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**LESSONS FROM
STRUCTURAL ADJUSTMENT
IN BOLIVIA**

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List of abbreviations

ADN	Acción Democrática Nacionalista
ALADI	Asociación Latinoamericana de Integración
BCB	Banco Central de Bolivia
CAN	Comunidad Andina de Naciones
CEDLA	Centro de Estudios para el Desarrollo Laboral y Agrícola
CEPAL	Comisión Económica para América Latina y el Caribe
COMIBOL	Corporación Minera de Bolivia
EIH	Encuesta Integrada de Hogares
ESF (FSE)	Emergency Social Fund
ESAF	Enhanced Structural Adjustment Facility
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
HIPC	Heavily Indebted Poor Countries
IDB	International Development Bank
IMF	International Monetary Fund
MERCOSUR	Mercado Común Sudamericano
MIR	Movimiento de la Izquierda Revolucionaria
MNR	Movimiento Nacionalista Revolucionario
NEP	New Economic Policy
NGO	Non-Government Organization
PRGF	Poverty Reduction and Growth Facility
SA	Structural Adjustment
SAF	Structural Adjustment Facility
SAP	Structural Adjustment Program
SD	Supreme Decree
SDR	Special Drawing Rights
SIF	Social Investment Fund
TGN	Tesoro Nacional de la Nación
ToT	terms of trade
UDAPE	Unidad de Análisis de Políticas Económicas
UDAPSO	Unidad de Análisis de Políticas Sociales
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
WB	World Bank
WTO	World Trade Organization
YPFB	Yacimiento Petrolíferos Fiscales Bolivianos

0 Abstract

The 1980s and 1990s can be seen as the era of structural stabilization and adjustment. It was the preeminent strategy among those countries seeking reform and amelioration of their economic and social situation.

Bolivia is one of the most cited countries in the context of structural adjustment. With the implementation of Supreme Decree SD 21060 on 29 August 1985, a program of structural stabilization and adjustment was launched in Bolivia that fulfilled the reform characteristics proposed by the International Monetary Fund and the World Bank.

Since the initial Supreme Decree SD 21060 and successive decrees and initiatives (SD 21660, SD 22407 and the initiatives for the heavily indebted poor countries, HIPC 1 and 2) have been in practice for almost 16 years now, an evaluation of the long term impact is feasible and relevant for the implementation of future development programs.

The objective of this paper is to evaluate the structural stabilization and adjustment program (SAP).

The different aspects of monetary and fiscal policy, as well as debt management are being considered. A consecutive chapter will evaluate the structural reforms implemented in the external sector, investment savings and growth, employment, distribution and poverty.

In the conclusion, it will first be extrapolated that significant lasting improvements in the stability of the Bolivian economy have been achieved. Secondly, the author will point out that debt management, including the HIPC 1 and 2 initiatives of IMF and World Bank, did not reach the goals set, although Bolivia was one of the first countries to complete the debt alleviation process. Thirdly, the author shows that the ambitious goals regarding growth, employment and poverty alleviation could not reach the hoped for levels. Chapter 5 will examine proposals for reform.

1 Adjustment as a development policy

Few economic concepts have been as widely used as that of structural adjustment. Since the early 1980s adjustment programs have been touted as the ultimate solution not only for debt problems, but also for virtually any other economic problem of struggling developing countries.

A structural adjustment program (SAP) is defined as a reestablishment of a macroeconomic equilibrium by bringing domestic absorption (consumption and investment) back to levels of available resources. In the end, the conditions of supply are to be improved to provide a stable path of growth.¹ It is therefore critical that the decisive actors do not perceive the policies introduced as temporary measures in the political process.

The neoclassical form of adjustment has a very strong belief in market forces. Rationality and efficient behavior of the acting individuals prefer international and domestic competitiveness to economic independence of a country.

Structural reforms aimed to achieve adjustment processes include:²

a.) Monetary reforms:

Stabilization of the exchange rate, unification of parallel exchange rates; improvement in the mobilization of domestic savings, liberalization of interest rates, elimination of selective credit market policies at rates below market equilibrium

b.) Fiscal reforms:

Shift from progressive property and income taxes to simpler, broader taxes on domestic consumption (e.g. a value added tax VAT)

c.) Trade liberalization:

Elimination of quantitative restrictions accompanied by general efforts to reduce domestic market protection, plus an overall reduction of tariffs³

d.) Labor market reforms:

Abolition of the indexation of salaries to the cost of living, wage regulations are to be abandoned

¹ Thiele, R., Sind die Anpassungsprogramme von IWF und Weltbank gescheitert?, Kiel, 2000, p.4.

² Epstein, J., Structural adjustment with social concern: The Bolivian case. In: journal of development finance, No. 25, 1993, p. 21.

³ Also export subsidies are to be abolished.

e.) Privatization:

After a long period during which public ownership was considered a part of national sovereignty, adjustment processes called for relinquishing public sector control over productive and service enterprises⁴

1.1 Criticism of structural adjustment

Criticism in adjustment programs is as old as the adjustment programs themselves. Arguments range from precise reviews to dilettante condemnations. Although undoubtedly all dimensions of arguments are linked to each other, the author will try to give a survey of the main arguments and subdivide them into different dimensions.

Time dimension

- a.) Time-related arguments imply that time frames used for the implementation of SAPs were too short. The World Bank had initially believed that financing would just be a matter of short time.⁵
- b.) The view that a developing country would just need an initial push to improve its economic performance was abandoned. Time frames for the implementation of funds were prolonged and it was demanded that vulnerable groups of economies in transformation should be granted protection.

Social dimension

- c.) Arguments criticizing the social dimension of adjustment programs mainly concern the unconsidered emergence of short term social costs, when adjustment reforms are put into place.⁶

As success of the programs is linked to their acceptance within the population and as implementation took longer than it was first expected, NGOs called for the introduction of social funds or social action plans to reduce poverty and integrate poorer groups of society.

- d.) NGOs also criticize that efforts made by IMF and World Bank are only addressing macroeconomic goals.

⁴ Nevertheless some commodities and services are still to be furnished by the public sector (infrastructure, social services and other meritoric goods)

⁵ Cornia, G. A., Jolly, R., Adjustment with a human face, Vol. I, Oxford 1987.

⁶ Thiele, R., Sind die Anpassungsprogramme von IWF und Weltbank gescheitert?, Kiel, 2000, p.8.

Paradigm dimension

- e.) Along with the criticism of not addressing the social dimension of adjustment, it has also always been argued that SAPs only use a limited set of instruments to achieve its goals.

Criticism includes that the structural adjustment programs in use are focusing only on policy failure and not considering adjustment obstacles such as market failure, limited information, risk and uncertainty.

- f.) Main criticism was and is still attributed to the conditionality of adjustment programs. The preeminent slur of NGOs is directed against the stronger outward orientation of the economies that are to undergo an adjustment process. An opening of domestic markets towards foreign competition is regarded as a threat for domestic producers that could be potentially competitive.⁷ The derived proposal of “protection of infant industries” argues that potentially competitive industries should be temporarily protected by reasonable tariffs until they have done away with their flaws, improved their experiences, built up a qualified stock of personnel and adequate infrastructure.⁸
- g.) Further criticism is directed towards liberalization efforts. It is argued that adjustment leads to a worse supply of loans for poor groups of population, because liberalization leads to an increase in interest rates.⁹
- h.) Another point that is criticized mainly by NGOs is the privatization of inefficient public services and enterprises – because in a short-term observation – unemployment rises.¹⁰
- i.) The IMF’s and the World Bank’s adjustment programs are further reproached for acting by the “one size fits all” principle. This implies that the implemented programs are not adjusted to the specific needs of one country, but are just developed and forced upon it.

⁷ OXFAM Policy Department, A case for reform. Fifty years of IMF and World Bank, Oxford, 1995, p. 17.

⁸ List, F., Das nationale System der politischen Ökonomie, Tübingen, 1959, p. 277.

⁹ Hammond R., The impact of IMF structural adjustment policies on Tanzanian agriculture. In: Development gap, Friends of the Earth, Washington D. C., 1999, p. 43.

¹⁰ Thiele, R., Sind die Anpassungsprogramme von IWF und Weltbank gescheitert?, Kiel, 2000, p.10.

1.2 Evaluation goals and methods

The goal of this paper will be to evaluate, if the Bolivian structural adjustment program structural was successful or not. It will be investigated into, whether the stabilization of the Bolivian economy worked out, and if the population's well-being could be increased in the long term.

Evaluation will mainly rely on the empirical comparison before and after the structural adjustment program. Results will also be quantitatively compared to targets initially set by the World Bank and the IMF. Both approaches have the advantage that they are very objective in the definition of standards. A counterfactual approach comparing hypothetical standards to results that were actually achieved, will not be applied, since it is impossible to extrapolate an optimum structural adjustment program. A comparison of indicators to a control group of countries appears inadequate also, because the relations between Bolivia and neighboring countries are too close to distinguish between causes and effects.

The basis for comparison between the stabilization phase (1985-1987) will be the time of chaos and hyperinflation (1983-1985). The structural adjustment phase (from 1987-2000) will be compared to the time period of recession and non-adjustment (1980-1985).

2 Evaluation of the Bolivian stabilization efforts

2.1 Monetary policy: exchange rate oriented stabilization

Economic theory of exchange rate stabilization

The policy of exchange rate oriented stabilization is a combination of the exchange rate as a nominal anchor (as a nominal variable) and fiscal adjustment (as a real variable). This does not mean that the exchange rate has to be fixed. A crawling peg is also possible. In addition, an adequate fiscal policy is necessary.^{11 12}

¹¹ Kiguel, M., Liviatan, N., Inflationary rigidities and stabilization, World Bank working paper No. 4, Washington D.C., 1988, p. 41.

¹² Sachs, J., The Bolivian hyperinflation and stabilization, NBER Working paper No. 2073, National bureau of economic research, Cambridge MA, 1986, p. 35.

The starting point is the relative purchasing power parity, which is assumed to be true in the long run. It is noted in equation 1:¹³

$$(1) \quad [p^d/p^f]_1 / [p^d/p^f]_2 = e_1/e_2$$

p^d = domestic price level
 p^f = foreign price level
 e = exchange rate
 1,2 = points in time

The ratios between domestic and foreign prices at points in time 1 and 2 equal the ratio of the exchange rates at both points in time.

The following assumptions are made:

- a.) Inflation is caused by expanding the monetary mass to finance a budget deficit.¹⁴
- b.) The present demand for money has a negative correlation to the present rate of inflation.
- c.) The change in the monetary base (b) equals the change in domestic credits (DC) plus the change in international foreign assets (FA).

$$\Delta b = \Delta DC + \Delta FA$$

Under flexible exchange rates the fiscal deficit is fully financed by an augmentation of domestic credit (i.e. that the fiscal deficit is financed by an inflation tax).

The policy change is that inflation is fought by fixing an exchange rate, without lowering the fiscal deficit. According to equation 1, inflation ends at once because with a fixed exchange rate domestic inflation equals foreign inflation. Domestic demand for the home currency will increase. Assets on foreign currency are being transferred into domestic currency assets. This means that a domestic fiscal deficit is no longer financed by an inflation tax. Instead now foreign assets are used to finance the fiscal deficit.

As foreign assets diminish, individuals will start to retransfer assets abroad, as they expect a devaluation. The speculative outflows of capital (maybe combined with speculative attacks of foreign investors) lead to an actual devaluation of the exchange rate, as the central bank of the concerned country might not have the means to defend the fixed exchange rate.

¹³ This formulation of the relative purchasing power parity requires, that the same commodity is traded on domestic and foreign markets, e.g. Hicks' composite commodity.

¹⁴ This was true in the Bolivian case of 1985.

