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Bolivia and the Slowdown of the Reform Process

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1

Introduction

1.1 Bolivia was one of the early adjusters of the 1980s, and the success of its stabilization program of August 1985 in stopping hyperinflation has received considerable attention. The program went beyond stabilization and included a broad set of economic reforms, encompassing the liberalization of the markets for goods, money and credit, and labor. The stabilization program and these first reforms were packaged in the omnibus Supreme Decree 21060. Later, S.D. 21060 became the symbol of the new development model for Bolivia. Bolivians would refer to the liberal model in force after 1985 as the model of S.D. 21060.

1.2 In the aftermath of S.D. 21060, the government designed and implemented, in a very orderly way, an economic policy rich in transformations. Victory in the fight against inflation, a problem well-defined and clearly identified by the public, increased the mandate of the government in other policy areas.

1.3 Bolivia's experiment of the 1980s was not only successful in controlling inflation, but was also was a forerunner in the adoption of structural reforms. Equally significant, changes in government did not imply breaks in economic policy. All administrations, despite differences in personality and previous visions, have followed the development model outlined in the reforms of 1985.

1.4 After demonstrating extraordinary zeal in pursuing reform in 1985 and the first few years of the program, the momentum seems lost. I hypothesize that this happened because the new reforms demanded greater governance capacity, understood in the sense given by Frischtak (1994, p. vii), "as the ability to coordinate the aggregation of diverging interest and thus promote policy that can credibly be taken to represent the public interest." A main objective of this paper is to look at the missing political and institutional conditions that are needed to forcefully renew and sustain the reform process.

1.5 The most important, although still preliminary, result that emerges from the study is that the Bolivian experience lends support to the hypothesis that the dynamics of stabilization and the reforms that immediately followed differ from the complementary structural adjustments. Once the situation is ripe, stabilization measures, however harsh and undemocratic, can be taken without losing the public's support. When the emergency disappears and things go "back to normal," the design and, to a greater extent, the enactment of the complementary reforms become more complex. A major aim of this paper is to contrast the two different settings in such a way that we can isolate the main features of governance capacity.

1.6 The stabilization and the first structural reforms, which were indistinguishable during several months of the stabilization package, will be labeled, for convenience, first-generation reforms. The stabilization and the first reforms were designed to: (1) restore macroeconomic stability; (2) correct relative prices to make them closer to market-determined prices; (3) not unrelated to the point before, open the economy to foreign trade; and (4) remove the bigger obstacles to the smooth functioning of markets. These measures were mostly of a macroeconomic nature. The complementary, or second-generation, reforms are related more to a redefinition of the roles of government and the private sector, and of the national government and the local governments. Privatization and decentralization within government are central to this redefinition. Also, the complementary reforms are intended to foster institutional change to enhance savings and investment and to strengthen international competitiveness. The reform of Social Security and the laws to guarantee private investment stand out in this area.

1.7 The tax and budget reforms cross both generations of reforms, but there are distinctive differences between the two generations. The content of the first fiscal reforms was defined by the urgent need to narrow the budget deficit. This was achieved with easy-to-collect taxes and easy-to-reduce expenditures. The second fiscal reforms take a longer view. A great deal of effort is given to changes in the composition of expenditure, assuming that there is a ceiling. Also, significantly more attention is paid to the efficiency and equity issues in the tax structure, which were somewhat neglected in the first generation of reforms because of the overwhelming need for revenue.

1.8 The distinction between stabilization and the subsequent first reforms, and the second generation of reforms, can also arise (as in Naim 1994) from the way they were formulated and implemented. Naim prefers to identify the stabilization and the first generation of reforms as Phase I reforms, and our second generation of reforms as Phase II. The Phase I reforms were undertaken in the midst of a severe crisis by a small number of powerful ministers and the president of the Central Bank, advised by high-level technocrats, and isolated from political pressures. The economic theory behind the Phase I reforms is well-established, and utilizes the lessons of previous experience in the country and elsewhere. The measures are packaged in decrees and executive orders, in Naim's words (1994, p. 8), "hard-to-decide but simple-to-execute."

1.9 The second-generation reforms are significantly more complex. Their requirements in statecraft, political adroitness, and administrative talent will be examined in detail in the pages that follow.

