PD-ABD-351
74188

EVALUATION OF THE FIRST YEAR OF OPERATION OF THE GOVERNMENT OF BOLIVIA'S NEW ECONOMIC PROGRAM

September 6, 1986

By Clark Joel, Ph.D.
USAID/Bolivia

OUTLINE

		Page
I.	Introduction, Summary and Conclusions	1
II.	Background	4
III.	The New Economic Program	7
IV.	Evaluation	12
	A. Success of the Stabilization Program	12
	B. Economic Reactivation	18
V.	Some Thoughts on Restructuring	21
Tables		
1.	General Consumer Price Index	25
2A.	Budget Deficit of the Consolidated Public Sector	26
2B.	Budget Deficit of Consolidated Public Sector as % of GDP	26
3A	Bank Credit Expansion and Money Supply	27
3B	Money Supply Outstanding at the End of Year	27
4	Total Liquidity and its Determinants	28
5	Central Bank Financing of Public Sector	29
6	Official Exchange Rate (1982-August 1986)	30
7	Exports, Imports and Balance of Payments Deficit	31
8.	Balance of Payments in 1985 and Projection for 1986	32
9	Selected Economic Indicators	33
10.	Gross Domestic Product by Type of Economic Activity	34
11.	Gross Domestic Product by Type of Expenditure	36
Appendix:	Summary of Measures Contained in Supreme Decree 21060 (August 29, 1985)	37

Sept. 6. 1986

I. INTRODUCTION, SUMMARY AND CONCLUSIONS

Following a brief background section describing the magnitude and causes of the economic chaos inherited by the present government, and a brief description of the main economic features of the New Economic Program promulgated on August 29. 1985, this paper will evaluate the success of the program in achieving its objectives of stabilizing the economy and setting the basis for economic recovery.

The Government deserves high marks for achieving relative economic stabilization in less than a year through a comprehensive set of measures, some of them quite drastic, that required considerable political courage. The main ones include the wage freeze for public employees (followed by very moderate increases), tax and tariff reform, substantial increases in the prices of goods and services sold by state enterprises to eliminate their substantial operating deficits, the freeing of the exchange rate (with resulting significant impact on tax and customs collections) and substantial reductions in the rate of credit expansion to both the public and private sectors.

Although control of inflation has substantially improved the economic climate, there are no indications to date that economic reactivation has in fact taken place. It may be premature, however, to expect reactivation so soon after the economic chaos of previous years. Preliminary estimates of the Central Bank indicate a decline of 3.7% in the country's real Gross Domestic Product in 1986, with major declines registered in the mining and export sectors. This outcome is not altogether surprising in view of the fact that (a) the hyperinflation was brought under control only in the last quarter of 1985, and (b) the economy recently has been subjected to a number of severe shocks, including a sharp decline in the price of tin since 1983, a 10% drop in the price of natural gas sold to Argentina under the recently renegotiated contract, floods which depressed agricultural output, and beginning in July of this year, the joint, and apparently successful, GOB-US campaign to disrupt the narcotics industry.

While Bolivia's current account position deteriorated severely in 1986, its overall balance of payments situation has improved substantially through the renegotiation of the country's external debt on very generous terms with the Paris Club. The size of the balance of payments deficit in 1986 will depend on the outcome of the forthcoming debt renegotiations with foreign commercial banks. If relatively liberal terms can also be obtained from the commercial banks, the 1986 balance of payments deficit could be narrowed substantially, perhaps to a range of $25 million to $40 million. If no renegotiation took place and the country were to attempt to meet its debt servicing obligations as they now stand, the balance of payments gap (without even counting repayment of arrears) could fall within the range of

$150 million to $175 million, a gap that is clearly beyond the country's capacity to bridge. It is also to be noted that if the renegotiation with the private commercial banks does not involve substantial concessions in terms of both lower interest rates and much longer maturities, the relief obtained from the debt rescheduling would be merely of a temporary nature.

The Government's first priority should continue to be the implementation of the stabilization program. Second, some restructuring of the economy is essential to replace the employment, income and foreign exchange earning opportunities provided by the shrinking mining and narcotics industries. One of the best prospects appears to lie on the development of the agricultural sector (mainly soybeans, poultry and livestock), agro-industry, the wood and wood processing industry, and drawback industries, to take advantage of both the country's natural resource base and its ample supply of low-wage labor. Systematic surveys should be undertaken to determine the areas of potential comparative advantage and to identify the various obstacles to investment and increased private economic activity, particularly in the export area, that entrepreneurs regard as major impediments to recovery and growth.

II. BACKGROUND

The Paz Estenssoro Government inherited a chaotic economic situation characterized by hyperinflation, a foreign exchange crisis triggered by the collapse of tin and petroleum prices and a growing debt servicing problem, a substantial and growing budget deficit, a real GDP that declined each year after 1981, and an economy that had become increasingly reliant on coca production, narcotics trafficking and smuggling.

The following statistics illustrate the magnitude of the problems that confronted the new government. The rate of increase of the consumer price index increased from 123% in 1982 to 276% in 1983, 1,281% in 1984 and 11,750% in 1985 (Table 1). The rate of increase of the budget deficit of the consolidated public sector (a key cause of the hyperinflation) increased from 353% in 1983 to 2,033% in 1984 and 4,638% in 1985 (Table 2). Note that most of the increase in the budget deficit was due not to the current operations of the Central Government, but to the large operating deficits incurred by the state-owned enterprises, particularly COMIBOL (tin mining) and ENFE (railroads).

The rate of Central Bank credit expansion to the public sector increased from 287% in 1983 to 1,166% in 1984 and to 17,029% in 1985 (Table 3A). However, credit to the public sector was not the only cause of the increase in money supply as bank credit expansion to the private

sector increased at comparable rates during the 1983 to 1985 period (Table A). As a result of both factors, the supply of currency plus demand deposits (M1) increased at a rate of 1,798% in 1984 and 6,116% in 1985 (Table 3).

Predictably, substantial deficits appeared in the current account of the balance of payments. These rose from US$129 million in 1984 to US$281 million in 1985; while the overall deficit in the balance of payments increased from $103 million in 1984 to $329 million in 1985 (Table 7). The balance of payments problem can be attributed to the following major causes: (1) collapse of the prices for tin and natural gas; (2) the large debt service payments resulting from the incurrence of substantial debt for poorly conceived projects in the 1970's and early '80's; and (3) the rapid expansion of money supply and price level unaccompanied by a corresponding devaluation. As a result, the official exchange rate at which all exports had to be surrendered, was consistently and substantially overvalued.