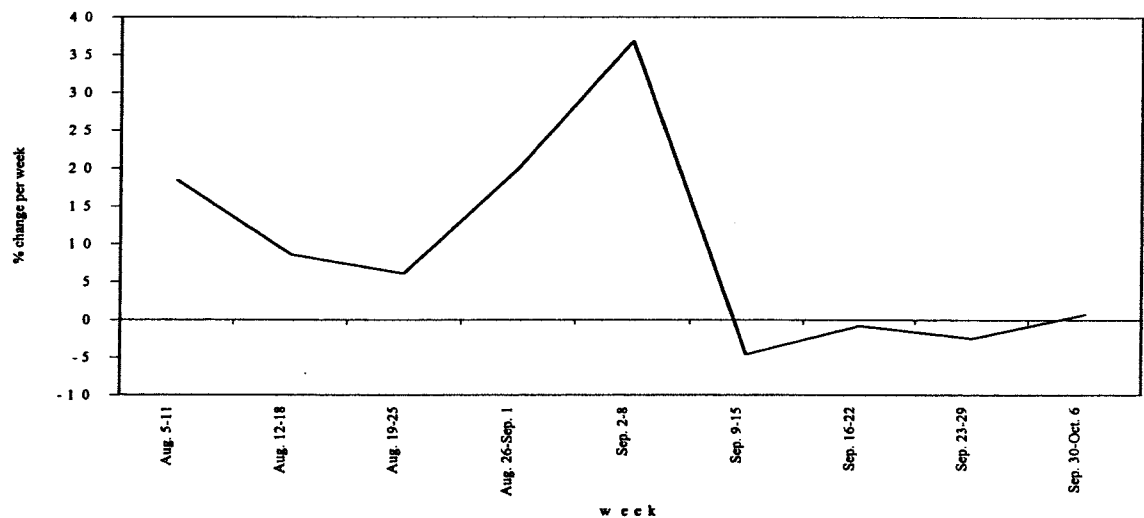
After the devaluation, assets in foreign currency are lower than before (under the assumption that not all assets could be transferred abroad before the devaluation). The fiscal deficit increases due to lower interest resulting from the reduced assets in foreign currency. The increased fiscal deficit has to be financed by a higher inflation tax, which equals higher inflation.

This argumentation shows that a lasting reduction of inflation needs fiscal reform and a reduction of the fiscal deficit. Linked to this, a restrictive monetary policy is necessary. Another prerequisite is that there are no inert mechanisms, e.g. the indexation of wages and prices.¹⁵

Presentation for Bolivia

With SD 21060 of 29 August 1985, the exchange rate was allowed to devalue freely, consequently, it depreciated by about 1600% in a single day. The market set the new unified exchange rate at about 1.1 million Pesos per US\$. Domestic prices for fossil fuels were adjusted to world market prices, or from 0.03 US\$ per liter to 0.28 US\$ per liter, which equals an increase of 833%.¹⁶ All other price controls were lifted. Inflation dropped immediately.

Figure 1: Weekly rates of inflation (% change per week, 5 Aug. 1985-6 Oct. 1985)¹⁷



¹⁵ Kiguel, M., Liviatan, N., Inflationary rigidities and stabilization, World Bank working paper No. 4, Washington D.C., 1988, p. 43.

¹⁶ Candia, F., Bolivia: Reforma Estructural y Politicas Publicas entre 1985-1997, manuscrito, La Paz, 1999, p. 23.

¹⁷ Morales, J. A., Sachs, J., Developing country debt and economic development, Chicago 1999, p. 240.

Inflation rates remained relatively low during the second year of the program. As the low inflation rates caused trust in the domestic currency to grow, demand for currency grew, too. The monetary mass M1, indicator of private money demand augmented by 63%.¹⁸

The questions for the Bolivian central bank were now, how to support the increased demand for money. According to the monetary theory of the balance of payments there are three choices:

- a.) Rise of loans to public debtors
- b.) Rise of loans to private debtors
- c.) Rise of international currency reserves

The Bolivian central bank chose to raise its international currency reserves.

First, it was assumed that Bolivians would hold considerable assets in US\$ abroad. There are no official estimates on the circulation of US\$ in Bolivia¹⁹, but there must have been considerable amounts circulating. The actual amount of US\$ assets eliminated can also only be guessed; different authors estimate them to have amounted for 20 Million US\$, since deposits with the Bolivian Central Bank grew by that amount in the period under concern.

Nevertheless, the Bolivian economy experienced three severe external shocks in the aftermath of the ending of hyperinflation. Bolivian exports have depended heavily on three items in recent years. Tin and natural gas constituted about 90% of Bolivia's exports. Coca represented the third sector. This sector is pursued in violation of legal statutes and therefore brings about a problem of evaluation. The inclination to avoid detection therefore makes it difficult to describe and evaluate the effect of this sector on the economy. Only indirect measurements and evaluation methods are used.²⁰

Once the stabilization program started there were major distortions in those three main markets. The tin price collapsed; the revenues sank from 34 million US\$ in October

¹⁸ Cariaga, J., Bolivia's hyperinflation, Three policy experiments. Bolivia, in: Williamson, J. Latin American Adjustment, How much has happened?, Institute for International economics, Washington, p.48.

¹⁹ Melvin, M., The dollarization of Latin America as a market enforced monetary reform, In Economic development and cultural change, Vol. 37 No. 2 p. 548.

1985 to only 6 million US\$ in November 1985. An augmentation of the produced quantity was not possible in this short range of time.²¹

In January 1986 the world market price of natural gas also sank. Consequently, Bolivia had to renegotiate the contracts with Argentina for its second most important export commodity. As a result, Bolivian revenues from the exploitation of natural gas sank from 373 million US\$ to 329 million US\$.²²

A third shock was that the Bolivian military forces tried to limit the production of coca. The losses in production are estimated to have accounted for 175 million US\$.

On 18 January 1986 the Prime Minister announced that a further devaluation of the Peso of up to 35% might be necessary. Hence, lending to the public sector was cut back. The inflation of January 1986 reached 33%, while the February 1986 inflation only amounted to 8%.²³

Conclusion for the exchange rate stabilization

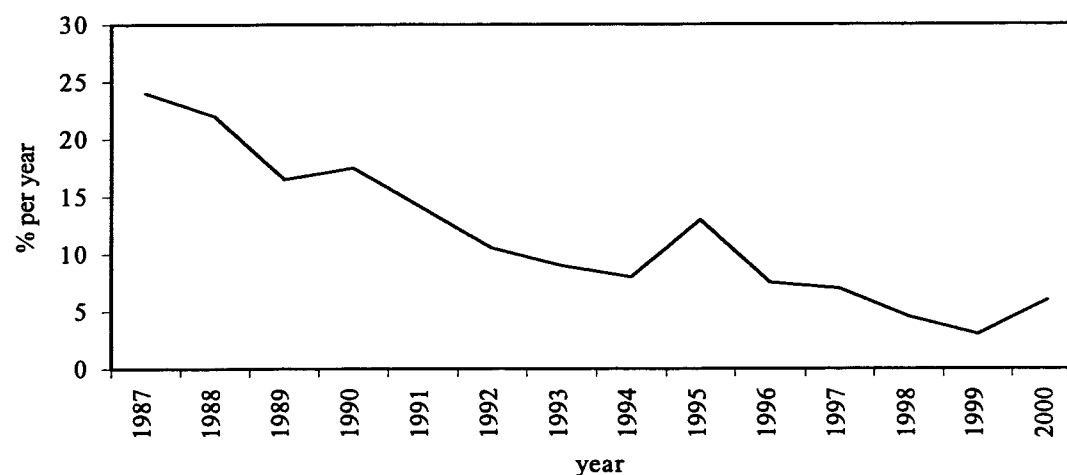
The economic theory shows that stabilization is impossible without devaluation and fiscal discipline. The data available displays that the stabilization program was successful in reducing and even ending hyperinflation. Bolivian inflation rates sank, and have remained at considerably low levels up to now.

²⁰ Grütter, J., A socio-economic evaluation of the structural adjustment program in Bolivia, Chur, 1993, p. 36.

²¹ Schiesser-Gachnang, D., Bolivien, Hyperinflation, Stabilisierung und Anpassung, 1993, Hallstadt, p. 132.

²² Banco Central Boliviano, Boletín Estadístico No. 256 (1985) and Banco Central Boliviano Boletín Estadístico, No. 258 (1986), La Paz, 1985-1986.

²³ Morales, J. A., Inflation stabilization in Bolivia, in: The inflation stabilization in: the experience in Israel, Argentina, Brazil, Bolivia and Mexico. The MIT Press, Cambridge, MA, p.352.

Figure 2: Rate of inflation per year 1987-2000²⁴

A non-inflationary exchange rate management was crucial, which could only be attained by swift devaluation and a change in the budget practice (thus at high social cost, which will be shown in chapter 3.3). The high social costs were intensified by the external shocks Bolivia underwent.

Hence, the criticism stated in subchapter 1.1 (arguing that the emergence of short term costs were not considered) is partly true. The emergence of short term social costs should have been cushioned earlier than it actually happened.

The process of restoring a stable currency was completed with the introduction of a currency reform on 1 January 1987. One million Pesos accounted for 1 Boliviano.

2.2 Monetary policy: interest rates

Economic theory of interest rates

The theory of interest rates assumes that a shortage of domestic loans leads to an increase in real interest rates. If controls on interest rates are abolished at the same time, the rise in real interest rate that follows, expresses the real scarcity of capital. According to the preceding argumentation, a rise in the supplied quantity of loans ensues. Even capital that fled might be attracted to come back into the country. According to the theory, the efficiency of allocation is augmented, which has positive effects on growth. At the same time investment and consumption, decrease. If political actors are not credible, complete information does not prevail, there is a lack of macroeconomic

²⁴ IMF, Bolivia Staff Report, Article IV Consultation and request for second annual arrangement under the poverty reduction and growth facility, Washington D. C., 2000, p. 34.

stability, and banking supervision is ineffective, adjustment processes can pose the problems stated below:

Lack of credibility about the success of a stabilization program can influence the interest rate. The abolition of the controls of interest rates can cause creditors to raise the interest rates for loans to levels that include the anticipated depreciation of the home currency. These expectations can be illustrated in the interest rate spread between loans in a non-inflationary environment and the currency that is affected by inflation.

If the **distribution of information is asymmetric**, debtors have more information than creditors. Raising real interest rates to a level of i^1 , result in more credits given to debtors. If the real interest rates rise to i^2 , banks will anticipate a loss of refunds and lower the amount of loans granted.²⁵ The refunds expected are lower because of two reasons: First, trustworthy debtors are not willing to pay the higher interest rate i^2 ; second, all remaining debtors have a higher incentive to choose projects with a higher risk involved, because projects with a higher risk are associated with a higher revenue. The resulting shortage of loans leads back to equilibrium interest rates.

If liberalization of interest rates coincides with an **unstable macroeconomic environment**, the bank will augment its reserves to be prepared for unforeseen situations. Hence the quantity of loans is reduced.

Presentation for Bolivia

Following the Supreme Decree SD 21060 all banks were allowed to set their interest rates freely. A shock approach was chosen, which has led to positive real interest rates and allowed an inflow of foreign capital into Bolivia. The dedollarization of President Siles Zuazo was however reversed. Minimum reserve quota for assets without guaranty of value maintenance were issued; however no minimum reserve quota for assets in foreign currency were introduced. De facto bank supervision was loosened.²⁶ Different authors (e.g. Dunkerley²⁷) have argued that the easing of banking controls caused illegal revenues from coca exports to be laundered in Bolivian banks after the start of the program.

²⁵ Villanueva, D., Mirakhor, A., Interest rate policies, stabilization and bank supervision in developing countries. IMF working paper No.8, IMF, Washington. D. C., 1990, p.2-4.

²⁶ Schiesser-Gachnang, D., Bolivien, Hyperinflation, Stabilisierung und Anpassung, 1993, Hallstadt, p. 142.

Credibility in the wake of stabilization

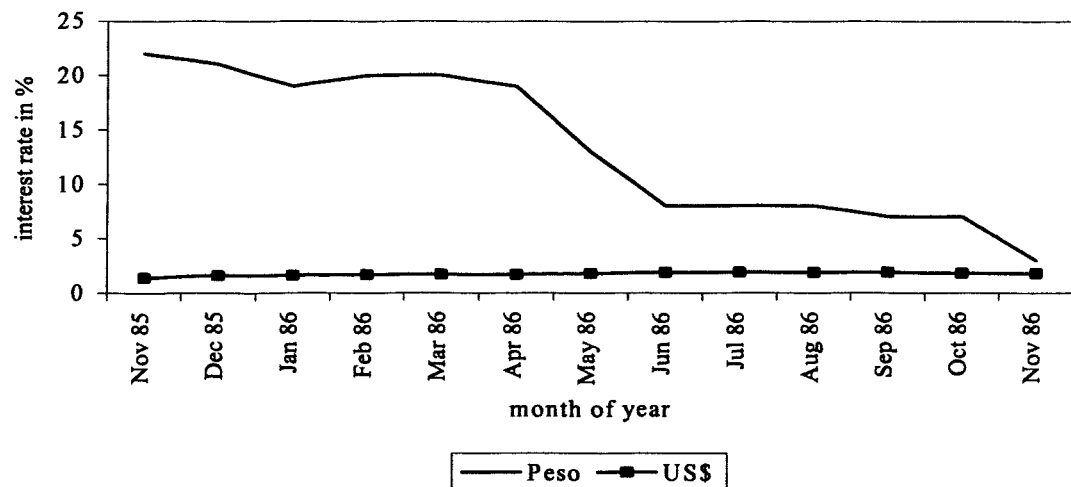
The stabilization attempts did not alter inflationary expectations of the public. This was because the stabilization program was already the seventh in four years; the executing President did not have a majority in Congress and won less than 30% of the electoral vote. The program also reflected a radical change from the socialist program the same President had introduced when he was first in power in 1952.

