Volume Title: Developing Country Debt and Economic Performance, Volume 2: The Country Studies -- Argentina, Bolivia, Brazil, Mexico

Volume Author/Editor: Jeffrey D. Sachs, editor

Volume Publisher: University of Chicago Press, 1990

Volume ISBN: 0-226-73333-5

Volume URL: http://www.nber.org/books/sach90-1

Conference Date: September 21-23, 1987

Publication Date: January 1990

Chapter Title: Trade Policies, 1970- 85

Chapter Author: Juan Antonio Morales, Jeffrey D. Sachs

Chapter URL: http://www.nber.org/chapters/c8936

Chapter pages in book: (p. 202 - 214)

Table 3.4 **Structure of Expenditures in the Central Government, 1970–84 (as percentage of total expenditure)**

| | 1970 | 1976 | 1980 | 1982 | 1984 |
|---|---|---|---|---|---|
| Personnel | 54.1 | 42.4 | 46.4 | 20.8 | 59.7 |
| Materials | 1.4 | 6.3 | 7.3 | 3.0 | 5.5 |
| Transfers | 16.3 | 16.6 | 11.6 | 10.0 | 19.8 |
| Debt service | 13.6 | 2.1 | 16.3 | 26.8 | 7.6 |
| Payments to Central Bank | .0 | .0 | .0 | 40.7 | .0 |
| Other | 14.6 | 22.7 | 18.4 | 4.1 | 7.6 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

*Sources:* Data refer to central government (TGN) and are based on the data given in table 5.4 of Breuer (1988), which in turn were provided by UDAPE in the Ministry of Planning, Bolivia.

central administration increased by 92.4 percent between 1970 annd 1982, yielding an average annual rate of growth of 5.6 percent. This rate of growth was well above that of the urban population and of GDP, with the main increases occurring between 1970 and 1976. We know from the political analysis that succeeding administrations used patronage as a way to cement patron-client relations, and thereby build a political base of support. It does indeed seem that the result was a profligate and inefficient overextension of public sector employment.

Expenditures on investment that were on average around 2 percent of GDP during 1976–79 fell to around 0.3 percent during the crisis years of 1981–85. Since central government investment expenditure is mainly on social overhead, the impact of its substantial reduction has important repercussions on income distribution and on growth. The fall in this particular type of investment will have long-lasting effects, the magnitude of which has not yet been fully appreciated.

# 4 Trade Policies, 1970–85

It should be recalled from our overview in chapter 1 that the long-run growth of the Bolivian economy has been critically determined by the exports of primary commodities, mainly tin and natural gas. Bolivia's economy depends crucially on the performance of the export sector. In turn, shifts in indebtedness have coincided, procyclically, with the export cycle. Bolivia's dollar export earnings during 1970–88 are shown in table 4.1.

Export earnings and, by extension, the domestic economy have been greatly affected by the instability of Bolivia's export prices. As a result, policymakers have focused on measures to stabilize and improve Bolivia's

**Table 4.1** **Export Earnings, 1970–88 (in millions of U.S. dollars)**

| | | | |
|---|---|---|---|
| 1970 | 190.4 | 1980 | 942.2 |
| 1971 | 181.6 | 1981 | 912.4 |
| 1972 | 201.3 | 1982 | 827.7 |
| 1973 | 260.8 | 1983 | 755.1 |
| 1974 | 556.5 | 1984 | 724.5 |
| 1975 | 444.7 | 1985 | 623.4 |
| 1976 | 563.0 | 1986 | 545.5 |
| 1977 | 634.3 | 1987 | 518.7 |
| 1978 | 627.3 | 1988 | 542.5 |
| 1979 | 759.8 | | |

*Source:* IMF, *International Financial Statistics*.

terms of trade, particularly with respect to tin. These measures have been pursued mainly by participation in international stabilization agreements on tin and by lobbying to forestall sales of this commodity by the industrial countries. In regard to natural gas, the trade policy has been much more passive.