The cumulative decline of the real GDP over 1982-85 is estimated at 17.2% (based on the IMF estimates in Table 9), while the real per capita GDP is estimated to have declined by 25.8% over this period (Table 9).

These developments had serious social consequences. The economy suffered from numerous and prolonged strikes as workers attempted to defend their living standards; many businesses failed as a result of heavy

decapitalization; members of the middle class that were slow to convert their funds into dollars or physical assets lost all their savings; rational decision making in the "productive sector"1/ became next to impossible; its output contracted severely; income was redistributed on a massive scale; there was a substantial shift of resources from the "productive sector" into speculation activity and into the "illegal sector", consisting largely of coca production and processing, narcotics trafficking, and smuggling.

1/ Defined here as industries creating "form utility", i.e., mostly the agriculture, manufacturing and construction sectors.

III. THE NEW ECONOMIC PROGRAM

A detailed description of President Victor Paz Estenssoro's August 29, 1985 New Economic Program was provided in Robert Burke's excellent "Analysis of the New Economic Program of the Government of Bolivia" of October 22, 1985. Only its main features will be recapitulated here. A summary of its main provisions is provided in the Appendix.

1. Adoption of a Flexible Foreign Exchange Rate Adjustment Mechanism: A basic problem with the previous system had been the maintenance of a fixed exchange rate in the face of continuing and substantial increases of the domestic price level. As a result, the exchange rate had become increasingly overvalued and the official rate bore no relationship to the purchasing power parity. Exporters had been receiving only a fraction of the free market rate, with predictable disastrous impact on export earnings. Under the new exchange system announced on August 29, the official exchange rate would be adjusted at least twice weekly at auctions conducted by the Central Bank at which foreign exchange would be offered for sale. However, all exporters were still required to surrender one hundred percent of their export proceeds to the Central Bank at the official rate, though with guaranteed access to specified quantities of foreign exchange when required. These export proceeds will provide the principal source of foreign exchange for the auctions.

In addition to correcting the strong bias towards subsidizing imports and penalizing exports, the substantial exchange rate adjustment had

very favorable fiscal implications. The official Central Bank buying rate of foreign exchange moved from 67,000 pesos to the dollar to $b 1,075,000 to $1,00 (Table 4). The export sales of COMIBOL (mining), YPFB (natural gas and petroleum) and other state enterprises increased very substantially in terms of pesos, thus yielding larger tax revenues. Imports valued at the new rate produced substantial increases in duty collections. While foreign debt service payments and public sector purchases of goods and services also increased in terms of pesos, the net fiscal effect, on balance, was strongly positive.

2. Petroleum Price Adjustment: The domestic petroleum price was increased significantly in line with the world market price translated into pesos at the new market-determined exchange rate. This represented, at one stroke, a ten-fold increase over the previous price. Petroleum prices subsequently were adjusted periodically to maintain the dollar equivalency.

3. Increases in the Rates of Other Utilities, including Electricity Telephones, etc.: Rates were increased to compensate for actual service costs. Public utility prices were fixed in dollars, with bills payable in pesos at the exchange rate of the day.

4. Monetary Reform: The program eliminated interest rate ceilings on all deposits and loans. Other provisions authorized commercial banks to carry out foreign exchange rate transactions and to offer foreign exchange denominated accounts, accounts with a dollar maintenance of value clause, and to make dollar denominated loans.

5. Tariff Reform: Bolivia, like most of its South American neighbors, has a long history of very high tariffs on imports of finished manufactured goods combined with low or non-existent tariffs on capital goods and on industrial and agricultural inputs. In addition, since 1982, most imports of consumer goods had been prohibited, a feature that greatly encouraged contraband. The new GOB program abolished all import prohibitions and replaced the former high tariff structure with a flat 10% ad-valorem duty plus a variable duty equal to 10% of the formerly prevailing tariff. (This provision was replaced by a flat 20% ad-valorem duty in August 1986). This measure was designed to improve revenue collections and also to reduce the degree to which import tariffs distort the allocation of resources.

6. Fiscal, Wage and Labor Policy: The program specifically froze public sector wages until December 31, 1985, in an attempt to reduce expenditures. The program also substantially increased the free play of market forces in the private sector labor market by allowing employers to discharge employees for any reason, subject to the payment of severance pay.2/ In addition, the implementing decree provided that private sector wages would be freely negotiated between employers and employees. This replaced the previous practice of Government-decreed across-the-board wage increases applicable to both private and public sector workers.

2/ Equal to a minimum of three-months pay for employees with a tenure of less than five years. For those with a tenure of over five years, the legal severance pay is one month's pay for every year of employment. An additional three-months' pay must be paid if the employee is discharged (involuntary separation).

7. Price Decontrol: The GOB program abolished all price controls, except for items produced or marketed by state enterprises, such as gasoline, electricity, and telephone services.

8. Improved Accounting by State Enterprises: The Decree required all State enterprises to submit a set of accounts as of July 31, 1985, and submit a detailed budget for the last quarter of 1985. Moreover, the law prohibits extension of Central Bank credit to enterprises that have not complied with this provision. All state enterprises were required to maintain peso deposits in the Banco del Estado, and were prohibited from maintaining bank accounts outside the country. All legal monopolies were abolished.

9. State Enterprise Decentralization: The state mining company, COMIBOL, was divided into four regional enterprises, and YPFB (the state petroleum company) into three, and has turned other state enterprises (those previously held by the central government holding company CBF) over to the Departmental Development Corporations. This decentralization serves a number of purposes, all directed at increasing the management efficiency of state enterprises. First, it will enable the GOB to dispense with most of the bloated central bureaucracy of YPFB and COMIBOL. Second, it should increase fiscal discipline over state enterprises by placing strict controls on their access to Central Bank credit to cover deficits. Finally, the move also appeared to be an attempt to reduce the power of the disruptive mining and YPFB employee unions.