Despite the lack of credibility with the public, the stabilization process succeeded.

The key to this paradoxical view is that it was possible for the government to intervene and prevent foreign currencies from appreciating, because the Central Bank was willing to commit at least a part of its reserves into supporting the exchange rate of the Peso and did not print new money.

The inflationary expectations of the public, can best be seen in the spread between US\$ and Peso interest rates for thirty day loans in the concerned time (Figure 3).

Figure 3: Spread between nominal interest rates for loans in Peso and US\$²⁸



From November 1985 until November 1986 interest rates for 30 day loans remained at high levels. Up until March 1986, the inflation expectations proved to be underestimated. The consequence was that real interest rates were negative from November 1985 to January 1986. From February to September 1986 there was a

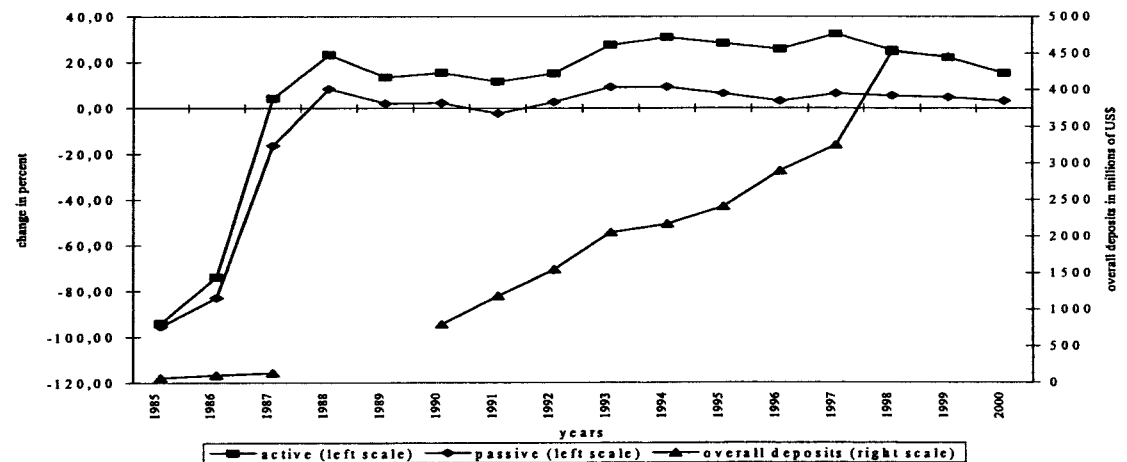
²⁷ Dunkerley, J., Political transition and economic stabilization, Bolivia, 1982-1989, Research paper No. 22, Institute of Latin American studies, London, 1990, p.33.

²⁸ Morales, J.A., Sachs, J., Developing country debt and economic development, Chicago 1999, p. 246.

slighter depreciation of the Bolivian Peso. The data clarify that confidence in the Bolivian currency was not immediately restored with the launch of the program.

In the following years the interest rates continued on a stable path. Deposits in the Bolivian banking system grew, mainly also due to the return of capital that had fled and the increase in laundered “narcodollars”.²⁹

Figure 4: Real active and passive interest rates for 30 day loans in Bolivian currency and overall banking system deposits from 1985-2000³⁰



Conclusion for interest rate stabilization

From the theoretical background it can be argued that with the introduction of the NEP, the portfolio quality of Bolivian banks diminished. The rising real interest rates (starting in February 1986) increased the liabilities of Bolivian banks, thus creating a higher demand for new loans. Unmet loans increased.³¹ This led to an adverse selection. “Good” debtors could not afford to pay the high interest rates; only debtors that accepted high risks and a higher probability of failure would continue to close deals. The diminishing quality of bank portfolios was also caused by external factors that dated back to times before the New Economic Policy.³² The strongest external factor was the dedollarization policy of President Siles Zuazo starting in 1982. Banks and private households were forced to convert their US\$ assets into Peso and to write off

²⁹ Cariaga, J., Three policy experiments. Bolivia. In: Williamson, J. Latin American Adjustment. How much has happened? Institute for International Economics, Washington D. C., 1990, p. 48.

³⁰ Source: instituto nacional de estadísticas, homepage: www.ine.gov.bo, 14.03.01 (no data available for bank deposits from 1988-1989).

³¹ Morales, J. A., Bolivia’s post stabilization problems, documento de trabajo No. 8, Instituto de investigaciones socio economicas, Universidad Catolica Boliviana, La Paz, 1990, p. 13.

³² Schiesser-Gachnang, D., Bolivien, Hyperinflation, Stabilisierung und Anpassung, 1993, Hallstadt, p. 144.

considerable amounts of their portfolios.³³ At the same time, investors were partly expropriated.³⁴

It can be derived that the banking sector was already in a difficult situation, before the NEP was introduced. The sudden liberalization of interest rates intensified elements of asymmetrical information (adverse selection and moral hazard). Looking at results over time, it becomes obvious that after initial problems, the banking sector continued to attract increasing quantities of deposits (including illegal "narcodollars"), which are growing in quantity until today.

A shock approach of sudden liberalization to attract international capital should have been linked to an increase in banking supervision afterwards. In fact, banking supervision was increased in 1996.

The criticism stated in subchapter 1.1 e (disregard of problems like market failure, risk and uncertainty) proves to be adequate. The loosening of banking supervision induced adverse selection and moral hazard.

2.3 Fiscal policy

Economic theory of fiscal policy

The macroeconomic approach:

Domestic consumption can be expressed as a function of domestic income. Exports correlate positively to foreign income, imports correlate positively to domestic income:

This relation is expressed in equation 2:³⁵

$$(2) \quad Y - A(Y) = Ex(Y^a) - Im(Y)$$

Y	= domestic income (equals output)
Y ^a	= constant foreign income
Ex	= exports
Im	= imports
A	= private consumption + investment + government consumption

³³ Bank credits had to be converted into US\$ at 145 Pesos/US\$, although the official exchange rate was 196 Pesos/US\$.

³⁴ Estimations name amounts of up to 60%. Pick's Currency book, New York, 1984, p. 105.

³⁵ Meller, P., Review of the theoretical approaches to external adjustment and their relevance to Latin America., In CEPAL review, No. 32, p. 175.

Equilibrium is only attainable by changing Y (income). That income leads to equilibrium on both the commodities market and the account balance is coincidental, though.³⁶ Equilibrium on the commodities market can entail an account balance deficit. In situations of economic crisis, domestic consumption (private and government) are higher than income. If the government then lowers its consumption, an equilibrium can be reached.³⁷ This can help to reduce a short term budget deficit.

The microeconomic approach:

Another way to reduce budget deficits is the introduction of a tax reform, which induces higher government revenue. Using the inefficient inflation tax to finance higher government consumption can thus be avoided. A tax reform includes the broadening of the taxable base, the simplification of the tax system and an improvement of the tax administration to complicate evasion.

Another positive effect is that with rates of inflation declining, real tax revenues increase without increasing the tax rates.

The macroeconomic approach to the balance of payments regards only the overall size of a budget deficit and its negative and paralyzing effects on the actions of a government.³⁸ Effects on supply, efficiency, and the time component are taken into account only in the microeconomic approach.

One can conclude that not only the mere (macroeconomic) reduction has to be a goal of a stabilization process, but that microeconomic incentives (increasing efficiency) have to be taken into consideration, too.

Presentation for Bolivia

Soon after the implementation of the NEP in 1985 it became obvious that the fiscal policy had changed. The Tesoro General de la Nacion (TGN, i.e. the treasury) was put under strict control. Credits issued by the Central Bank as a major source of money for government institutions were abolished, eliminating the direct and indirect funding it was granting before. The freezing of banking accounts of the TGN, major public enterprises and decentralized entities worked in the same direction.³⁹ On top of that, the

³⁶ Only if inclination to consume $\Delta A/\Delta Y$ equals inclination to import $\Delta Im/\Delta Y$.

³⁷ It is also possible to lower private consumption by curtailing income and thus imports. But this equilibrium would entail unemployment, since output is reduced.

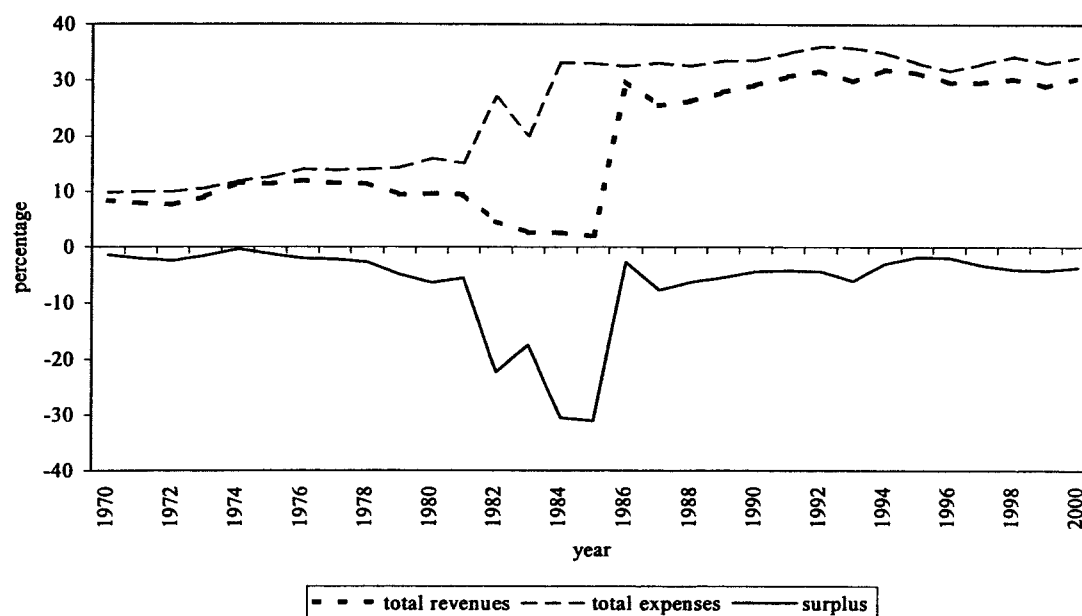
³⁸ Tanzi, V., Public finance in developing countries, Washington D. C., 1991, p. 40.

³⁹ Cariaga, J., Estabilizacion y Desarrollo, Los Amigos del libro, La Paz, 1996, p. 35.

salaries of the employees of the public sector were set to a fixed level; numerous employees of public companies were fired. As a result of the collapse of the world market price of tin (see chapter 2.1.3) the state owned Corporación Minera de Bolivia (COMIBOL, Bolivian mining corporation) fired 70% of its workforce in one day.⁴⁰ Also, public investment declined to a minimum in the first month of the stabilization program. Prices were adjusted to world market levels, thus eliminating subsidies (most important for gasoline, see chapter 2.1.3)

The combination of measures allowed the Bolivian government to decrease the budget deficit from levels of more than 20% in the preceding years to 2.7% in 1986.

Figure 5: Revenues and expenses of the Bolivian public sector in percent of the GNP⁴¹



The overall tax structure of the country was also changed. The Bolivian Congress voted Law No. 843 on tax reform in May 1986, thus eliminating the old system of more than 450 different taxes.

The new system was simplified and was now based on only eight indirect taxes, principally on overall costs, but some of them also on property. For the first time

⁴⁰ Jemio, L., Quince años de reformas estructurales en Bolivia, Universidad Católica de Bolivia, La Paz, 2000, p.25.