Many domestic economic policies have affected the development of Bolivia's foreign trade performance in recent years. Some of the policies were particularly harmful and played an important role in the severity of the crisis in the 1980s. In part because of adverse trade policies and in part because of adverse terms-of-trade shocks that were out of Bolivia's control, Bolivia suffered one of the sharpest declines in Latin America in the purchasing power of exports (PPX) between 1981 and 1988, as shown in table 4.2.[1] In this chapter, we review the main trade policies and their effects on trade performance. Particular attention is paid to exchange rate management. The structure of tariffs and the taxation of natural resources are also examined. The important question that underlies the whole chapter is why, despite a high dependency on exports, Bolivia's long-run export performance has been so poor.

## 4.1 Export Policies

Bolivia's export policies during 1961–81 were primarily aimed at strengthening or at least stabilizing Bolivia's terms of trade in the major commodity markets.[2] From 1982 to 1985, little attention was paid to trade policies given the overwhelming problems of internal stabilization.

By far the most important scheme of price stabilization was provided by Bolivia's participation in the International Tin Agreements (ITA). Five agreements were signed—1956, 1961, 1966, 1971, and 1976—but Bolivia did not join in signing the last one in 1976, in protest against price targets that it regarded as too low. In the 1970s, agreements of lesser scope were also signed for tungsten and antimony, other important mineral exports of Bolivia.

**Table 4.2** **The Purchasing Power of Exports (PPX) in Bolivia and Selected Countries, 1988 (1980 = 100 for all indices)**

| Country | PPX, 1988 | Export Volume | Terms of Trade |
|---|---|---|---|
| Bolivia | 57 | 69 | 89 |
| Argentina | 102 | 131 | 79 |
| Brazil | 167 | 197 | 86 |
| Chile | 156 | 158 | 101 |
| Colombia | 152 | 174 | 90 |
| Ecuador | 103 | 159 | 67 |
| Mexico | 139 | 228 | 62 |
| Peru | 75 | 71 | 108 |
| Uruguay | 148 | 130 | 116 |
| Venezuela | 56 | 106 | 55 |

*Source:* Economic Commission for Latin America and the Caribbean, United Nations (ECLAC), "Preliminary Overview of the Latin American Economy, 1988" (3 January 1989): table 8, export volumes; table 10, terms of trade; and table 12, purchasing power of exports. As explained in endnote 1 to this chapter, the PPX should equal the product of the export volume index and the terms-of-trade index. This is only approximately true for the data shown, apparently because of the differing coverage of goods in the three indices reported by ECLAC.

The ITAs were agreed upon by the main tin producing and consuming countries, with the exception of the United States. The governing body of the ITA is the International Tin Council (ITC). The main, but not the only, instrument for achieving the price stabilization objective was a buffer stock of tin metal financed by the producing members. In negotiations for the five agreements, Bolivia, which had the highest production costs among the producing countries, lobbied systematically for higher floor and ceiling prices than those set by the ITC. Other producers did not follow Bolivia, feeling that a long-run policy of high prices would backfire on them. Time proved them right.

There is considerable controversy over the workings of the ITC and of the buffer stock. For example, there was a problem with the small size of the agreed-upon stock. In fact, the buffer stock became irrelevant in the booming market of the 1970s. Moreover, the buffer stock could hardly cope with the most important destabilizing factor in the tin market, namely, the huge strategic stockpile of tin held by the U.S. General Service Administration (GSA). In the 1980s, the ITC held prices that were much too high instead of allowing a smooth accommodation to the weaker market conditions. High prices induced the entry of new producers in the market and hastened the process of technological substitution with other metals and materials. In addition, the financing of the buffer stock became a problem. This conjuction of an excessively high price with financing problems led to the collapse of the tin agreement in October 1985 and the collapse of tin prices from $5.60 per pound on the eve of the collapse to $2.55 per pound in July 1986, nine months later. The October collapse had a stunning effect: the buffer stock declared insolvency and the London Metal Exchange ceased trading in this metal. The

evolution of the real price of tin (relative to the unit value of imports of the developing countries) was shown in figure 1.2 in chapter 1, in which the collapse in October 1985 is plainly evident.