Far as this program goes, it clearly does not represent the sum total of the Government's efforts in the area of stabilization. A number of additional measures were enacted in 1986, while others were incorporated in conjunction with the latest Stand-By Agreement with the IMF. The most important measure is the tax reform enacted in May, 1986, which abolished a number of existing revenue measures, including the corporate income tax, and replaced them with a general value added tax of 10% on all transactions. This tax is complemented by a 10% personal income tax from which value added tax payments may be deducted. Another new tax was levied on the net worth of enterprises, amounting to 3% during the first year, and 2% thereafter. A 3% net worth tax will be applied to the updated value of automobiles, dwellings and land holdings. Internal revenue tax collections will be further increased by updating a number of specific taxes, including those on beer, other alcoholic beverages and cigarettes, and the introduction of a 1% tax on transactions. The uniform rate of the customs tariff was raised to 20%, with no exemptions, in August of 1986.

In its Stand-By Agreement with the IMF, the government committed itself to a reduction in general government spending. Government spending already declined from 30% of GDP in 1984 to about 21% in 1985, and is scheduled to decline to below 20% in 1986, chiefly by limiting non-interest current expenditures of the Central Administration. The key measure to effect this reduction is a government commitment to continue to pursue a tight wage policy for both the general government and the state enterprises. The overall deficit of the non-financial public sector is targeted to decline from an estimated 11% of GDP in 1985 to 6.4% in 1986 and to below 6% in the IMF program period (June 19, 1986 to June 18, 1987).

IV. EVALUATION.

This evaluation is divided into two parts: the first assesses the success of the stabilization program; the second analyzes whether economic reactivation can be said to have occurred. A final section discusses the need for restructuring the economy and the lines such restructuring should take.

A. Success of the Stabilization Program.

The performance of the Government's stabilization program will be analyzed below in terms of the behavior of the price level, the budget deficit, expansion of bank credit and money supply, stabilization of the exchange rate, debt renegotiation and the balance of payments deficit.

The key indicator of the success of a stabilization program is the behavior of freely determined market prices. The general consumer price index, presented in Table 1, shows that the annual rate of increase in the general consumer price index which increased from 276% in 1983 to 1,281% in 1984, and to 11,750% in 1985; then declined to 703% between June 1985 and June 1986. The annual rate of increase declined substantially in the last quarter of 1985 -- from 1,333% in the third quarter to 73% in the fourth. The rate rose back to 175% during the first quarter of 1986, then dropped back to 36% during the second quarter.

In sum: While it cannot yet be said that the Government has attained total price stability, there has been a very substantial reduction in the rate of inflation. The IMF projects a rate of inflation of 84% between December 1985 and December 1986, a projection that would be consistent with an annual rate of increase of 35% during the second half of 1986. It now appears that the authorities will be able to hold the rate of inflation below that level.

The primary cause of the hyperinflation of 1983-1985 was the GOB's budget deficit (Table 2A and 2B) and the rapid rate of bank credit expansion to both the private and public sectors (Table 3A), which accounted for the extraordinary increase in money supply (Tables 3B). The increase in the budget deficit, in turn, is attributable mostly to the substantial transfers of funds from the Central Government to the state enterprises, mostly to COMIBOL and ENFE (the Bolivian Mining Corporation and the state owned railroads) to cover for their large operating deficits. This is clear from the data presented in Tables 4 and 5 which show, respectively, all factors affecting liquidity since 1982, and the breakdown of all financing provided by the Central Bank over 1974 - May 1986.

In 1986, it is expected that the rate of increase of the budget deficit of the consolidated public sector will slow to 129%, down from 4,638% in 1985 (Table 2A). As a proportion of the GDP, the budget deficit of the consolidated public sector declined from 29% in 1984 to 11% in 1985, and is projected to be only 6.4% in 1986 (Table 2B), which reflects a substantial reduction in real terms. The total rate of bank credit expansion to the consolidated public sector is expected to slow from 17,000% in 1985 to only 28% in 1986, while the rate of expansion of bank credit to

the private sector is projected to decline from 15,000% in 1985 to only 104% in 1986 (Table 3A) Credit expansion to both sectors declined sharply in real terms over this period.

This deceleration in the rate of increase of bank credit predictably resulted in a sharp reduction in the rate of expansion of money supply. The annual rate of increase of M1 (currency plus demand deposits) declined from 6,100% in 1985 to only 76% projected for 1986, while the rate of increase of M2 is expected to decline almost in the same proportion (See Table 3B).

The official exchange rate which had long been allowed to lag significantly behind the decline in the internal value of the Bolivian peso, was allowed to rise sharply when the new auction system was introduced. Between August and September of 1985, the Central Bank's dollar buying rate increased from $b 67,000 to $1 to $b 1,075,000 to $1, an increase of 1500 percent. Subsequently it rose very little -- to $b. 1,692,000 in December and $b.1,900,000 in March 1986, where it has since remained (Table 6). However, since the initiation of more aggressive anti-narcotics operation in July, the demand for dollars has increased sharply while the amount offered for sale has declined, resulting in severe pressure on the nation's scarce exchange reserves. There is some question as to whether the present exchange rate can - or should - be maintained.

The current account of the balance of payments presented in Table 7 does not as yet reflect the improvement generally associated with a substantial devaluation. In fact, the deficit is expected to increase substantially, both as a result of the decline in the prices of tin and natural gas and of the substantial increase in imports, projected to rise by

20% above the 1985 level.3/.

However, there is a substantial reduction in Bolivia's overall balance of payments deficit resulting from the Paris Club renegotiations concluded in June. The terms obtained were extremely favorable to Bolivia as they provided for the capitalization of all interest on both arrears and current debt maturities falling due through June 30, 1987. The interest rate on arrears and payments currently due is to be negotiated between the Government of Bolivia and individual creditors. The Paris Club agreement also provided that Bolivia cannot give to non-Paris Club members a more favorable treatment than to Paris Club members, a provision that will strengthen Bolivia's hand in negotiations with its foreign commercial bank creditors.