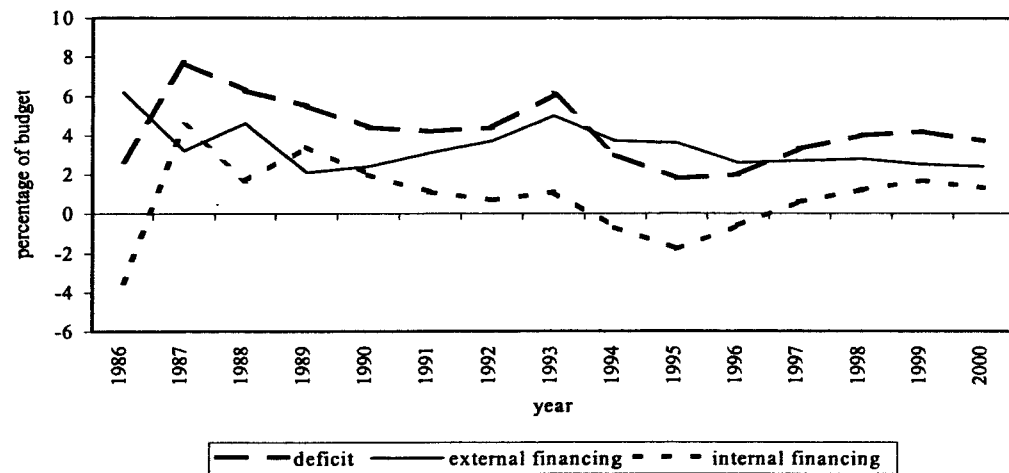
⁴¹ Source: calculation on the database of Udape (Unidad de Análisis de políticas sociales y económicas (1985,1993,2000), La Paz, Bolivia, internet: www.udape.gov.bo. 15.03.01

Bolivia had a value added tax (VAT)⁴² Also for the first time the distribution of tax revenues was assessed. Seventy-five percent of all taxes collected were to benefit the central government, 20% for the communities and 5% for the public universities.

According to estimations of the Udape,⁴³ the tax reform increased tax revenues about 40 to 50%. Today, tax-evasion is still a considerable problem for the Bolivian government. To meet this challenge the Bolivian congress passed Law No. 1990 in July 1999 to improve the administration of tax collecting.

After the implementation of the NEP and the establishment of a stand-by-agreement with the International Monetary Fund, the structure of financing the public deficit also changed. Obligations were met by accepting foreign loans, instead of just printing money. Before, foreign loans to the Bolivian public sector had been hard to access.

Figure 6: The financing of public deficit: foreign or domestic loans from 1986-2000⁴⁴



Conclusion for fiscal policy

The changes in the Bolivian tax system, as well as the actual level and the financing of the public sector deficit were substantial. An amelioration of the situation was not only established in the short run, but fairly good results, with moderate public sector deficits, last until today.

⁴² Jemio, L., Quince años de reformas estructurales en Bolivia, Universidad Católica de Bolivia, La Paz, 2000, p.27.

⁴³ Udape (Unidad de Análisis de políticas sociales y económicas (2000), La Paz, Bolivia, internet: www.udape.gov.bo. 16.03.01

⁴⁴ Jemio, L., Quince años de reformas estructurales en Bolivia, Universidad Católica Boliviana, La Paz, 2000, p. 27, 29.

The aims portrayed in the macroeconomic approach (reduction of overall public deficit) were emphasized in order to support the reduction of the hyperinflation.

Overall it can be argued that the government's efforts focused much more on raising revenues than on lowering expenses (macroeconomic approach). Revenues rose by 1500% from 1985 to 1986, whereas spending was only lowered by less than 2%. The microeconomic approach was not extensively applied, thus lowering growth expectations for the years to come. In short, quantity was chosen over quality.⁴⁵

The criticism stated in subchapter 1.1 d. (IMF and World Bank programs only regard macroeconomic goals) appears to be true.

2.4 Debt management

Cessation of foreign lending to Bolivia, combined with heavy debt-service payments was a key factor in promoting Bolivian hyperinflation. The commercial bank debt payments were unilaterally stopped in May 1984. From this base, the author will try to show the significance of sustainable debt management, first theoretically and, then give a presentation for Bolivia.

The economic theory of debt management

It may be beneficial for the country to pay a multiple of a sum owed, instead of accepting consequences that would prove much worse in the long run. It will also be advantageous to pay back as much as possible, to minimize sanctions from creditors. But countries in debt will always try to reschedule their payments. A cash starved country will find it advantageous to pay the present value of credits in the future.

Bilateral debt rescheduling underwent substantial changes starting in 1988. Bilateral debt reduction levels (in percent of total debt) offered by the G7 nations rose in the sequence of the various summits from 33% (Toronto summit 1988), 50% (London summit 1991), 67% (Naples summit 1994), 80% (Lyon summit 1996) to finally 90-100% (Cologne summit 1999).^{46 47} But multilateral debt further increased. In 1996 37% of all developing country debts were of multilateral nature. This led to the creation of the HIPC Initiative by the IMF and the World Bank to significantly lower debt levels of

⁴⁵ Schiesser-Gachnang, D., *Bolivien, Hyperinflation, Stabilisierung und Anpassung*, 1993, Hallstadt, p. 156.

⁴⁶ Kampffmeyer, T., *Lösungsansätze für die Verschuldungsprobleme der ärmsten Länder*. Aus: *Politik und Zeitgeschehen*. Beilage zur Wochenzeitung *Das Parlament* B9/2000 25.2.2000, p. 24.

⁴⁷ Nuscheler, F., *Lern- und Arbeitsbuch Entwicklungspolitik*, Bonn, 1998, p. 312.

the “Heavily Indebted Poor Countries”. The initiative was reviewed in 1999 and was renamed the HIPC2 initiative.⁴⁸ Both initiatives consisted of two phases taking up six years:

- in the first three years the developing country is obliged to use all available sources to lower its debt with bilateral creditors
- after three years, it is decided whether relief is necessary to reach sustainable debt level
- after six years, creditors assume the apt measures to reduce the country’s multilateral debt

Table 1: Sustainable debt levels according to the HIPC1+2 :⁴⁹

	HIPC1 initiative	HIPC2 initiative
Debt of overall exports	200-250%	150%
Debt of public revenue	280%	250%
Debt payments of overall export revenues	20-25%	15%

Presentation for Bolivia

When the NEP was introduced, one of the main objectives was to reduce the Bolivian external debt.

Multilateral debt management:

Initially Bolivia negotiated a debt buyback of its external debt titles. It was granted at a value between 11 and 17 US Cents per US\$ of Bolivian debt. The buyback was primarily financed with funds granted by the international community.⁵⁰ In 1986, Bolivia started negotiations with multilateral organizations. It was able to establish a stand-by agreement with the IMF, which was followed by a treaty to obtain funds from the Structural Adjustment Facility (SAF) by the IMF. Under these conditions Bolivia could claim 70% of its Special Drawing Rights (SDR) as means for structural adjustment.⁵¹ In 1988 a treaty was signed on the conditions of the Enhanced Structural Adjustment Facility (ESAF) that permitted the Bolivian government to avail itself with

⁴⁸ Abendroth, H., La deuda externa de Bolivia, centro de estudios del desarrollo de labor y agricultura, (CEDLA) La Paz, 2001, p. 351.

⁴⁹ Oxfam policy paper, Debt relief and poverty reduction: Meeting the Challenge, London, 1999, p. 12.

⁵⁰ Larrazabal, H., Todo el alivio de la deuda externa para el desarrollo local sostenible, La Paz, 2000, p. 17.

⁵¹ Gómez, J. Apuntes sobre la evolución de la deuda externa de Bolivia 1990-1998, centro de estudios para el desarrollo laboral y agrícola, La Paz, 1999, p. 14.

up to 190% of its SDR.⁵² Coverage of Bolivia under the Enhanced Structural Adjustment Facility (ESAF, started in 1988) and the Poverty Reduction and Growth Facility (PRGF, started in 1999) still continues today. From 1995, Bolivia was one of the first countries to participate in the HIPC1+2 initiative of the IMF and the World Bank.

Bilateral debt management:

In 1986 Bolivia began to reschedule its debt and interest payments with the Club of Paris. Subsequently, Bolivia received bilateral restructuring and rescheduling of its debt according to the Naples conditions (after the Toronto and London/Trinidad conditions had already been negotiated)⁵³ The terms of agreement did not only imply a restructuring, but also a reduction of the stock of debts by 978 Million US\$, of which 67% consisted of direct or indirect donations.⁵⁴

Commercial debts were repaid until 1998, and do not play a significant role in the structure of Bolivia's external debt.

Figure 7: Evolution of the Bolivian external debt from 1985-2000 (constant prices of 1989)⁵⁵

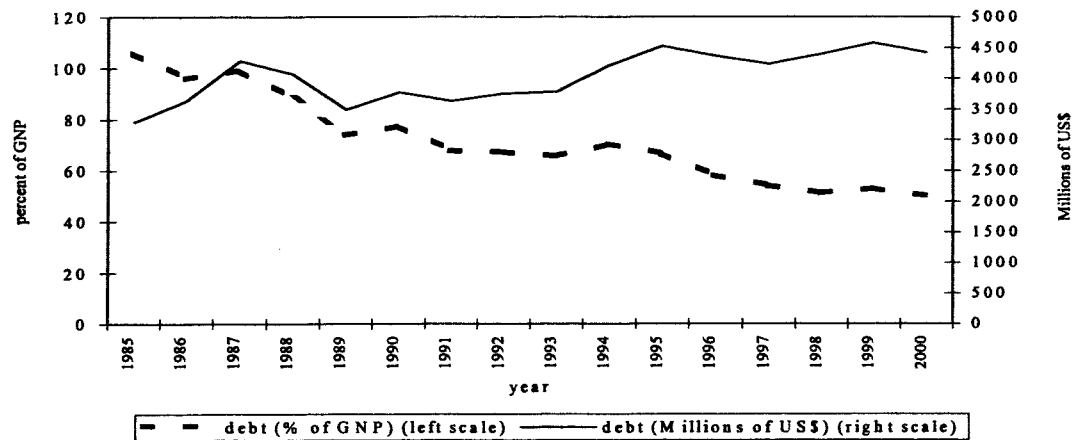
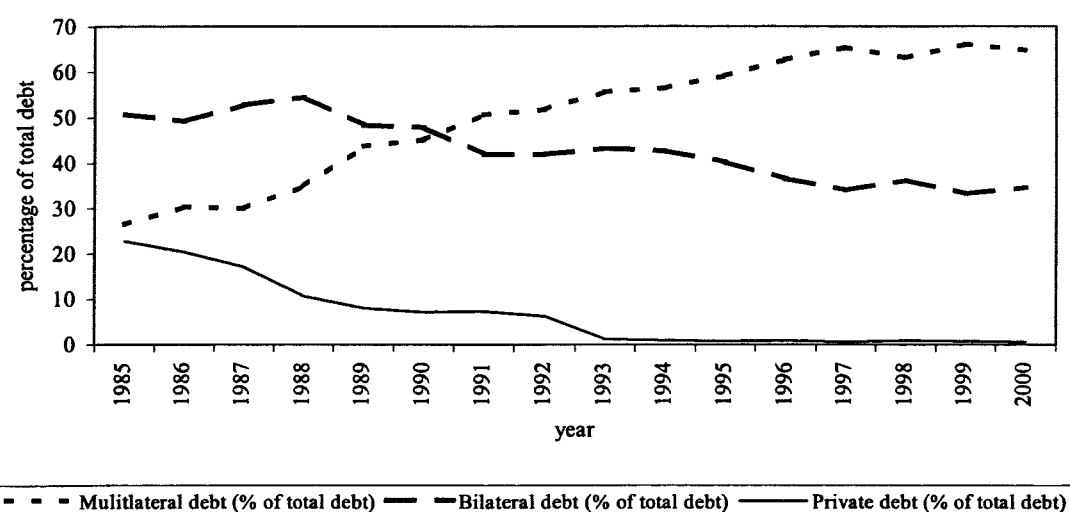


Figure 7 shows that the external debt/GNP ratio of Bolivia has decreased considerably since the implementation of the NEP in 1985. Nevertheless absolute debt levels grew. The distribution of the external debt show that multilateral debt became the main problem.

⁵² Nuscheler, F., Lern- und Arbeitsbuch Entwicklungspolitik, Bonn, 1998, p. 323.

⁵³ Jemio, L., Quince años de reformas estructurales en Bolivia, Universidad Católica Boliviana, La Paz, 2000, p. 39.

⁵⁴ Evia, J., Las reformas estructurales en Bolivia, Tomo II, La economía de 1993-1997, La Paz, 2000, p. 41.

Figure 8: Distribution of Bolivian external debt from 1985-2000⁵⁶

Today, due to increased lending of the IMF, along with slow procedures of the HIPC1 and 2 initiative, multilateral debt is the highest in the history. Bolivia reached the completion point of the HIPC1 initiative in September 1998 ahead of schedule and was released from 448 Million US\$ (present value).⁵⁷

Table 2: Comparison between sustainable and achieved debt levels for Bolivia (all indicators for the year 2000)⁵⁸

	HIPC1 initiative	HIPC2 initiative	Indicator of Bolivia
Debt of overall exports	200-250%	150%	382%
Debt of public revenue	280%	250%	327%
Debt payments of overall export revenues	20-25%	15%	23,3% ⁵⁹

Conclusion for debt management

Bolivia was able to reduce its debt in relation to its GNP by more than 50%, although the absolute external debt level increased in the last 15 years. The rescheduling and release of bilateral debt was established quickly with good results. Today private debts no longer play a significant role.