Besides the problem of price stabilization, the production and export activities of the mining sector during the 1970s were adversely affected by onerous tax legislation, which was somewhat eased after 1979. The mining sector was subjected to two main types of taxes: a *regalía*, which was initiated in 1965, and an export tax imposed with the devaluation of 1972. The *regalía* is a tax on presumed income, given that the nominal base of the tax results from the difference between world mineral prices and a presumed cost set by the Bolivian Ministry of Mines. Since presumptive costs changed infrequently, the *regalía* functioned in fact as a tax on the gross value of output. The *regalía* overtaxed the mining sector, and particularly the weakest enterprises, in years of low mineral prices, whereas it failed to fiscally appropriate the rents that were generated in years of rising mineral prices (Gillis 1978). Moreover, tax codes did not encourage investment in mineral exploration and development.

Petroleum was a major export in Bolivia. But after 1973, with the rise in domestic consumption and the progressive depletion of reserves, the amount left for exports decreased substantially, and Bolivia ceased to be a net petroleum exporter in 1977. The systematic domestic underpricing of petroleum products encouraged the demand for both domestic consumption and for contraband exports, which hindered a sensible development of petroleum exports and appropriate tax revenues. In addition, petroleum production and exports have been subjected to punitive taxation and this, too, has had long-run costs in discouraging supply.

Bolivia has important deposits of natural gas. In fact, the export prospects for energy lie mainly in natural gas. Exports of gas to Argentina have been a very important source of foreign exchange. In the 1970s, gas exports were already marred by controversies about price, and these controversies have gained in intensity in the last years. Unfortunately, pricing principles were not clearly established when the gas pipeline to Argentina was put into operation in 1972. A negotiation during the 1970s between Bolivia and Brazil to export natural gas to Brazil did not succeed because of domestic political opposition to sales of the "national patrimony" to Brazil. These negotiations have been resumed under the New Economic Policy begun in 1985.

In 1977 the Bolivian government decided to subsidize nontraditional (or minor) exports, including selected agricultural products and manufactures. The Law of Fiscal Incentives of 1977, and its reform in 1982, for nontraditional exports included exemptions from all export taxes as well as from import duties for inputs into exports and a tax rebate certificate granted to the exporters. The certificate, which amounted to between 10 and 25 percent of the FOB value of exports, could be used to pay taxes on income,

sales, or imports. It could also be sold freely for use by other exporters. The tax certificate was a direct subsidy that partially compensated an increasing overvaluation of the peso.

An ex post evaluation of export policies demonstrates that these policies were not always clearly stated, nor were their effects fully appraised. It is clear that with respect to traditional exports, fiscal measures were generally inimical to a long-term increase in supply. The fiscal system focused on expropriating economic rents—a legitimate objective, of course—more than on encouraging the opening of new mines or the drilling of new wells. In regard to the promotion of nontraditional exports, it is possible to make two appraisals. First, the scheme of 1977 (and the reform of 1982) was subject to considerable abuse, without really leading to increased incentives for more exports. Second, the exportable products that benefited from this export promotion policy constituted less than 5 percent of the value of all exports. In fact, the emphasis on fiscal measures obscured the fact that domestic firms and industrialists first had to learn how to improve their production and merchandising methods. Thus, it appears that more effective forms of encouraging nontraditonal exports could have been sought.