The balance of payments projection for 1986 shown in Table 8 (based on preliminary and unofficial Central Bank, IMF and AID estimates) shows the situation before and after the Paris debt renegotiations. According to this projection, Bolivia's overall balance of payments deficit before Paris is estimated at $ 408 million. After Paris, the deficit is expected to decline to $ 164 million. Note that the "after Paris" projection only takes account of the debt service renegotiation with the Paris Club members. It does not take into account the result of any renegotiation or concessions expected from private commercial banks. Debt service to the latter is treated in this projection as if it would be paid. If no payments were made to foreign

3/ On the basis of import data for the first six months of 1986.

commercial banks (as in the case of Paris Club members), the balance of payments gap in 1986/87 would decline substantially, though the arrears problem would still have to be addressed. Total arrears on Bolivia's debt on December 31, 1985, exceeded $ 1.0 billion, while arrears to foreign commercial banks alone were $787 million, equal to 56% of total projected 1986 merchandise exports.

The following conclusions emerge from this balance of payments analysis:

1. Given the magnitude of Bolivia's debt, and the terms in which it was contracted, there is a very close interrelation between debt renegotiation and the magnitude of the current balance of payments deficit. The ability of the Bolivian authorities to obtain favorable terms from the commercial banks will be a key factor in enabling the country to avoid unmaneagable balance of payments deficits over the next few years, and will therefore significantly affect its prospects for economic recovery.

2. Unless Bolivia obtains significant concessions in the form of lower interest rates and much extended repayment periods, any relief obtained through debt renegotiation will be merely of a temporary nature, doing little more than postponing the debt servicing problem from one year to the next. It would not eliminate the balance of payments disequilibrium.

3. While debt servicing is a major cause of Bolivia's balance of payments problem, it is not the only one. The sharp drop in exports and the recent upsurge in imports highlight the importance of restructuring the economy, viz. of expanding and diversifying export earnings.

In conclusion: The GOB stabilization program can be described as an unqualified success in terms of almost all of the usual financial indicators - price index, money supply, budget deficit of the consolidated public sector, credit expansion, relative exchange rate stability, and improvement of the debt service situation. The debt and the balance of payments remain as difficult and unresolved problems. The current account deficit has increased considerably. As a result, the present exchange rate may turn out to be overvalued, and an upward readjustment may be unavoidable. The increase in the exchange rate will undoubtedly entail a further rise in the general price level, which must be expected to induce some increase in wage rates, and a further upward push on prices. Such an increase, however, should be limited and self-contained as long as the Government continued to pursue a tight wage policy 4/, maintained fiscal discipline and kept tight control on the expansion of bank credit to both the public and private sectors.

4/ It is not suggested here that wages must be held constant, or even that a further reduction in real wages is necessary or desirable; it is clear, however, that the Government must avoid setting in motion - and financing - an inflationary wage-price spiral.

B. Economic Reactivation

There is general recognition among entrepreneurs and businessmen that the economic and political climate is much better now than it was a year ago. Both the economic and political situations have stabilized. Under the condition of hypherinflation that prevailed over 1983-1985, any medium term planning in the manufacturing, agricultural and construction sectors was clearly impossible since prices and costs could not be predicted, resources were being diverted to speculation, contraband and narcotics, and people concentrated on protecting their assets rather than producing. The present condition of relative price and exchange rate stability permits restoration of normal planning in productive activity. There is greater confidence that the democratic form of government will be maintained. The emphasis on freely determined market prices, and on wages set through negotiation between employers and employees, is also viewed as a positive factor.

On the other hand, there are as yet no clear signs of economic reactivation. Given the fact that the hyperinflation was not brought under control until late 1985, it would be unreasonable to expect a recovery in early or mid 1986. Indeed, preliminary estimates of the Gross Domestic Product just issued by the Central Bank, with breakdown by sector of origin and final expenditure, show a continuing decline in the real GDP in 1986 (Tables 9 and 10)5/. These estimates project a real GDP decline of 3.7% in

5/ Admittedly, these estimates are preliminary and are based on sample surveys that are available only for some of the items in the series. Final figures could be substantially different.

1986, compared with a 1.7% drop estimated for 1985 . While the sharpest decline will be in the mineral sector (down by 22%), significant declines are also projected for manufacturing (by 5%), agricultural production (3%), and General Government (2.3%). In terms of final expenditure, the sharpest reduction is in exports (down by 4%), followed by private and General Government consumption (Tables 9 and 10).

These gloomy projections are not in contradiction to the statement that the general economic and political climate has improved. Account must be taken of the fact that the economy has been subjected to a number of exogenous shocks. First, there is the sharp decline in the price of tin and natural gas. The price of tin declined from $ 6.42 cents a pound in 1981 to only $2.57 in May 1986. The price of natural gas also declined, though not nearly as much as that of petroleum; the recently renegotiated contract with Argentina involves a price cut of about 10%. The agricultural sector has been plagued by serious floods, which depressed agricultural output; and finally, the recent raids on the narcotics industry that started in July must be expected to reduce the available supply of foreign exchange, while stimulating the speculative demand for dollars._6/ Of the four sectors mentioned above, three - mining, agriculture and narcotics - are highly labor intensive. While

6/ In anticipation of the fact that the dollar may be overvalued at $bl.9 million to US$1 and that the authorities may not be able to maintain the exchange rate indefinitely at the present level.

value added by the narcotics industry is obviously not counted in the official GDP estimates, the production, transport and processing of coca have significant multiplier effects on the formal economy, and thus contribute to the decline of the measured GDP.

Even if these various external shocks had not occurred, a significant lag must be expected between the successful implementation of a stabilization program and the reactivation of the economy. It takes time for businessmen to regain confidence in the ability of the authorities to control the situation, to adjust to the new price-cost structure, to perceive new profit opportunities, and to shift resources back from speculative into "normal" productive activity. It takes even more time for potential investors to regain sufficient confidence to start planning for the medium term and consider a program to modernize or expand plant and equipment. In its 1986 Annual Report issued in September 1986, the Interamerican Development Bank expressed optimism that Bolivia might achieve "a significant increase in productivity in most economic sectors... if only it succeeded in controlling its inflation and in changing inflationary expectations."7/ The first of these conditions already has been largely met.

GOB plans to promote recovery include providing loans at lower interest rate 8/ to enterprises in the "productive sector, channel funds to the labor intensive construction sector and finance public works (e.g. road maintenance and construction). It is recommended that they also include improving the general economic climate for the private sector.

7/ IDB, Economic and Social Program for Latin America, Report for 1986. P. 232 (free translation of Spanish version).

8/ Of about 10%

V. SOME THOUGHTS ON RESTRUCTURING

In what direction should the economy go? What should be the Government's principal priorities?