⁵⁵ Calculated on the base of data available at Banco Central de Bolivia, www.bcb.gov.bo 22.03.01.

⁵⁶ Calculated on the base of data available at Banco Central de Bolivia, www.bcb.gov.bo 22.03.01.

⁵⁷ Jemio, L., Quince años de reformas estructurales en Bolivia, Universidad Catolica Boliviana, La Paz, 2000, p. 40.

⁵⁸ own calculations on the base of data from Udape (Unidad de Analisis de politicas sociales y economicas) (2000), La Paz, Bolivia, internet: www.udape.gov.bo and Banco Central de Bolivia www.bcb.gov.bo La Paz, 23.03.01.

⁵⁹ Boletín del Sector Externo No. 18 Diciembre 2000, Banco Central de Bolivia, p. 13.

The indicators for multilateral debt show clearly that the IMF's goals have not been reached. Although Bolivia was one of the first countries to have had a release of debt, results have been shattering. Further release from debt payments are therefore needed by the Bolivian economy.

3 Evaluation of the structural reforms implemented

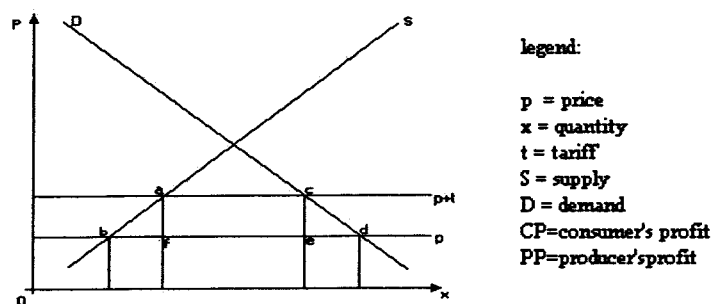
This chapter describes the structural changes evoked by the reforms of 1985. In some cases it is difficult to attribute present day situations to elements of the reforms, since the Bolivian economy was influenced by numerous incentives other than the structural reforms.

3.1 The external sector: tariffs, terms of trade and the balance of payments

Economic theory of the external sector

Theory of tariffs:

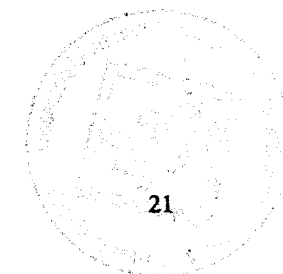
Graph 1: Effects of a tariff on consumers, producers and government in a small open economy (prices for domestic exports cannot be influenced, prices for imports can be influenced)⁶⁰



Tariffs that are collected by the government (not just quantitative limitations imposed on importers) raise the government's revenue (by the rectangle acef). While tariffs are collected, the consumer's profit CP is lowered (by the area cdgh), due to higher consumer prices. Domestic producers are able to realize higher profits PP (by the area abgh). The overall balance remains negative though and the economy is missing some of the potential well-being that could be achieved. (areas abf and cde).

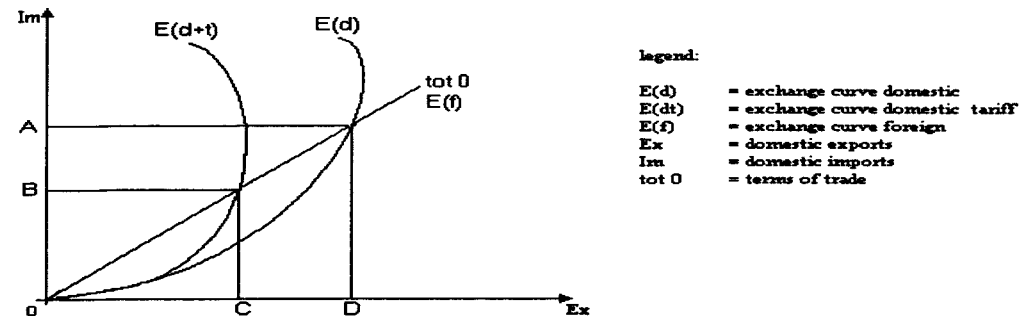
Terms of trade:

⁶⁰ Rose, K., Theorie der Außenwirtschaft, München, 1978, p. 388.



Generally the terms of trade express how many exports (domestic goods) a country must provide in order to obtain one imported commodity.

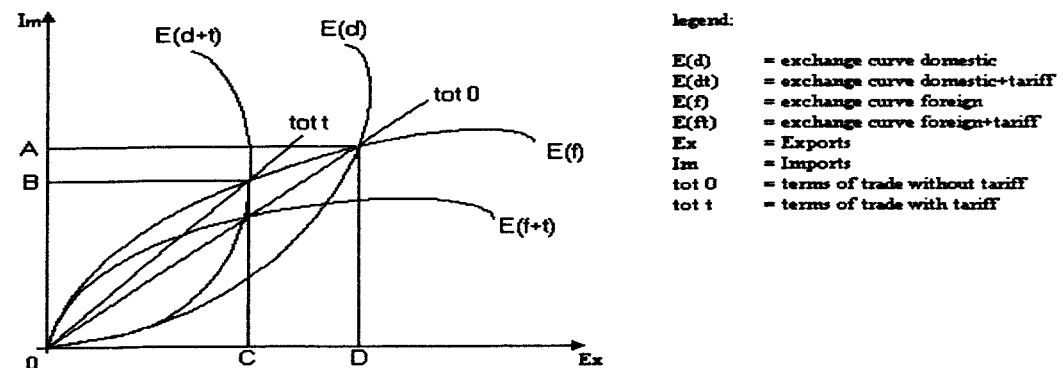
Graph 2: Effects of a tariff on the terms of trade in a small open economy (prices for domestic imports can be influenced, prices for domestic exports are determined on the world market)



At the beginning the home country does not impose a tariff on imports. Both countries trade at the exchange curves $E(d)$ and $E(f)$. The terms of trade 0 ($tot\ 0$) are realized. The home country must export OD commodities to obtain OA commodities from abroad. The ratio OD/OA represents the terms of trade for the home country.

If the home government collects a tariff on the importation of foreign commodities, exchange curves $E(d+t)$ and $E(f)$ are realized, (assuming that the foreign country does not have to take compensatory measures since the world market price did not change). In this situation the home country provides OC goods to obtain OB . Ratio C/B is the same as the former ratio D/A . Its terms of trade have not improved. Only the quantity of traded goods has decreased. Negative effects of the tariff prevail.

Graph 3: Effects of a tariff on the terms of trade in a big open economy (prices for domestic exports and imports can be influenced)⁶¹



⁶¹ Rose, K., *Theorie der Außenwirtschaft*, München, 1978, p. 400.

At the beginning neither countries imposes a tariffs on imports. They trade at the exchange curves $E(d)$ and $E(f)$. The terms of trade 0 (tot 0) are realized. The home country must export OD commodities in order to obtain OA commodities from abroad. The ratio OD/OA represents the terms of trade for the home country.

If the home government collects a tariff on the importation of foreign commodities, exchange curves $E(d+t)$ and $E(f)$ are realized. (assuming the foreign country does not take compensatory measures, to improve its situation again). In this situation all the home country has to provide are OC goods to obtain OB . Ratio B/C is higher than the former ratio A/D (The slope of tot t is higher). Its terms of trade have improved, but the quantity of traded goods has decreased.

If the foreign country takes compensatory measures and imposes a tariff on its imports the terms of trade are set back to the beginning. No country has an advantage by imposing a tariff. Only the quantity of goods traded is lowered. It is harder for the two countries to take advantage of their comparative advantages.

Presentation for Bolivia

As Bolivia is a small country, it cannot influence world market prices for its exports, but can influence the prices of imports by setting tariffs. Only with tin as an export commodity, Bolivia and other countries were able to influence the world market price, by signing mutual agreements about production capacities and exported quantities.

Before the introduction of Supreme Decree 21060 in 1985, Bolivia operated a system of tariffs chiefly aimed at stabilizing the prices of its main export commodity tin. Bolivia had signed agreements on tin in 1956, 1961, 1966, 1971, only the last one in 1976 was not approved, because it regarded the price targets as too low (due to Bolivia having the highest production costs of all tin producing countries⁶²). The high price policy was not supported by other producer countries because they feared that high prices lead to the substitution of tin in production processes. With the collapse of the tin market (see chapter 2.1.3) this assumption proved right in 1985.

Hydrocarbons were also a major export commodity of Bolivia.⁶³ However, with the rise of domestic consumption after 1973, the amount left for exports decreased. From 1977

⁶² Morales J. A., *Deuda de paises en desarrollo y el rendimiento económico*, La Paz, 1990, p. 204.

⁶³ Morales, J. A., *The Bolivian external sector after 1964*, in: *Modern day Bolivia*, Tempe, AZ, 1982, p. 53.

on Bolivia was a net importer of hydrocarbons. In 1977, the Bolivian government decided to subsidize export goods such as tin and petroleum.⁶⁴

A critical feature of the Bolivia's import tariff structure, in place until 1985, was the existence of preferential tariff provisions for commodities according to the final use they were put to. These provisions also existed for goods used in the Northwestern region of Bolivia and goods stemming from countries with which Bolivia had bilateral agreements on the reduction of tariffs.⁶⁵ Tariffs varied between 10% and 150%. Frequent changes in the system of tariffs were brought about by pressures of special groups of interest. Quantitative restrictions on imports were only used from 1970-1982, and even decreased in that period.⁶⁶

With the implementation of Supreme Decree SD 21060 in August 1985 the complicated system of tariffs was changed into single tariffs of 10% plus 10% of the tariff effective at date. In 1986 this system was modified again. A general tariff of 20% was introduced for the majority of goods. Non-tariff trade barriers were practically abolished. Nontraditional exports were freed of taxes. The aim of all these measures was to open the Bolivian economy and establish Bolivia on the world market. This liberalizing led to Bolivia's acceptance in the GATT (accord agreed in 1989) and later in the newly created WTO.⁶⁷ Still later Bolivia became an associated member of the MERCOSUR⁶⁸, the CAN⁶⁹ and the ALADI⁷⁰. Free trade zones were established with Mexico and Chile.⁷¹ Most favored nation statuses were conferred with the US (Andean Preferential System), the European Union (Preferential Regime for selected Andean commodities), Canada, and Japan (G7 global system of commercial preferences).

Between 1985 and 1998 Bolivia's export structure changed.

⁶⁴ Sachs, J., *Developing country debt and economic development*, Chicago 1989, p. 206.

⁶⁵ Heldt, S., *superacion de crisis exige crecimiento*, Boletín de la cámara de comercio e industria boliviano alemana, La Paz, 5-6/1986, p. 33.

⁶⁶ Due to a lack of space, these non-tariff trade restriction are not discussed in detail.

⁶⁷ Antelo, E., *Políticas de estabilización y de reformas estructurales en Bolivia de 1985*, La Paz, 2000, p. 43.

⁶⁸ Mercado comun sudamericano, (South American Common Market)

⁶⁹ comunidad andina de naciones (Community of Andean Nations) aimed at ameliorating international relations and trade of the Andean countries.

⁷⁰ Asociación Latinoamericana de Integración (Association for Latin American Integration)

⁷¹ Candia, F., *Bolivia, Reforma Estructural y Políticas Públicas entre 1985-1997*, La Paz, 1999, p. 54.