### 4.2 Import Policies

Major import tariff reforms took place in 1967, 1973, 1982, 1985, and 1986. Before the changes of 1985 and 1986, the most important was the reform in 1973, which had been distorted with piecemeal changes in the tax rates but which nonetheless affected the schedule in significant ways. A very important feature of the tariff structure in place until 1985 was the existence of preferential tariff provisions for (1) commodities, according to the final use to which they were put; (2) goods used in the northwestern regions of the country; and (3) goods coming from countries with which Bolivia had (and has) economic agreements for bilateral reductions in tariffs.

Examples of preferential tariffs of the first type were the special provisions for imports for the mining and petroleum sectors and the exemptions accorded by the Investment Laws of 1972 and 1981. Preferences of the third type included the Bolivian Lists of Tariff Concessions to the member countries of the Latin American Free Trade Association and the Andean Group. These provisions for preferential tariffs affected an important proportion of Bolivian imports. Depending on the year, the value of imports subject to the preferential rates ranged between 25 and 35 percent of total imports.

Considerations of government revenue and exigencies of the balance of payments (i.e., the need to constrain the fall of reserves in the context of a pegged exchange rate) prevailed over the view of using tariffs (and other import policies) as effective tools for guiding industrial policy. The piecemeal changes eroded the original intentions of coherent and limited protection in

the 1973 reform and in subsequent tariff changes. While one could find economic reasons to justify the distinct tariff rates in the reforms on protection and revenue grounds, the piecemeal changes introduced a high degree of dispersion of the tariffs, reflecting ad hoc considerations with little economic justification.

Frequent changes were often brought about by the pressures of special interest groups of industrialists and importers. Before 1986, tariff duties, as is to be expected,were high on luxuries and competitive consumer goods and exhibited significant variation. On the other hand, tariff rates for capital goods were very low. Duties on raw materials and intermediate goods, which are necessary for domestic manufacturing and hence could be treated in a manner like that for capital goods, were, however, quite variable.

The effective rate of protection is better than the nominal tariff rate as an indicator of the extent to which a particular set of tariffs protects domestic producers. Table 4.3 shows the effective rates for selected products prevailing in the second half of the 1970s. It is clear that there is considerable variation among the effective rates. Note that effective rates have also been computed for imports subject to quantitative restrictions by finding the implicit tariffs involved, which were calculated as the relative difference between international and domestic prices. This procedure was used as well in the case of prohibited imports.

More specific conclusions can also be drawn from the data in table 4.3. First, the high protection provided by the import bans stands out. Apart from the case of import prohibitions, the most important characteristic that appears in the structure of effective protection is the high effective rates for goods considered luxuries. The effective rates are considerably higher than the already high nominal tariff rates. Second, it is clear that there is high effective protection for domestic production. In the cases of goods subject to import bans there is complete protection, but this is also true in many cases which are only subject to tariffs. Third, most intermediate products for industrial usage have low (or even negative) effective rates, which are generally very close to the nominal rates. Fourth, the effective rates for capital goods are close to the nominal rates; however, in many cases the effective rates are negative.

Quantitative restrictions, including prohibitions, were used along with tariffs to limit imports during 1970–82, but their scope was reduced during the decade. In 1978 less than 2 percent of the Brussels Trade Nomenclature was subject to prohibitions. During the crisis years of 1982–85, many luxury and competitive imports were banned for balance-of-payments purposes (around 10 percent of the items of the Brussels Trade Nomenclature).

Smuggling has greatly limited the application of tariff and quota policies and has substantially hurt government revenues. Once again, the expansion of smuggling was a symptom of the increasing administrative weakness of

**Table 4.3** **Bolivian Nominal Tariffs and Effective Rates of Protection by Industry (31 December 1977)**

| | Mean | Standard Deviation |
|---|---|---|
| *A. Summary statistics for a list of 337 groups of commodities* | | |
| Nominal tariff | 38.9% | 28.0% |
| Effective rate of protection | 74.4% | 97.5% |