1. Continued emphasis on stabilization. While the most difficult steps with respect to the achievement of stabilization have been taken, continuing implementation of the stabilization program should remain the Government's principal priority. In particular, the Government should continue to pursue a tight monetary and fiscal discipline, limit wage increases, implement the new tax measures and improve the level of fiscal administration. Without continuing special efforts in these area, the ceilings agreed to with the IMF could not be maintained.

2. Some structural adjustments will have to be considered following emergence from hyperinflation. These include, but will not necessarily be limited to, a careful look at the Government's pay scale to ensure that salaries are such as to enable the Government to demand reasonable honesty and efficiency of its employees. This is particularly important in the area of tax and customs collections, though it is also relevant in other areas of public sector activity. Other key areas include the exchange rate which must be set at a level that will encourage the development of industries in which the country has a present or potential comparative advantage, and diversification of state-owned and operated enterprises. The closing of unprofitable mines, an essential measure, is already an integral part of the Governments's restructuring program.

3. The encouragement and development of export industries clearly has to be given high priority in the reactivation program. The internal market is far too limited to constitute the basis for recovery and growth. A policy aiming at import substitution is clearly not indicated for Bolivia. On the other hand, an export-oriented strategy runs up against the problem of a very underdeveloped infrastructure, the mountainous nature of the terrain and the country's lack of access to the sea, all factors that combine to produce very high transport costs. In spite of these handicaps, the country has no alternative but to embark on an export-oriented strategy.

With respect to the areas and products in which the country may have a potential comparative advantage, the following appear to represent the best opportunities:

1. Soybeans: David Morawetz, Consultant for the World Bank, in his August 1986 report on "After Tin and Natural Gas, What", undertook an exhaustive analysis of the country major exports possibilities, and concluded that the country should concentrate on the production and export of soybeans in the Santa Cruz region, which in his estimation, could earn upward of $400 million a year. He made a strong case for completing the road from Santa Cruz to Corumba to transport the product from the Santa Cruz region to Puerto Quijarro, where a loading plataform, silos and grain elevators are presently under construction.

While this recommendation appears sound and is worthy of serious consideration, the country would be ill-advised to rely on a single export product. The recent sharp drop in the price of soybeans 9/ (which may be only a temporary development) strengthens this recommendation.

2. Other agricultural and livestock products in which the country may have a present and potential comparative advantage include food grains, tropical fruits, spices 10/, exotic flowers, chicks, and beef. The processing of various agricultural products (some for export) probably offers the best potential in the manufacturing area.

3. Wood and Wood Products: The country still has an abundance of wood, the export of which could be significantly expanded if the infrastructure is improved and incentives are provided. The feasibility of developing processing and manufacturing facilities based on this raw material (e.g. furniture, parquet floors, doors, and window sills) appears to have excellent potential.

4. Drawback Industries: Attracting drawback industries by establishing free trade zones involving duty free privileges for the importation of raw materials, capital and intermediate goods for the elaboration of export products should be seriously considered. So should the establishment of an "industrial park". The Panama model might be appropriate in this regard.

9/ From $215 a ton in May, 1986 to $175 in September.

10/ E.g. cinnamon, cardamom, black pepper, ginger

Finally, a careful survey should be undertaken to identify the factors that potential exporters in the manufacturing and agricultural sectors regard as major obstacles to economic recovery and growth. The Government is already aware of the need to provide credit at lower interest rates and on more suitable terms to "productive" enterprises, and is reportedly prepared to reduce the interest rate to 10% for such activities.

Other policy areas identified by private sector representatives as requiring attention include the subject of bank guarantees for loans (generally described as excessive), the terms of bank loans (maturities are generally too short to meet the working capital requirements of productive enterprises), the need for special credit lines for small manufacturing enteprises, the advisability of giving the Government the right to impose countervailing duties on imports from neighboring countries that subsidize their exports, tighter measures to prevent smuggling, the suitability of the exchange rate for the purpose of promoting exports and balance of payments equilibrium, the application of the net worth tax to businesses experiencing losses, and the simplification of bureaucratic procedures that impede imports, exports, the payment of taxes and the obtention of credit.

TABLE 1

GENERAL CONSUMER PRICE INDEX

1966 - 100

	Index	Annual Rate of Increase
1981	923.1	
82	2,063.5	123.5
83	7,750.2	275.7
84	107,058.2	1,281.4
85	12,686,008.0	11,749.7
June 85	6,023,641.8	
Sep. 85	26,098,526.4	1,333.1
Dec. 85	30,873,311.6	73.2
March 86	44,343,478.3	174.5
June 86	48,357,315.2	36.2

Source: Instituto Nacional de Estadistica, cited in Estadisticas Monetarias y Financieras, No. 31, May 1986.

TABLE 2A

BUDGET DEFICIT OF THE CONSOLIDATED PUBLIC SECTOR

(In Billions Bolivian Pesos)

		Annual Rate of Increase
1982	57.2	
83	259.7	353.3
84	5,531.4	2,033.2
85	202,096.6	4,638.3
86(Progr)	600,555.6	129.1

TABLE 2B

BUDGET DEFICIT OF CONSOLIDATED PUBLIC SECTOR AS % OF GDP

82	14.7
83	19.1
84	29.0
85	10.8
86	6.4

Source: IMF, Bolivia - Request for Stand-By Arrangement, June 2 1986, Table 10 (page 48), and Table 3 (Page 5).

TABLE 3A

BANK CREDIT EXPANSION

	Annual Rate of Increase of Bank Credit	
	To Non Financial Public Sector	To Private Sector
1982	635	304
83	287	119
84	1,166	1,405
85	17,029	15,066
86	28	104

Source: IMF Ibid, Table 5 (Page 7).