Figure 9: Structure of Bolivia's main exports from 1985-1998 (current prices)⁷²

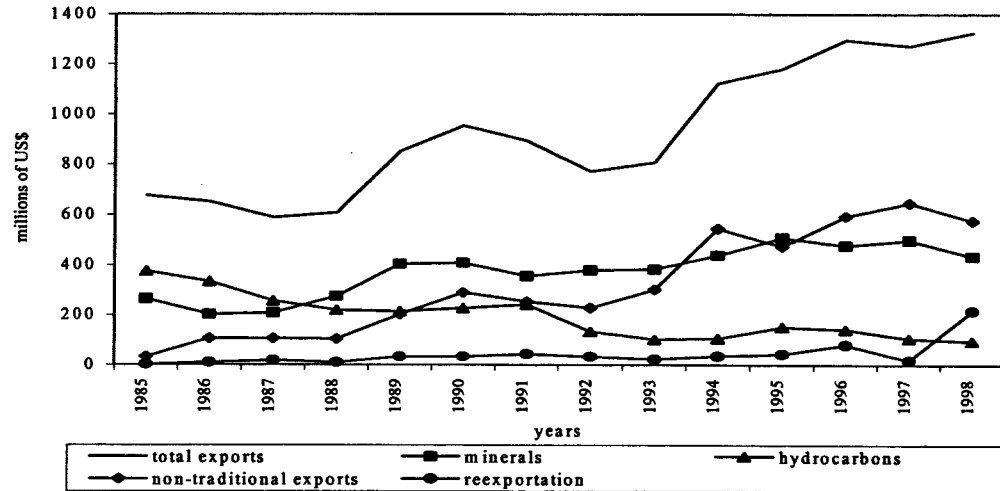
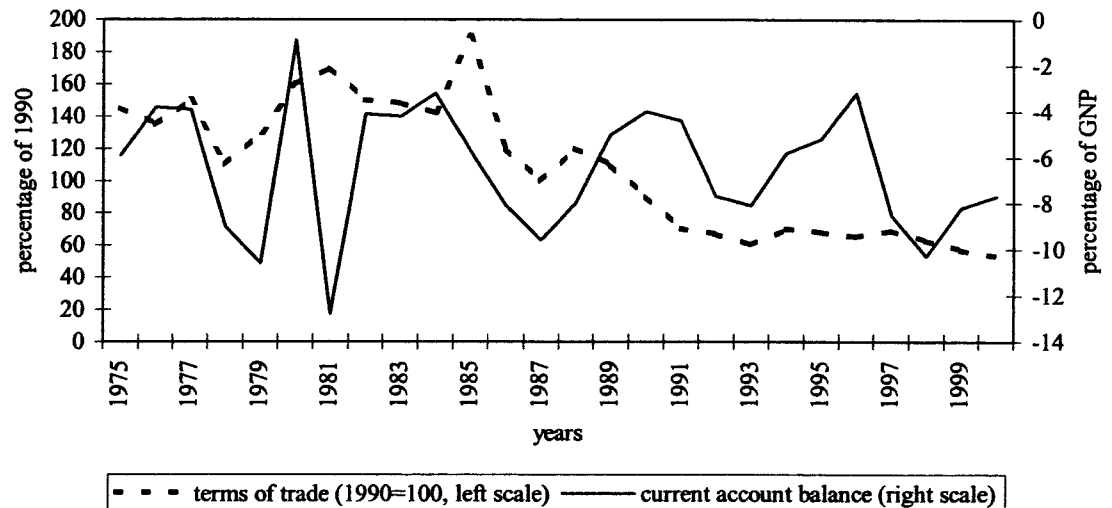


Figure 10: Development of the terms of trade and the balance of payments' deficit⁷³



Conclusion for the external sector

One consequence of the abolishment of tariffs and the collapse of the world market prices for tin was a decrease in the terms of trade as shown figure 10, which declined from its high level in 1985 straight downward until today.

The measures taken in the reform program show the dilemma between the benefits of stabilization (aimed to raise taxes) and the aims of a policy aimed to increase growth

⁷² Jemio, L., *Quince años de reformas estructurales en Bolivia*, La Paz, 2001, p. 45.

⁷³ International Monetary Fund, *Bolivia: statistical annex*, Washington D. C., 2000, p. 44.

(exemption from taxes). Beginning in 1987, export promotion policies got into place with the reactivation decree SD 21660.⁷⁴

As a result of the efforts stated above, the value of exportations doubled between 1985-1998. Nevertheless, the Bolivian economy did not reach the values of imports and exports that were envisaged by the government in "strategy for economic and social development 1989-2000".⁷⁵ (The strategy will be explained in the next chapter) In spite of the export structure of Bolivia shifting to non-traditional exports, imports of goods and services have more than doubled (in terms of US\$) leaving a deficit in the balance of payments.

The proposal stated in chapter 1.1 f (infant industries need protection) does not appear to be an adequate remedy. Although this argument is accepted by the liberal school, protection is often overdone. Levels of tariffs are set too high at too long lapses of time. Renewed protection would lead back to the protectionism the reforms tried to end.

3.2 Investment, savings and growth

The following pages will discuss some of the economic effects of investment on a general basis to identify benefits and weaknesses of the current situation in Bolivia. Successes and failures of the public investment policy will be examined along with incentives for private and foreign savings destined to increase economic growth.

Economic theory of investment, savings and growth

To evaluate investment, it is first necessary to separate the tasks of the public and private sector.

Generally, limited resources should be utilized to realize the highest revenue compared to other possibilities of use (opportunity costs are to be minimized). Public resources should be used to provide services of public interest that would otherwise not be offered in the market process.

Private domestic investment is influenced by the preference of the domestic population to accomplish savings. Domestically savings are determined by the intertemporal allocation of income, the rate of inflation (the inclination to save has a negative relation to the rate of inflation), the cost of living (determined by the aggregate income) and the

⁷⁴ The instituto nacional de exportaciones (INPEX) was created in 1987.

⁷⁵ See chapter 6.2.2 for the detailed strategy.

economy's inclination to fulfill necessities with domestic products (determined by exchange rates and the terms of trade).

The net transfer of resources is determined by the ability of a country to attract foreign capital⁷⁶

Presentation for Bolivia

To evaluate the performance of the structural adjustment program it seems adequate to compare investment prior to the adjustment to the investment accomplished afterwards.

Figure 11: Public, private domestic and private foreign investment from 1980-2000⁷⁷

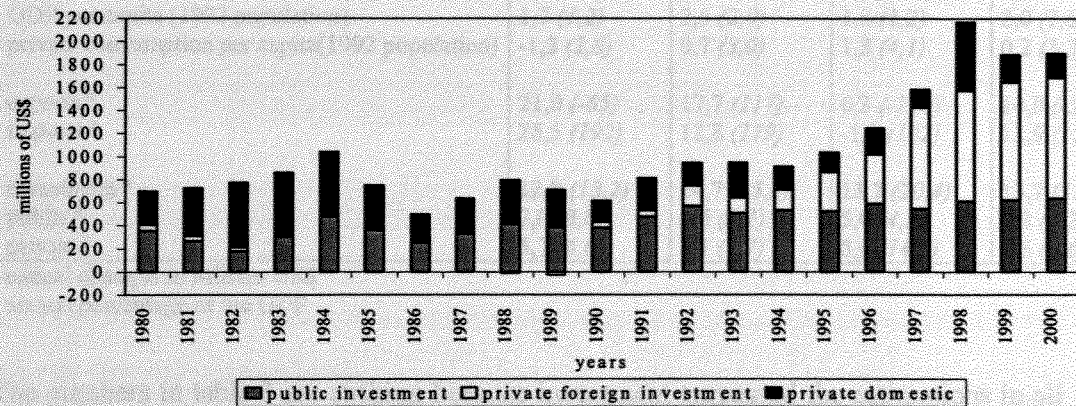


Figure 11 shows that investment has grown considerably since the implementation of the NEP in 1985. Public investment grew moderately while private domestic investment has decreased since 1989. This can be attributed to the high social costs of NEP. Private foreign investment only started about four years after the NEP. Authors attribute this lag to the late introduction of an adequate investment policy, which only happened in 1989.⁷⁸

To raise the well-being of the Bolivian population, the “strategy for economic and social development 1989-2000” was introduced.⁷⁹ It envisaged to strengthen market forces and to limit public activity to areas where market failure and inadequate

⁷⁶ Rijckeghem, W. v., Growth, Savings and Investment, in: Dijk, P. v., The Bolivian Experiment, Structural Adjustment and Poverty Alleviation, Amsterdam, 1998, p. 61.

⁷⁷ Instituto Nacional de Estadísticas, www.ine.gov.bo, 02.04.01.

⁷⁸ Schiesser-Gachnang, D., Bolivien, Hyperinflation, Stabilisierung und Anpassung, 1993, Hallstadt, p. 251.

⁷⁹ Ministerio de Planeamiento y Coordinación, estrategia del desarrollo económico y social, La Paz, 1989.

distribution would prevail without interference of the public sector.⁸⁰ As the plan envisaged precise growth rates for the various sectors, an evaluation according to the “comparison to targets” approach is feasible.

Table 3: Growth indicators of the development plan 1989-2000⁸¹ (in annual changes in %, realized value in parentheses⁸²)

	1989-1992	1993-1996	1997-2000	1989-2000
GDP	4,5 (3,7)	5,3 (4,5)	4,7 (2,9)	4,9 (3,7)
- agrarian sector	4,1 (2,1)	4,1 (4,7)	4,2 (3,7)	4,1 (3,5)
- mines	11,1 (10,2)	13,5 (3,4)	13,6 (2,8)	12,7 (5,7)
- hydrocarbons	6,9 (2,1)	12,0 (4,7)	6,4 (4,5)	8,4 (3,7)
- processing industry	7,1 (4,4)	7,6 (5,3)	8,3 (2,3)	7,6 (4,0)
- population ⁸³	2,8 (3,5)	2,8	2,8	2,8
- GDP per capita (1992 population)	1,7 (1,2)	2,5 (2,0)	1,8 (1,2)	2,0 (1,8)
- private consumption per capita(1992 population)	-1,3 (2,8)	0,7 (3,0)	1,3 (4,1)	0,2 (3,3)
- exports *	21,0 (-65)	17,7 (117)	6,3 (-110)	14,8 (-58)
- imports *	25,5 (192)	12,8 (179)	-1,1 (102)	11,9 (157)
- investment °	12,8 (15,2)	14,7 (15,8)	13,7 (20,4)	13,7 (17,1)
- public °	7,0 (8,6)	6,6 (8,1)	5,0 (4,9)	6,2 (7,2)
- private °	5,7 (6,6)	8,1 (7,7)	8,6 (14,5)	7,5 (9,6)

* annual changes in Million US\$

° annual percentage of the GDP

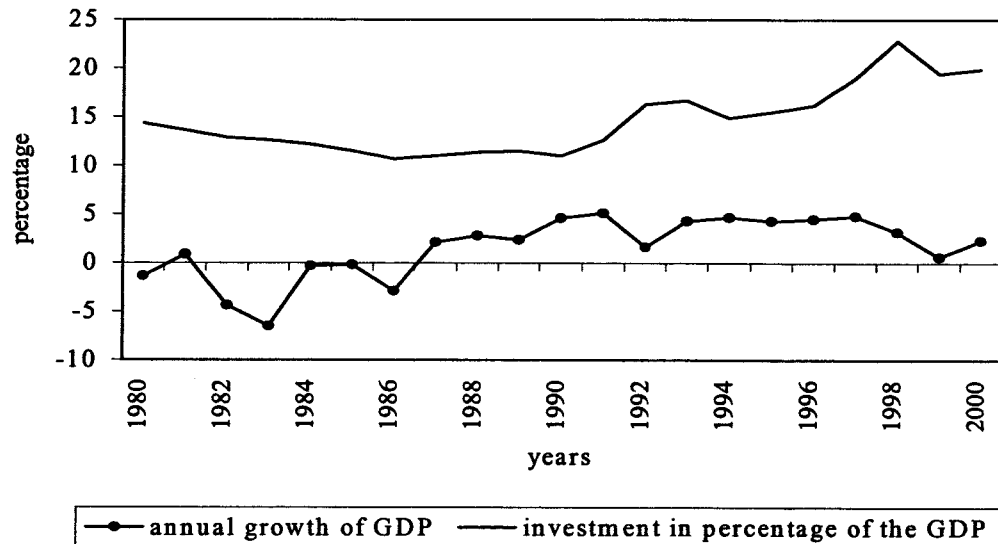
The numbers in table 3 are striking because investment surpassed the estimations in all lapses of time (except private investment in 1997-2000), growth of GDP, GDP per capita and all sectors of the Bolivian economy failed to grow as expected. Figure 12 partly shows the same information as Table 3 about GDP growth and the investment quota in graphical form.

⁸⁰ Schiesser-Gachnang, D., *Bolivien, Hyperinflation, Stabilisierung und Anpassung*, 1993, Hallstadt, p. 252.

⁸¹ Ministerio de Planeamiento y Coordinacion, *estrategia del desarrollo economico y social*, La Paz, 1989.

⁸² Bolivia, *Statistical annex*, IMF Staff report, No. 00/38, Washington D. C., 2000, different pages.

⁸³ Since the last census was conducted in 1992, no reliable data is available for the lapse 1993-2000.

Figure 12: Annual growth rates of GDP and investment quota of the GDP 1980-2000⁸⁴

Explanations for the discrepancy between investment and growth

This subchapter will first regard, why investment has been higher than predicted. In a second step, 4 hypotheses will examine why a surplus of predicted investment did not convert into additional growth.

The excess in predicted investment is for the most part due to the capitalization of the Bolivian economy, which started in 1992.⁸⁵ As Bolivia had a large public sector with inefficient public enterprises, the government chose capitalization to render public enterprises to the market. With Law 1544 of 21 March 1994⁸⁶, public enterprises were transferred into mixed corporations.