Simple correlation between nominal and effective rates = 0.88
Rank order correlation between nominal and effective rates = 0.88

| | Nominal Tariff | Effective Rate of Protection |
|---|---|---|
| *B. Indices for selected items within this list* | | |
| Livestock products | .17 | .14 |
| Chemical & fertilizer mineral products | .27 | .38 |
| Butter | .81 | 4.83 |
| Cheese | .67 | 2.33 |
| Canned fruits & vegetables | .62 | 1.81 |
| Flour mill products | .29 | .77 |
| Bakery products | .42 | .58 |
| Processed tobacco | .97 | 4.29 |
| Carpets | 1.18 | 5.83 |
| Lace products | .91 | 1.88 |
| Jersey fabric | .71 | 2.15 |
| Carpeting products | 1.13 | 2.33 |
| Premanufactured wooden structures | 1.12 | 2.36 |
| Papers for sanitary use | .67 | 1.67 |
| Pharmaceutical preparations | .17 | .19 |
| Paints, inks, & dyes | .36 | .65 |
| Leather | .65 | 1.72 |
| Soles and other shoe components | .97 | 1.89 |
| Mining machinery | .07 | .05 |
| Steel structures | .32 | .49 |
| Hand tools | .24 | .30 |
| Farm machinery, except tractors | .11 | .09 |
| Textile industry machinery | .09 | .01 |
| Industrial furnaces | .10 | .05 |
| Business & office machines | .38 | .53 |
| Domestic kitchen appliances | .48 | 1.03 |
| Washers | .79 | 2.54 |
| Fans & other domestic appliances | .76 | 2.24 |
| Domestic refrigerators | .37 | .61 |
| Trucks | .93 | 2.82 |
| Household radio & TV sets | .53 | .91 |
| Motorcycles, bicycles, & parts | .43 | 1.30 |
| Wood furniture for homes | .94 | 1.60 |

*Source:* Morales, Ulloa, and Jimenez (1978), table 7.

the public sector. Although there are no good data for this illegal activity, a fair guess for the late 1970s was that contraband imports constituted around 20 percent of legal imports. The expansion in contraband imports after 1978 is also related to the laundering of dollars earned in the drug trade.[3]

## 4.3 Economic Integration

Bolivia has adhered to two main economic integration schemes, the Latin American Free Trade Association (LAFTA), which later became the Latin American Integration Association, and the Andean Group, as well as to a host of other organizations of economic cooperation with less ambitious aims.

Bolivia joined LAFTA in 1966 and was given a relatively less developed country status with preferential treatment that consisted essentially in postponing dates for the implementation of tariff reductions and dismantling nontariff barriers. The direct benefits of Bolivia's association with LAFTA were virtually unnoticeable. Bolivian exports to the countries consisted mainly of petroleum, natural gas, and minerals. These exports, however important, would have taken place anyway, with or without LAFTA membership. Bolivian imports of manufactures from LAFTA grew at a very fast pace, but this expansion can hardly be attributed to its participation in the organization.

The apparent failure of LAFTA, at least from the viewpoint of the relatively more poor Andean member countries, led to the formation of the Andean Group with the signing of the Cartagena Agreement in May 1969. The Andean Group integration scheme had two main instruments: (1) a customs union, and (2) a joint mechanism of investment programming for a list of goods for the Sectorial Industrial Development Program (SIDP). In addition, in order to counteract the adverse effects that these instruments might unintentionally provoke, the Andean Group countries agreed upon a set of measures to harmonize other policies that affected trade and agreed to set common policies for the treatment of foreign private investment.

Bolivia was again given a relatively less developed country status in the group, along with Ecuador, and both were accorded preferential treatment for the two main instruments and subordinate policies. Economic integration within the Andean Group created considerable hope among Bolivian policymakers, who thought that it would provide the big push necessary for Bolivian industrial development with the incentive of a large market for manufactures. Bolivia, therefore, enthusiastically supported the Andean Group at the outset.