TABLE 3B

MONEY SUPPLY OUTSTANDING AT END OF YEAR

(In Billions of Bolivian Pesos)

	(1) M1	(2) Annual Rate of Increase of M1	(3) Quasi Money	(4) M2 (1) + (3)	(5) Annual Rate of Increase of M2
1982	58		31	89	
83	177	205.2%	78	255	186.5
84	3,359	1,797.7%	529	3,888	1,424.7
85	208,800	6,116.1%	76,900	285,700	7,248.3
86	367,700	76.1%	149,000	516,700	80.9

IMF, Ibid., Table 5 (Page 7)

TABLE 4

TOTAL LIQUIDITY AND ITS DETERMINANTS

1982 - MAY 1986
(In billions of Bolivian Pesos)

	1982	1983	1984	1985	May 1986
1. Net Intl. Reserves	-78.1	-52.6	311.0	156,079.5	260,005.4
2. Net Credit to Public Sector	81.5	275.8	2,926.5	-84,345.0	-423,953.4
a) Central Gov. net	-8.9	10.6	-409.4	-365,817.2	-704,231.0
b) Local Gov.	3.9	7.6	110.1	28,199.2	24,175.3
c) Public Enterprises	86.5	257.6	3,225.4	253,273.0	256,102.3
3. Credit to Private Sector	91.2	191.4	2,624.0	409,714.5	555,928.4
4. Other Determinants	4.0	-148.9	-1,875.7	-191,130.5	44,850.5
Total Liquidity (M2)	98.5	266.1	3,985.7	290,318.5	436,831.0

Source: Economic Statistics Division, Monetary and Financial Statistics, Nov 31, May 86, Table No. 5

TABLE 5

CUADRO No. 9

FINANCIAMIENTO DEL BANCO CENTRAL AL SECTOR PUBLICO

(En millones de $b.)

	GOBIERNO CENTRAL			GOBIERNOS LOCALES Y REGIONALES			EMPRESAS PUBLICAS			T O T A L		
	Cred.Bruto a	Depositos b	Cred.Neto c=a-b	Cred.Bruto a	Depositos b	Cred. Neto c=a-b	Cred.Bruto a	Depositos b	Cred.Neto c=a-b	Cred.Bruto a	Depositos b	Cred.Neto c=a-b
1974	3.053	2.672	381	10	70	(60)	660	1.066	(406)	3.723	3.808	(85)
1975	3.626	3.540	78	47	53	(6)	1.838	1.187	651	5.511	4.788	723
1976	4.399	5.753	(1.354)	74	51	23	4.525	1.472	3.053	8.998	7.276	1.722
1977	6.582	8.091	(1.509)	295	81	214	4.845	2.078	2.767	11.722	10.250	1.472
1978	8.553	8.784	(231)	401	93	308	4.775	1.456	3.319	13.729	10.353	3.396
1979	14.665	11.311	3.354	677	114	563	6.043	2.775	3.268	21.385	14.200	7.185
1980	22.344	15.551	6.793	700	217	483	9.119	3.826	5.293	32.163	19.594	12.569
1981	31.002	21.292	9.710	731	225	506	11.564	5.726	5.838	43.297	27.243	16.054
1982	142.444	151.318	(8.874)	4.829	958	3.871	94.268	7.805	86.463	241.541	160.031	81.460
1983	439.991	429.349	10.642	9.381	1.794	7.587	276.211	18.634	257.577	725.583	449.777	275.806
1984	8.263.172	8.672.534	(409.362)	133.544	23.459	110.085.	4.718.406	1.492.656	3.225.750	13.115.122	10.188.649	2.926.473
Abril 1985	21.971.528	41.008.224	(19.036.696)	712.699	71.684	641.015	23.171.979	7.485.450	15.686.529	45.856.206	48.565.358	(2.709.152)
Mayo	32.494.985	60.865.880	(28.370.895)	1.186.315	314.886	871.429	34.700.994	11.215.537	23.485.457	68.382.294	72.396.305	(4.014.009)
Junio	39.792.258	62.164.053	(22.371.795)	1.197.951	347.817	850.134	35.266.719	12.186.590	23.020.129	76.196.928	74.698.460	1.498.468
Julio	55.187.350	66.774.677	(11.587.287)	1.411.770	391.219	1.020.551	40.208.539	12.583.571	27.624.968	96.807.699	79.749.467	17.058.232
Agosto	84.362.106	79.614.744	4.747.362	1.413.814	583.017	830.797	51.860.816	16.072.185	35.788.631	137.656.736	96.289.946	41.366.790
Septiembre	244.677.919	937.095.410	(692.417.491)	19.470.841	1.478.741	17.992.100	548.731.046	187.891.459	360.839.587	812.879.806	1.126.465.610	(313.585.804)
Octubre	251.587.068	1.102.939.287	(851.432.219)	24.013.269	1.904.807	22.108.461	554.432.084	146.917.214	407.514.870	829.952.421	1.251.761.308	(421.808.888)
Noviembre	344.376.893	1.336.902.292	(992.525.399)	35.669.500	3.123.529	32.545.971	766.804.249	216.738.877	552.065.372	1.146.850.642	1.556.764.698	(407.914.056)
Diciembre	1.936.260.444	2.302.077.626	(365.817.182)	37.242.642	9.043.436	28.199.206	491.809.581	238.536.581	253.273.000	2.465.312.667	2.549.657.643	(84.344.976)
Enero 1986	1.916.706.154	2.370.943.519	(454.237.365)	43.262.335	11.374.166	31.888.169	536.548.868	324.865.579	211.683.289	2.496.517.357	2.707.183.264	(210.665.907)
Febrero	1.866.226.437	2.334.830.696	(474.604.169)	37.254.996	5.271.073	31.983.923	533.481.339	329.296.167	204.185.172	2.436.962.772	2.669.397.846	(232.435.074)
Marzo	1.867.430.458	2.422.239.498	(554.809.040)	37.313.631	10.795.365	26.518.266	544.717.587	309.585.351	235.132.236	2.449.461.676	2.742.620.214	(293.158.538)
Abril (p)	1.876.160.077	2.463.147.643	(586.987.566)	39.299.459	16.376.742	22.922.717	544.996.431	345.766.990	199.229.441	2.460.455.967	2.825.291.375	(364.835.408)
Mayo (p)	1.875.591.525	2.579.822.548	(704.231.023)	35.858.563	11.683.248	24.175.315	572.864.166	316.701.823	256.102.343	2.484.294.254	2.908.247.619	(423.953.365)

FUENTE: Banco Central de Bolivia - Departamento de Estadistica
(p) : Preliminar

TABLE 6

OFFICIAL EXCHANGE RATES
(1982- August 1986)
(BOLIVIAN PESOS PER US$)
($b per US$)

End of Year or Month	Central Bank Buying Rate	Central Bank Selling Rate
1982	196.0	199.8
83	500.0	509.8
84	8,571.0	8,995.0
June 85	67,000.0	74,330.0
August	67,000.0	74,330.0
Sept.	1,075,000.0	
Dic.	1,692,000.0	
March 86	1,900,000.0	
July	1,907,000.0	
August	1,909,000.0	

Source: Central Bank, Estadisticas Monetarias y Financieras, May 1986, Table 21, Page 39, and IMF, Recent Economic Developments, September 6, 1985, Table 22.