From 1992-93 in total forty-four companies were capitalized rendering US\$ 20,674,748.00. In the span of time from 1994 to 1997 fifty-three companies were capitalized. The amount of money raised during this period was US\$ 97,490,895.84.⁸⁷ These sums substantially raised the public revenue, which also explains the rise of public investment from 1992 – 1996. (see figure 13). Mere capitalization cannot explain though, why private domestic and private foreign investment have increased without considerably altering growth.

⁸⁴ Ministerio de comercio exterior y inversion, www.mcei.gov.bo 02.04.01.

⁸⁵ Urdininea, J. B., La capitalizacion, in: Las reformas estructurales en Bolivia, Tomo I, La Paz, 1998, p. 55.

⁸⁶ Ministerio de la capitalizacion, Ley de la capitalizacion 1544, La Paz, 1994, p. 3.

⁸⁷ Ministerio de comercio exterior y inversion, www.mcei.gov.bo 02.04.01.

The following hypotheses will seek to extrapolate why the growth goals set by the Bolivian government (see Table 3) have not been met.

Hypothesis 1: inadequate and incomplete structural adjustment

a.) Stabilization promoted a recession in Bolivia.⁸⁸

As stated in chapter 2.1.3, the launch of the stabilization program coincided with three major external shocks for the Bolivian economy, which accounted for a loss in exports earnings in the order of 10% of GDP.

In other economies such a loss of export earnings could lead to a deep recession, but for Bolivia, export earning losses had amounted to 2.9% of GDP per year from 1981-85, so that an aggravation of the recession can not be easily attributed to the launch of the New Economic Policy in 1985.

b.) Inadequate legal and political system:⁸⁹

An uncertain legal situation (as to which part of shares of a corporation may be owned by a foreign company) and the uncertainty regarding investment (e.g. the danger of nationalization of foreign companies) led to a hesitance of foreign investors in the period after the implementation of the NEP in 1985. The period from 1991 to present, this argumentation no longer holds true. Private foreign investment has increased considerably since 1991 (see figure 11); Bolivia has since established a „tradition“ in open market economy and proved with the capitalization of major public companies that nationalization is not an option for the political elite.

c.) Inefficient administrative system:

A more efficient state administration is crucial in the creation of social services and physical infrastructure.⁹⁰ Therefore, the fight against corruption is one of the main objectives to be resolved by the current administration.⁹¹ The CEDLA argues that with the government of Hugo Banzer Suarez, corruption increased significantly, and it has

⁸⁸ Morales, J.A., Sachs, J., *Developing country debt and economic development*, Chicago 1989, p. 246.

⁸⁹ Grütter, J., *A socio-economic evaluation of the structural adjustment program of Bolivia*, Chur, 1993, p. 48.

⁹⁰ Borner, S., *Institutional obstacles to Latin American growth and proposals for reform*, WWZ Studien 26, Basel, 1990, p. 23.

⁹¹ Arze, C., *centro de estudios de desarrollo de labor y la agricultura*, (cedla, La Paz) interview on 12 March 2001.

made the administrative system less efficient and just. Fighting corruption to increase public saving and investment would therefore be necessary.

d.) The absorptive capacity of the economy for investment is too low.

The argument is that financial transfers do not transfer into physical investment but that additional resources spill over into the consumption sector and are not used in a more productive way.⁹²

In fact private household consumption has increased by 46 % in the last twelve years and accounts for 59% of all imports and transfers counted in the balance of payments.⁹³

The absorption problem seems especially grave as the IMF predicts inflows of capital into Bolivia in the order of 10% of GDP in the next four years⁹⁴.

Hypothesis 2: unfavorable internal and external conditions of the Bolivian market

The hypothesis relates to the Keynesian argument that poor expectations impede investment and thus limit economic growth. Secondly, it is argued that interest rates are too high and thus limit investment that yields lower rates of return. For the last two years, this argument holds true, because the level of overall investment decreased in real terms from 1999-2000. From 1990-1998 the Keynesian argument is not applicable. The investment quota grew from 10,5% in 1990 to 23% in 1998. It was not investment being withheld due to negative expectations; but other factors impeded growth. Excessive interest rates cannot explain a lack of growth either, because high interest rates would impede investment in the first place and not just limit growth.

Hypothesis 3: low productivity of labor and low profitability of invested capital impede growth

Another proposal made by various authors⁹⁵ is investment grew, but profitability and productivity remained low. The hypothesis does not only refer to technical innovation, but also to external competitiveness (terms of trade) and labor productivity. A decrease

⁹² Rijckeghem, W. v., Growth, Savings and Investment, in: Dijck, P. v., The Bolivian Experiment, Structural Adjustment and Poverty Alleviation, Amsterdam, 1998, p. 62.

⁹³ Instituto Nacional de estadísticas (INE) www.ine.gov.bo, 05.04.01.

⁹⁴ IMF, Bolivia staff report for 1999, indicators of fund credit projections for 1998-2006, Washington, D. C: 2000, p. 33.

⁹⁵ Raza, W., desarrollo sostenible en la periferia neoliberal, 1999, Wien, p. 69.

in the profitability of investment (decreasing terms of trade) could explain why growth remained low, while the investment quota grew.

Figure 13: Development of profitability of selected Bolivian enterprises⁹⁶ (return on invested capital in %)

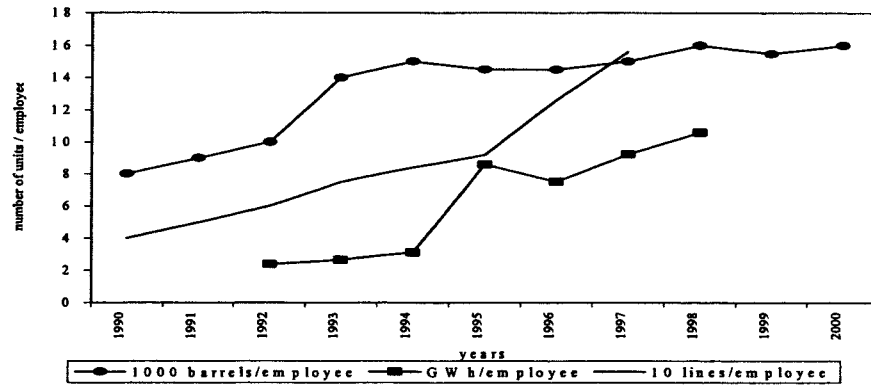
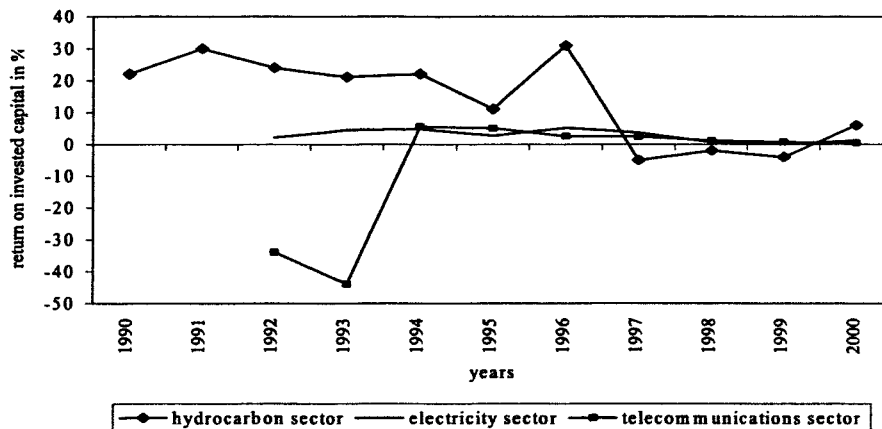


Figure 14: Development of productivity / worker in selected sectors of the Bolivian economy 1990-2000⁹⁷ (hydrocarbon, electricity and telecommunications sector)



Figures 13 and 14 show that the return on invested capital decreased in the time from 1990-2000, while labor productivity increased.

The findings can be interpreted in the following way: because of declining terms of trade (see chapter 3.1, figure 10) it has become harder to export goods at a profit. This is especially true for the hydrocarbon sector, which depends on world market prices. Thus

⁹⁶ Jemio, L., Quince años de reformas estructurales en Bolivia, La Paz, 2001, p. 145-308.

⁹⁷ Ayala, V., Inversion y Productividad en la industria de hidrocarburos, in: quince años dereformas estructurales en Bolivia, La Paz, 2001, p. 276.

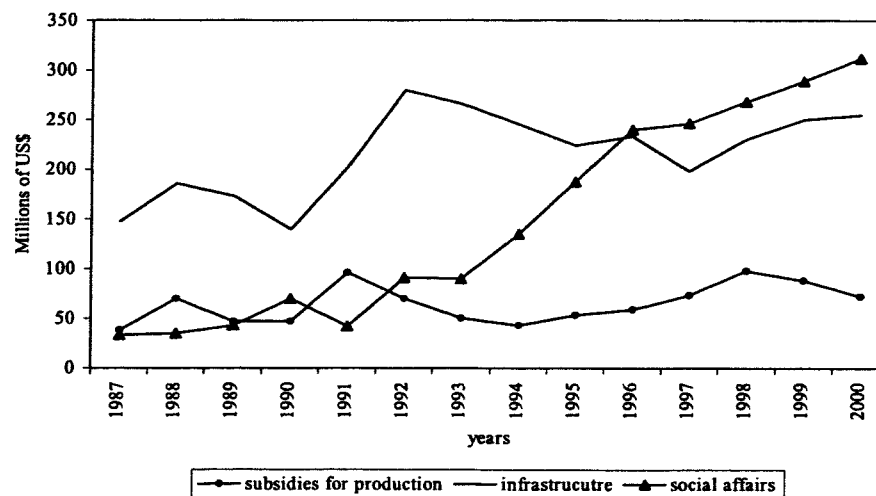
it can be concluded that decreasing return on invested capital hindered growth, although investment was high.

Regarding labor productivity the hypothesis is false. Because of the capitalization of public enterprises, overall employment did not increase in the years after 1994 (see chapter 3.3 Employment and distribution), which led to an increase in labor productivity/worker. This holds especially true for the electricity and telecommunication sector, in which all the existing companies were capitalized after 1994.

Hypothesis 4: Under various governments investment funded poverty alleviation, social affairs and infrastructure (especially under the governments of Lozada and Banzer)

It is argued that public investment conducted by the Bolivian Central government, as well as funds granted by the IMF, were primarily directed to poverty alleviation, social affairs and infrastructure. The administration of President Lozada (1993-1997) and President Banzer (1997-) had the goal to achieve a reduction in foreign debt levels (see chapter 3.1 external sector) in order to alleviate poverty with the means not used for debt payment. It is supported by the following figure:

Figures 15: Evolution of public investment 1987-2000 (in 1990 prices)⁹⁸



⁹⁸ Barja, G., Las reformas estructurales y su impacto sobre inversiones, La Paz, 2001, p. 142.

From 1987 to 2000 the public investment in infrastructure and social affairs grew by the factor 1,72 resp. 9,45. It can generally be assumed that well-being only reacts with a longer time lag to public investment, since government expenditure is used for goods that would normally not be produced in the market process. Thus, public investment could induce sufficient changes in economic growth which can be measured in a longer scale of time.

Conclusion for investment, savings and growth

Although investment has been higher than predicted, growth has been overestimated. First, the lack of growth is partly due to incomplete and inadequate structural adjustment. Corruption is the most preeminent impediment. Hence, the criticism stated in subchapter 1.1 f. (conditionality of SAPs is negative) cannot be upheld. As corruption is a problem in Bolivia, a lack of conditionality of the IMF would increase unjust behavior by powerful groups in the Bolivian society.

Secondly the absorptive capacity of the Bolivian economy for investment is too low. The effect of decreasing profitability of invested capital and increased productivity of labor on growth remains unclear, because it is impossible to tell which effect predominates. This will be examined in the next chapter. The Keynesian argument of poor expectations can only explain the decreasing investments in the last two years.

3.3 Employment, Distribution and Poverty

Economic theory of employment, distribution and poverty

Apart from stability and economic growth, income growth for the poor primarily depends on the growth of employment, which is related to factor intensity and the degree of factor mobility within sectors and regions.⁹⁹ These factors, along with discriminatory factors such as ethnicity and sex, determine distribution of well-being generated by adjustment and growth. Another important factor is the rate of investment (mostly public) into social services.

Presentation for Bolivia

Bolivia's initial conditions did not provide the adequate foundation for the creation of a virtuous circle of growth, employment and poverty reduction.

⁹⁹ Vos, R., *Structural adjustment and poverty*, in: Dijk, P. v., *The Bolivian Experiment, Structural Adjustment and Poverty Alleviation*, Amsterdam, 1998, p. 83.