By 1978 there was considerable disillusionment with the workings of the Andean Group among government officials and industrialist organizations in Bolivia. From their point of view, the benefits of integration seemed rather scant and the costs were presumed to be high. The fact that the whole

Andean Group entered into a state of crisis contributed to the problem. Chile, with the most healthy of the Andean Group economies, in fact withdrew from the group in the mid-1970s under the policy of the Pinochet regime. The Andean Group has continued in prolonged crisis, a crisis which deepened markedly with the international economic turmoil of the 1980s.

In the aftermath of the hyperinflation, with public policies dominated by the need to consolidate the stabilization, Bolivia's participation in the Andean Group and in all the other integration schemes is almost dead. Notwithstanding this, the collapse of the markets for traditional exports may inspire Bolivian policymakers to seek some fresh approaches to economic integration, especially with Brazil and Argentina, which represent large potential markets for light industrial exports from Bolivia.

### 4.4 Exchange Rate Policies

Between 1957 and 1982, Bolivia followed a regime of unified pegged official exchange rates. The abundance of credits from 1957 until the late 1970s allowed the government to maintain a fixed exchange rate without the need to resort to explicit foreign exchange rationing, and thus prevented the development of a parallel market with significant premiums. Between 1957 and 1979, the exchange rate showed a surprising stability: only once, in October 1972, was the peso devalued. After the drying up of foreign inflows in the early 1980s and with the resistance of the government to undertake timely devaluations, the economy operated with what was in effect a dual exchange rate: an overvalued and rationed official rate and a floating, parallel (sometimes illegal) rate. After 1985 the exchange rate was again unified and operated as a managed float.

On some occasions during the 1960s and 1970s, foreign exchange reserves fell significantly, prompting policy measures to avoid an outright devaluation through hidden or explicit rationing of foreign exchange. Various temporary trade policy instruments were used for this purpose. On at least two occasions, a uniform increase in import tariff rates was used as a substitute for devaluation from the import side: in 1969, an almost uniform surtax of 10 percent was levied on all imports; in 1975, another surtax of 3 percent was created. Export subsidies for minor exports were also used to compensate for overvaluation in 1977. However, the percentage of trade that benefited from those subsidies was very small.

As mentioned in section 4.2, quantitative restrictions were also used for balance-of-payments purposes. For instance, in 1969 the restoration of external equilibrium was obtained with temporary prohibitions on the imports of automobiles and of luxuries. A new tool in the kit of import controls was introduced in 1976 in the form of prior import deposits.[4] It is important to note that these deposits were both a monetary measure and a tariff-like regulation raising the cost of imports. Because of both features,

they were initially very effective in curtailing imports. However, to the extent that importers could roll over their deposits, the monetary contraction aspect was lost, except when there were increases in the level of imports.

Thus fiscal and, to a lesser extent, monetary measures were used to avoid open devaluations of the peso in the 1960s and the 1970s. In accordance with the spirit of the times, devaluation was viewed as a declaration of failure in economic policymaking. General Banzer, who had to go through a devaluation in 1972, paid the costs, political and otherwise, of very painful adjustments in the economy distributed over more than a year after the devaluation. Although never publicly declared, a widely held opinion in government circles at the time was that the boom in export prices in 1973–74 saved Bolivia from a string of further devaluations.

The devaluation of 1972 deserves some additional attention. Since the end of 1969 when the assets of the Bolivian Gulf Oil Corporation were nationalized, pressures on the peso had been building up. In 1970 the government decided to impose some mild administrative regulations on the convertibility of the peso; for instance, requiring a full registration in the Central Bank of demanders of foreign exchange.[5] These regulations were not sufficient to avoid the drain on foreign exchange reserves of the Central Bank. By the end of 1972, it became clear that a devaluation was unavoidable. The IMF was called for consultations, and Bolivia applied for a standby loan. The peso was devalued by 40 percent, and some public sector prices, as well as interest rates on savings deposits, were increased. Workers obtained a uniform compensation of $b 135, equivalent to U.S. $7 (1972 dollars), at the new rate of exchange. After the devaluation, many prices were subject to controls and fixed at their pre-devaluation levels. Some of the prices were revised upward only in October 1973 and the rest in January 1974. Strong excess demand conditions made the revisions unavoidable.