TABLE 7

EXPORTS, IMPORTS AND BALANCE OF PAYMENTS DEFICIT

(IN MILLIONS OF US DOLLARS)

	Exports	Imports (CIF)	Deficit on Current Account	Overall BOP Deficits
1982	828	578	- 176	- 363
83	755	589	- 155	- 332
84	724	492	- 129	- 103
85	621	552	- 281	-329
86(Proj.)	505*	661*	Before Paris: -476** ~~(Before Paris)~~ After Paris: -407	-[illegible]** ~~(After Paris)~~ Before Paris: -405 After Paris: -104

* Revised Central Bank projections.
** Preliminary AID projections based on Central Bank data.

Source: IMF, Bolivia-Request for Stand-By Arrangement, June 2, 1986 (except for footnoted figures), Table 6, Page 9.

TABLE 8

BALANCE OF PAYMENT IN 1985

AND PROJECTION FOR 1986
(In millions of US Dollars)

	1985	1986 Central Bank/IMF	
		Before Paris	After Paris
Current Account	(281)	(476)	(407)
Merchandise Trade	69	(156)	(156)
Exports f.o.b.	621	505	505
Imports c.i.f.	(552)	(661)	(661)
Interest, net.	(317)	(276)	(207)
Received	17	15	15
Paid	334	291	222
Bilateral (a)	107	83	14
Multilateral	42	48	48
Banks	95	68	68
Others	32	37	37
Priv. Debt	58	55	55
Other Serv Transfers, net	(33)	(44)	(44)
Capital Account	(48)	(86)	89
Direct Investment	10	10	10
Long Term Capital	(238)	(96)	53
Disbursements, (Official Loans)	106	190	190
Bilateral	37		
Multilateral	69		
Amortization	(344)	(312)	(137)
Bilateral	(162)	(162)	0
Multilateral	(80)	(63)	(63)
Banks	(101)	(73)	(73)
Others	(1)	(1)	(1)
Adjustment (b)		(13)	0
Priv Debt	0	0	0
Others (s.t. trade lines)	180	26	26
Errors and Omissions (Unaccounted Earnings)(c)		154	154
Overall Balance	(329)	(408)	(164)

(a) For 1967-88 interest payment to scheduled payments shown in Annex 3 plus 7% interest on new disbursements made on the prior year.
(b) Amortization Adjustments resulting from refined External Debt Data.
(c Mostly from illegal net exports (i.e. narcotics)

Source: AID projection, based on preliminary and unofficial Central Bank and IMF estimates.

TABLE 9

Bolivia: Selected Economic Indicators

(In percent)

	Average 1976-78	Average 1979-81	1982	1983	1984	Prel. 1985	Prog. 1986
I. Annual Rates of Growth							
Real GDP (at factor cost)	4.6	0.8	-4.8	-7.3	-3.2	-3.1	—
Of which: agriculture	2.1	2.4	10.4	-27.6	15.8	2.5	--
mining	-2.5	-3.6	-3.9	-1.0	-13.9	-5.7	-0.7
manufacturing	6.6	-1.6	-12.8	-3.4	-15.2	-11.6	-5.0
GDP per capita	1.7	-1.9	-7.4	-9.8	-5.8	-5.7	-2.7
Prices							
GDP deflator	10.1	27.5	169.2	275.6	1,299.0	13,520.9	290.0
Consumer prices (average)	7.7	33.0	123.5	275.7	1,281.2	11,741.0	291.6
Consumer prices (end-of-period)	9.8	31.5	296.5	328.5	2,177.2	8,159.7	84.3
II. Ratios to GDP							
Consumption	82.0	86.6	86.4	93.6	91.6	96.2	91.3
Gross domestic investment	20.7	14.7	9.8	3.5	4.9	2.9	10.5
Exports of goods and nonfactor services	21.0	18.6	15.6	14.4	13.2	13.1	14.6
Imports of goods and nonfactor services	-23.6	-19.9	-11.7	-11.6	-9.7	-12.2	-16.4
External saving	4.9	7.5	3.9	3.6	3.0	6.5	7.9
National saving	15.9	7.4	5.9	-0.1	1.9	-3.6	2.6
Nonfinancial public sector	3.1	-0.5	-9.0	-18.0	-25.3	-10.9	-0.4
Private sector	12.8	7.9	14.9	17.9	27.2	7.3	3.0

Source: IMF, Bolivia - Request for Stand-By Arrangement, June 2, 1986, Table 2

TABLE 10

GROSS DOMESTIC PRODUCT BY TYPE OF ECONOMIC ACTIVITY
(IN MILLIONS OF BOLIVIAN PESOS - 1980)

TYPE OF ACTIVITY	1985(E)	1986(E)	PERCENTAGE CHANGE 1985	PERCENTAGE CHANGE 1986
A. INDUSTRY	91,421	87,515	-1.9	-4.3
1. AGRICULTURE, FORESTRY AND FISHING	21,417	21,086	3.1	-1.5
-AGRICULTURAL PRODUCTS	16,244	15,756	8.5	-3.0
LIVESTOCK	4,151	4,279	-13.9	3.1
-FORESTRY, FISHING AND HUNTING	1,022	1,051	3.2	2.8
2. MINING	13,751	10,540	-11.9	-22.3
-CRUDE PETROLEUM AND NATURAL GAS	6,899	6,223	-2.0	-9.8
-METALLIC AND NON-METALLIC MINERALS	6,852	4,317	-20.0	-37.0
3. MANUFACTURING	10,729	10,174	-9.2	-5.2
4. UTILITIES	936	931	0.5	-0.5
5. CONSTRUCTION	3,591	3,584	2.6	-0.2
6. COMMERCE	13,195	13,262	2.1	0.5
7. TRANSPORT AND COMMUNICATIONS	8,067	8,076	1.0	0.1
8. FINANCE	16,875	17,053	0.8	1.1
-FINANCIAL SERVICES	6,686	6,853	2.0	2.5
-HOUSING	10,189	10,200	0.1	0.1
9. SOCIAL SERVICES	4,425	4,413	-1.5	-0.3
-BANKING SERVICES (IMPUTED)	-1,565	-1,604	2.0	2.5
B. GENERAL GOVERNMENT	13,686	13,370	-2.0	-2.3

