. ACCORDING TO A LOCAL US BANKDER, ONCE A LETTER OF INTENT IS SIGNED BY THE GOB AND PRESENTED TO THE IMF, THE COMMERCIAL BANKS WILL FORM A STEERING COMMITTEE. THIS COMMITTEE WOULD PERMIT SOME FOLLOWERS TO TAKE PLACE IMMEDIATELY; HOWEVER, THIS WOULD BE ON AN INDIVIDUAL BASIS AND WOULD DEPEND UPON THE CIRCUMSTANCES OF INDIVIDUAL BANKS. NO NEW MONEY WOULD BE FORTHCOMING UNTIL THE NEGOTIATIONS ARE COMPLETED AND MEARUES TAKEN.

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## Message Attributes

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