In table 4.4 we show how the peso incurred a significant real appreciation vis-à-vis the U.S. dollar during 1973–84. The relatively long period of overvaluation had important implications for resource allocation. In the mining sector, the combination of overvaluation plus punitive taxation shifted resources from there to the nontradable manufacturing sector and the service sector. Overvaluation also encouraged the expansion of the very capital-intensive activities of tin smelting and oil refining. Traditional exports and nontraditional ones, such as commercial agriculture, suffered.

If overvaluation hurt exports, one may wonder why the issue was not debated more fully at the time or why there was not a significant lobby to push for a devaluation. The following reasons may be hypothesized. First, oil and mineral exporters can usually live with overvalued exchange rates until the rates are severely misaligned. Given their cost structure, exporters usually place more emphasis on lessening the weight of direct taxation than on the exchange rate to maintain their after-tax profitability. Second, the high

Table 4.4 The Real Exchange Rate in Bolivia, 1970–84

| Year | Index (1970-100) |
|---|---|
| 1970 | 100.0 |
| 1971 | 95.9 |
| 1972 | 88.3 |
| 1973 | 75.7 |
| 1974 | 110.3 |
| 1975 | 110.6 |
| 1976 | 109.2 |
| 1977 | 109.0 |
| 1978 | 113.0 |
| 1979 | 121.2 |
| 1980 | 125.6 |
| 1981 | 146.9 |
| 1982 | 125.7 |
| 1983 | 125.0 |
| 1984 | 164.6 |

*Source:* IMF data. *Note:* The index is constructed as $P/EP$, where $P$ is the Bolivian consumer price index, $E$ is the exchange rate (pesos per dollar), and $P$ is the U.S. CPI. For each year, annual averages are used for the three indexes. Note that $E$ is the official exchange rate; in the 1980s there was a large and persistent gap between the official exchange rate and the parallel market exchange rate.

prices for the main exports, well above previous trend, concealed the need to correct the exchange rates. Although profit margins in the exporting sector decreased with overvaluation, they were still very high in mineral, oil, and gas exports.

It was not fully realized that overvaluation hindered the expansion of *potential* exports. Since no significant actual exports were greatly damaged by overvaluation, no political lobby was established to gain a better price for the dollar earned in the exporting activities. Also, hopes for exports of manufactures were riding on the Andean Group market, and little attention was paid to the development of other markets. Markets in the Andean Group were protected by a relatively high common external tariff, while trade liberalization within the group benefited mainly noncompetitive imports from the partner countries. In those circumstances, overvaluation, if not severe, was not the major hindrance for export promotion of manufactures to the protected market. In the event, however, that market turned out to be much too limited to support much manufacturing export activity in Bolivia.

The hypothesis that overvaluation constituted a fiscal measure to extract resources from the hard-to-tax public enterprises also has to be taken into account. The weakness of the central government *vis-à-vis the public enterprises,* and especially the inability of the central government to tax the state enterprises directly, may explain one attraction to overvalued exchange rates. Such rates permitted the transfer of resources from the exporting sector, formed mainly by public enterprises, to the nonexporting public sector, formed mainly by the central government.[6]

The abrupt reduction in net foreign reserve flows in 1982, combined with the underlying budgetary disequilibrium, at first caused a rapid loss of

reserves and a collapse of the fixed exchange rate regime in March of that year. The collapse was followed by a dual market with a fixed official rate for a handful of transactions and a floating rate for all other transactions, either of current account or capital account. Unexpectedly for the public authorities, the exchange rate depreciated very rapidly in the parallel market, causing an upsurge of inflation. The difficulties of managing the exchange rate during the high-inflation period and the unification of rates at a realistic level with the stabilization program of August 1985 are discussed more completely in chapter 5.