TYPE OF ACTIVITY	1985(E)	1986(E)	PERCENTAGE CHANGE 1985	PERCENTAGE CHANGE 1986
C. DOMESTIC SERVICES	622	622	-1.7	-----
TOTAL: (AT PRODUCER PRICES)	105,729	101,507	-1.9	-3.9
INDIRECT IMPORT TAXES	3,384	3,600	5.0	6.4
TOTAL GDP: (AT MARKET PRICES)	109,113	105,107	-1.7	-3.7

SOURCE: CENTRAL BANK OF BOLIVIA
(E) : ESTIMATE (Preliminary and Unofficial)
REV : JULY 1986

TABLE 11

GROSS DOMESTIC PRODUCT BY TYPE OF EXPENDITURE
(IN MILLIONS OF BOLIVIAN PESOS: - 1980).

TYPE OF EXPENDITURE	1985(E)	1986(E)	PERCENTAGE CHANGE 1985	PERCENTAGE CHANGE 1986
CONSUMPTION EXPENDITURES				
GENERAL GOVERNMENT	16,116	15,746	-2.1	-2.3
PRIVATE SECTOR	76,624	75,035	0.7	-2.1
CHANGE IN INVENTORIES	-2,036	-2,193	----	----
GROSS FIXED CAPITAL FORMATION	13,104	13,522	-0.3	3.2
EXPORTS OF GOODS AND NON-FACTOR SERVICES	31,522	30,262	-1.3	-4.0
LESS: IMPORTS OF GOODS AND NON-FACTOR SERVICES	-26,217	-27,265	5.0	4.0
TOTAL GDP AT MARKET PRICES	109,113	105,107	-1.7	-3.7

SOURCE: CENTRAL BANK OF BOLIVIA
(E) : ESTIMATE (Preliminary and Unofficial)
REV: : JULY 1986

APPENDIX*

Summary of Measures Contained in Supreme Decree 21060 (August 29, 1985)

Title I

Establishes new exchange rate system and procedure for twice weekly auctions and legalized the parallel market.

Authorizes the sale of the BCB's monetary gold in support of the new economic program.

Title II, Chapter I.

Authorizes banks and other financial institutions to offer foreign exchange denominated accounts and accounts with a dollar maintenance of value clause and to make dollar denominated loans or loans with a maintenance of value clause. Financial institutions are required to pay no less than LIBOR on such deposits. Interest rates on such loans are specifically exempted from all interest rate controls. Such deposits are also exempt from reserve requirements.

Eliminates interest rate controls on all peso deposits and loans. Reduces the legally required reserve for peso denominated deposits to 50 percent for demand deposits, 10 percent for term and savings deposits.

Commercial banks are specifically authorized to carry out foreign exchange and trade transactions.

Chapter II

Eliminates all restrictions on imports, except those dealing with public health or state security.

Establishes a new system of customs tariffs equal to a flat ten percent rate plus an amount equal to 10 percent of the previously existing tariff. Eliminates all tariff exemptions except those established by international agreements.

Chapter III

Eliminates all restrictions and administrative controls on exports with the exception of armaments, narcotics and other dangerous substances, and items prohibited by regulation for the protection of endangered species, and the "preservation of the artistic patrimony and cultural treasures of the Nation."

---

* Source: Robert V. Burke
Analysis of the New Economic Program of the Government of Bolivia
October 22, 1985 (Appendix A)

Adjusts the system of taxation of minerals to provide more realistic and adjustable presumed costs.

Title III Labor Laws

Chapter I

Permits both public and private sector employers to rescind labor contracts subject to a severance payment of three months pay, if paid in a lump sum, or six months pay if paid monthly, at the option of the employee.

Chapter II

Freezes public sector wages until December 31, 1985.

Establishes that private sector wages are to be freely contracted between employer and employee.

Eliminates "Pulperias" (subsidized commisaries) operated by the state corporation of production.

Workers formerly having "pulperias" in the public sector are to be compensated by the amount of the subsidy in cash.

Public enterprises are prohibited from paying workers in kind or providing free products (e.g. gasoline, food) in addition to salary.

Chapter III

Reduces the number of public holidays to 10.

Title IV. Price Controls

Chapter I

Eliminates all price controls.

Establishes a price for regular gasoline of U.S.$.30 per liter and establishes corresponding prices for other petroleum products. The peso price to be adjusted twice monthly.

Establishes similar dollar denominated prices and price adjustments for electricity and telephone service and rail service.

Delegates rate setting for urban transport to municipalities.

Establishes free entry into inter-urban transport and domestic airline service and eliminates price regulation.

Title V. State Enterprises

Chapter I

Requires all state enterprises to submit a set of accounts as of July 31, 1985 and to submit a detailed budget for the last quarter of 1985.

Requires all state enterprises to submit a plan within 30 days for the rationalization of personnel.

Prohibits Central Bank Credit to enterprises which have not complied with the previous provisions.

State enterprises are required to maintain deposits in pesos only in the Banco del Estado. All state enterprises are prohibited from maintaining bank accounts outside the country.

Chapter II

YPFB is to be broken up in three regional institutions.

Chapter III

COMIBOL is to be decentralized into four regional institutions.

Chapter IV

The Bolivian Development Corporation (CBF) is to be dissolved and its assets transferred to the regional development corporations where they are located.

Chapter V.

The National Automotive Transport Enterprise (ENTA) is dissolved and its assets transferred to the municipalities in which they are located.

Chapter VI

The domestic public debt in arrears (floating debt) is consolidated through the issuance of notes with a dollar maintenance of value clause.

Chapter VII

Abolishes legal monopolies.

Title VII Fiscal and Monetary Reform

Requires the Ministers of Finance and Planning to submit to the Congress proposals for the reform of the monetary and tax systems.