Exports that heavily rely on primary materials (hydrocarbons, minerals and tin) were produced in a labor intensive way. The collapse of the tin and mineral world market (see chapter 2.1) led to declining of employment in this sector.¹⁰⁰ The developing soy production in the area of Santa Cruz applied large scale technologies, which impeded the growth of employment. A third factor hindering employment has been the low educational level of a large part of the population.

Table 4: Open unemployment from 1985 to 2000¹⁰¹

	1985	1989	1993	1996	2000
Percentage of open unemployment	6,0	10,4	6,0	3,5	5,1
Male unemployment	6,8	9,9	6,5	3,3	4,8
Female unemployment	4,7	11,0	5,3	3,8	5,3

Table 4 shows that the rate of unemployment decreased after 1990. It is understood that the data do not show hidden unemployment and do not clarify to what extent the working population is subemployed,¹⁰² or works in professions other than their educational preparation.

The tendencies in table 5 reflect a considerable degree of segmentation that continues to plague the Bolivian society today.

Table 5: Average monthly income according to occupation¹⁰³ (in Bolivianos of 1989)

	1989	1993	1996	Real Variation 1989-96(%)
Worker	251	244	250	-0,7
Employee	348	426	424	21,6
Free lance workers	310	249	281	-9,2
Independent professional	842	1159	882	4,8
Employer or patron	735	946	1095	49,1
House keeping personnel	128	116	113	-11,9
Average	325	358	376	15,7

In the last eleven years, the incomes above arithmetic average grew, while the incomes below arithmetic average declined. Because the groups below average account for

¹⁰⁰ Vos, R., Structural adjustment and poverty, in: Dijck, P. v., The Bolivian Experiment, Structural Adjustment and Poverty Alleviation, Amsterdam, 1998, p. 84.

¹⁰¹ Jemio, L., Reformas, crecimiento, progreso tecnico y empleo en Bolivia, in: Jemio, L. Quince años de reformas estructurales en Bolivia, La Paz, 2001, p. 370.

¹⁰² The term subemployment is defined as working less time than average working hours, and not showing up in the unemployment statistics.

¹⁰³ Instituto Nacional de estadísticas (INE) www.ine.gov.bo, 17.04.01. The data was extrapolated in surveys (Encuestas integradas de hogares (EIH) in 1989, 1993, 1996, in 2000 there has not been such a survey.

73,4%¹⁰⁴ of the Bolivian working population, the wage development has been unfavorable for the majority of Bolivians, hence increasing the overall poverty.

An overview of poverty estimates¹⁰⁵

Several institutions have issued poverty lines, indicating how many financial resources a person should earn of in order to not being considered poor.

Table 6: Poverty lines for Bolivia, per capita, per month in Bolivianos of 1995¹⁰⁶

	Urban	Rural
The World Bank	270,9	158,9
Psacharopoulos et al. ¹⁰⁷	207,5	--
UDAPSO Unidad de Analisis de Politicas Sociales	--	96,4
IDB	139,9	139,9

The institutions chose different methods to elaborate their poverty lines. The differences in the values mainly stem from differences in calculating the average urban or rural cost of a basic food basket to furnish an individual with 2100 calories per day. The poverty lines along with actual poverty can be measured using several different approaches.

The indirect method – poverty as a shortfall of income in relation to a minimum threshold.

The extreme poverty incidence refers to the share of population with income or consumption levels below the cost of minimum food, while the poverty incidence refers to the share of population unable to meet a poverty line considered adequate to meet minimum food requirements as well as a basket of other basic needs.

¹⁰⁴ Jemio, L., Reformas, crecimiento, progreso tecnico y empleo en Bolivia, in: Jemio, L. Quince años de reformas estructurales en Bolivia, La Paz, 2001, p. 383.

¹⁰⁵ Consistent information on poverty that allows insight into changes over time is very difficult to obtain in Bolivia. The base for this investigation stems from the encuesta integrada de hogares (household surveys) which have been conducted only for urban Bolivian areas in the years 1989, 1993 and 1996.

The census of 1992 only allows some conclusions about rural poverty.

¹⁰⁶ Vos, R., Structural adjustment and poverty, in: Dijck, P. v., The Bolivian Experiment, Structural Adjustment and Poverty Alleviation, Amsterdam, 1998, p. 89.

¹⁰⁷ Psacharopoulos, G. et al: Poverty and Income distribution in Latin America, The story of the 1980s, LAC Technical Department Report No. 27, The World Bank, Washington D. C., 1992, p. 12.

Table 7: Trends in poverty according to several studies (1986-95)¹⁰⁸ (percentage)

Source	Area	Unit of Analysis	1986	1989	1990	1991	1992	1993	1994	1995
Extreme poverty incidence										
The World Bank	Urban	Individual	--	28,1	--	--	--	29,3	--	--
		Household	--	21,8	--	--	--	22,4	--	--
	Rural	Individual	--	--	--	--	--	--	--	79,1
		Household	--	--	--	--	--	--	--	--
UDAPSO	Urban	Household	--	--	--	--	23,1	--	--	--
	Rural	Household	--	--	--	58,6	--	--	--	--
Psacharopoulos	Urban	Individual	22,3	23,2	--	--	--	--	--	--
IDB	Urban	Individual	11,7	12,0	--	--	--	7,9	6,4	8,6
Poverty incidence										
The World Bank	Urban	Individual	--	60,1	--	--	--	61,6	--	--
		Household	--	51,6	--	--	--	52,6	--	--
	Rural	Individual	--	--	--	--	--	--	--	87,7
		Household	--	--	--	--	--	--	--	--
UDAPSO	Urban	Household	--	52,9	55,2	--	53,3	--	--	--
	Rural	Household	--	--	--	66,8	--	--	--	--
Psacharopoulos	Urban	Individual	51,5	54,0	--	--	--	--	--	--
IDB	Urban	Individual	35,0	34,0	--	--	--	30,0	26,4	32,2

Despite differences in reporting, one might conclude that poverty is widespread in rural and urban areas. In almost all estimations (except for the IDB) the extreme poverty incidence could not be ameliorated and even increased from 1985 to 1993.

The direct method – social indicators added to the poverty line evaluation

The indicators show progress over the years measured by referring to the share of population unable to meet a poverty line considered adequate for minimum food requirements as well as a basket of other basic needs.

 Table 8: Poverty incidence by welfare measure and high and low poverty lines¹⁰⁹ (in percent)

Poverty measure	Area	1989	1993	1996
High poverty line (percent of population)				
Consumption	Urban	60,9	60,3	--
	Rural	--	--	88,3
Income	Urban	70,8	56,9	59,3
	Rural	--	--	77,1
Low poverty line (percent of population)				
Consumption	Urban	27,9	28,3	--
	Rural	--	--	85,8
Income	Urban	46,0	30,0	32,2
	Rural	--	--	73,3

¹⁰⁸ The World Bank, Bolivia, Poverty, Equity and Income, Washington D. C. 1996

UDAPSO, Unidad de Analisis de Politicas Sociales, La Paz, 1995.

Psacharopoulos, G. et al: Poverty and Income distribution in Latin America, The story of the 1980s, LAC Technical Department Report No. 27, The World Bank, Washington D. C., 1992, p. 16.

IDB, Basic Socio Economic Data

¹⁰⁹ Instituto Nacional de Estadística y Encuesta integrada de Hogares 1989, 1993 and 1996.

Conclusion for employment, distribution and poverty

Employment in Bolivia has increased slightly in the years following the NEP in 1985. Nevertheless increasing wages for higher income groups and decreasing wages for lower income groups have increased the unequal distribution in Bolivia. According to where the poverty line is set, one fourth to three fourth of the Bolivian population are considered poor. The NEP could not alleviate poverty or significantly increase the population's well-being.

The criticism stated in subchapter 1.1.2 a.+b (adjustment might need much longer time than expected, expectations were overoptimistic) is understandable.

4 Conclusion

The New Economic Policy as formulated in the Supreme Decrees SD 21060, SD 21456, SD 21660 and SD 22407 was a typical structural adjustment program. The neoclassical approach to achieving stability, adjustment and sustainability is obvious.

The structural adjustment program was successful in stabilizing the economy. Regarding debt management and adjustment, there are major restrictions to success.

The stabilization program was successful in reducing and even ending hyperinflation. Bolivian inflation rates sank, and have remained at low levels until today. The swift devaluation in combination with a change budgetary practice brought about high social cost, which should have been cushioned earlier (criticism 1.1 c.).

The banking sector was liberalized. Still, with real interest rates rising, a lack of banking supervision and adverse external factors, the portfolio quality of Bolivian banks diminished, inducing adverse selection and moral hazard. Therefore, the market failure and uncertainty should have been taken into account (criticism 1.1 e.), and banking supervision should not have been loosened.

The changes in the Bolivian tax system were successful in reducing the fiscal deficit. The policy emphasized the macroeconomic approach while the microeconomic approach was not extensively applied. The criticism that the IMF and World Bank only regard macroeconomic goals (criticism 1.1 d.) appears adequate.

A major flaw of the adjustment program was multilateral debt management. Absolute external debt continuously rose after implementation. The introduction of the HIPC1 and 2 initiative, which Bolivia completed as one of the first countries, could only

slightly ease the situation. Comparison to targets shows that the IMF's goals for indebtedness are far from being reached.

In the external sector, Bolivia is affected by a continuous deterioration of the terms of trade. Exports more than doubled in the last 16 years; still there remains a deficit in the account balance, because imports have grown even stronger. The proposal that industries exposed to competition for the first time ("infant industries") should be protected (criticism 1.1 f.) cannot be accepted.

Investment, savings and growth envisaged in the "strategy for economic and social development 1989-2000" show a stunning picture. Although investment grew stronger than predicted, growth remained under the estimations, due partly to incomplete and inadequate structural adjustment. Corruption needs to be fought in Bolivia. Hence, conditionality is a necessary aim of structural adjustment programs (criticism 1.1 f. cannot be upheld). Secondly the absorptive capacity of the Bolivian economy for investment is too low. The effect of decreasing profitability of invested capital and increased productivity of labor on growth remains unclear, because it is impossible to tell which effect predominates.

Employment in Bolivia has increased slightly in the years after the NEP in 1985. Nevertheless increasing wages for higher income groups and decreasing wages for lower income groups have increased the unequal distribution in Bolivia. According to where the poverty line is set, one fourth to three fourth of the Bolivian population have to be considered poor. Hence the criticism stated in subchapter 1.1 a.+b (adjustment might need much longer time than expected, expectations were overoptimistic) is understandable.

The success of adjustment has to be questioned, as the measures implemented had only a small effect on the overall well-being of the Bolivian population.

5 Proposals for reform

The conclusion showed that stabilization was successful, but that the debt management and the adjustment process have major flaws.

The following proposals for reform can be subdivided in different in three categories.

Improvement of implementation

A main reason for faulty debt management was the insufficient alleviation of multilateral debt by the IMF and the World Bank. It remains unclear, why both organizations did not release Bolivia from higher debt payments in order to attain the debt levels that were proposed by themselves.

Chapter 3.2 showed that higher economic growth was partly hindered by inadequate and incomplete implementation of the reforms. The IMF and the World Bank should therefore exert more pressure on foreign governments in order to increase the efficiency of political, legal and administrative systems aimed at increasing the absorptive capacity for invested capital. Corruption needs to be fought.

Direct measures to improve the situation of the poor

In those areas where resistance against the reforms is high, social investment should directly help those groups that are affected by the emergence of social costs. Especially health and education services are crucial for the poorer groups of society to participate in economic growth, it is suitable to link reforms to a binding condition for investment in these sectors. The SAP in Bolivia only included "soft" conditions, which did not show the hoped for effect. These conditions should not only include expenses, but also the qualities of the envisaged services.

Further emphasis should be directed towards the reintegration of the unemployed into the work process. Programs offering small credits to facilitate economic independence or reeducation for the unemployed appear to be apt measures.

To ensure budgetary means for these measures, it seems adequate to introduce a core budget that is exempt from all efforts to reduce spending. The size of a core budget would depend on the need for reform and consolidation.

Rise of information available

Deficits in information (as the poor data on income distribution in chapter 3.3) should be fought. Adequate help can only be introduced, if the information available indicates where help is needed. The design of successful programs is complicated without relevant pieces of information. Most necessary are regular surveys on household income as well as household consumption. On the basis of these surveys groups in need can be identified.

As groups in need and aims of an adjustment program would be evident, the control of an adjustment process would be facilitated.

Overall, socially desirable adjustment programs need an abundance of supplementary temporal, spatial and sectorally disaggregated measures that cannot be furnished in present Bolivian statistical offices. Renewed external support by the IMF and the World Bank for conception and enforcement and surveying of data of structural adjustment programs are needed.

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