## 4.5 Capital Flight

The overvalued exchange rate and lax management of the public sector contributed to widespread capital flight in the 1970s and 1980s. Ugarteche (1986) and the World Bank (1985) give some estimates of capital flight based on the "errors and omissions" account in the balance of payments.[7] The average annual capital flight is estimated to have been as follows (in millions of U.S. dollars): 1971–75, $77.3 (4 percent of the 1975 GDP); 1976–81, $216.9, (6 percent of the 1981 GDP); and 1982–83, $106.2 (3 percent of the 1983 GDP). Bank deposits held by Bolivians in banks in the United States were estimated to be on the order of $400 million in 1985, amounting to around 10 percent of GDP. This is an extremely conservative estimate of offshore bank accounts, especially in view of the fact that it is easy to hide foreign ownership of bank accounts and since many accounts are held in non-U.S. banks.

What were the forces behind capital flight? We have already mentioned that overvaluation coupled with expectations of devaluation is an important explanatory factor. In addition, three other factors deserve to be mentioned. First, illegal transfers to private individuals resulting from the mismanagement of public sector investments were likely to be exported to safe havens abroad. Similarly, subsidized loans, diverted from their intended uses, were placed in assets abroad where they could not be seized by the debt collectors. Second, fears of expropriation or of controls on the free movements of capital have motivated a substantial portion of capital flight. In this regard, one of the most negative effects of the dedollarization measure of 1982 was its impact on capital flight, since individual savers were left with an unsatisfied demand for deposits in the domestic banking system and had to look abroad for a safe vehicle for their savings.[8] Third, earnings from the coca trade have surely generated extensive capital flight, largely for non-macroeconomic reasons.

## 4.6 Conclusions on Poor Export Performance

It is clear from our survey of trade policies in Bolivia that relatively little careful policy attention was given to the promotion of Bolivia's export

potential. Traditional exports were seen as offering rents that could be distributed to other parts of the economy. Nontraditional exports were hindered severely by an inadequate exchange rate policy and by a range of fiscal incentives which really did not have much effect on the margin in the incentives to produce nontraditional exportables. Public investments in the tradable sector, as discussed in the previous chapter, generally were unprofitable and socially costly. They were motivated more by political considerations and easy foreign credit, rather than by a careful cost-benefit analysis. Finally, unwarranted policy hopes were held for export promotion within the context of regional integration schemes, particularly the Andean Pact. These regional schemes proved to be superfluous for Bolivia, not only because the target market remained very small even after integration, but also because the Andean countries almost all descended into deep crisis in the 1980s.

# 5 Aspects of Foreign Debt Accumulation, 1952–85

As was shown in table 1.8, Bolivia has depended significantly on foreign savings to finance gross capital formation since the late 1950s. The bulk of that foreign financing has come in the form of medium- and long-term (MLT) loans to the public sector, which is the category of capital inflow that we will examine in this chapter. Unfortunately, it is difficult to study the foreign debt of the Bolivian private sector because of a lack of adequate data, though available information suggests that the debt of the public sector is indeed by far the dominant form of external indebtedness.[1] It should be mentioned, however, that private nonguaranteed debt increased very rapidly in the crucial subperiod 1978–82, just preceding the extreme macroeconomic crisis. The measured short-term debt remained fairly constant over time, but the quality of the data on this type of debt prevents us from drawing any firm conclusions. The frequent shifts in the classification of the debt because of reschedulings, arrears, and the assumption of the debt of one sector by another during the past several years makes the analysis even more difficult.

An historical view of Bolivia's borrowing can help to discriminate among the different factors responsible for the debt crisis. Bolivia had access to loans from official multilateral sources and from governments since the final years of the 1950s. These credits had a concessional element, the size of which decreased significantly over time. Already by the first half of the