1.10 The market liberalizations were seen by the government of 1985 as a constituent part of--and indistinguishable from--the stabilization program. Only afterward did they acquire their own identity as structural reforms. Many doubts lingered of the permanence of the market liberalizations after the first signs of stabilization. The prevailing view in the public and in some parts of the government was that the adjustment measures were of a transitory nature. Yet there was also the conflicting perception that the hyperinflation was not only a temporary, albeit severe, disorder, but the most telling symptom of the failure of a development model, and thus that there was a need for extensive reforms with a long-term outlook. The government rapidly seized this argument. Equally important, it was a convenient contention to bring in crucial foreign aid.

1.11 Once it became clear to the public that the government was really committed to stop inflation, its capacity to formulate and implement reforms increased. The government could then shape a national project and offer it to the public and to the community of foreign donors. It is argued in the text that increased governance capacity was not the outcome of a previously set vision, but rather the result of the feedback between government and the public. Adjustment was essentially a dynamic process, with the contents of the program changing each time new information became available, either on the position of the public or the foreign donors.

1.12 The first-generation reforms could be delivered in clear and simple rules.[1] The public understood the messages and accepted them. Even when the reforms introduced regulations, they didn't stir special resistance, because they were perceived as universal. Rules, when seen as universal, are less likely to bring opposition than measures that are perceived as creating obvious and undeserving winners.

1.13 The first-generation reforms conveyed signals of fairness, and this was very important for their implementation. Even if they entailed costs, the so-called "social costs," they were lower than the costs of macroeconomic disarray. Similarly, the market liberalization appeared to place in the open widespread, but hidden, practices. More transparency was seen as an increase in fairness. Everybody could benefit from what had previously been benefits only for the few with privileged information. When regulations were imposed on some sectors--for example, banking--they did not tamper with prices or dictate the allocation of productive activities. Instead, they took the form of rules of prudence, which were understood as preserving the common good of the sector, even by those directly affected.[2]

1.14 This paper is organized as follows. The first section surveys the conditions preceding S.D. 21060 and the contents of the stabilization package of 1985. The next section offers a description of the state of the reforms, and ends with some quantitative results. In the third section, I look at the political competence of the reformist governments in dealing with the adjustment measures and coping with the opposition. The fourth section considers capacity governance, with an emphasis on the fiscal accounts and the difficulties met in two of the second-generation reforms, privatization and Social Security reform. The final section offers some concluding remarks.

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[1] To the informed, they looked like simplistic rules of thumb, such as "governments should not spend more than they receive."

[2] There is a public good argument to justify the acceptance of the prudential rules. Everybody in the sector could find the prudential rules desirable, but only if everybody else was accepting them. The coordinating role was left to the government.

2

S.D. 21060 and Its Background

2.1 It has become customary in the current Bolivian political science literature to place the beginning of the state-led development model in the Revolution of 1952, and its end in the structural changes brought by the set of measures encompassed in Supreme Decree 21060 of August 29, 1985. This section sketches the main political and economic developments between these two landmarks and provides a thorough description of the reforms included in S.D. 21060.

Overview of Political Developments and the State Capitalism Model of the Revolution of 1952

2.2 The Revolution of 1952 is a watershed in Bolivia's history.[3] The revolution, conducted by the Mr. Víctor Paz-Estenssoro and his party, the Revolutionary Nationalist Party (henceforth, MNR, the Spanish acronym), marked the beginning of a development model with strong state leadership. A high share of public investment in GDP and in total investment--not only in infrastructure but also in the agroindustrial and manufacturing sectors--became a permanent and prominent feature of the model.

2.3 Of equal importance with public investment was the establishment of a complicated system of incentives and sanctions to influence private sector production and investment decisions. The main intervention instruments were the allocation of heavily subsidized credit and tax incentives. There were also protective barriers to shelter domestic industry from competitive imports, although they were not as important as in the other Latin American countries, mainly because Bolivia's geographic position provides natural walls to trade.

2.4 The overexpansion of state involvement in the economy was a source of job patronage, as well as clientelism in contracts of public works and purchases of the government and the state-owned enterprises (SOEs). In the past forty years, Bolivia has had the highest share of public employment in the total urban labor force in Latin America, except for Cuba. In addition, after 1952 a segment of the middle classes emerged whose wealth and income resulted from the predation of public resources. Corruption became common, and its scope augmented compared with previous years.

[3] See, for example, Sachs and Morales 1988 and the references therein.

2.5 The MNR stayed in power during twelve eventful years. It was overthrown by the military in 1964. The internal strife in the MNR and its worn-out power were as much behind the coup as the ambitions of the military. Despite the demise of the MNR, the state capitalism model was continued by all governments between 1952 and 1985, military and civilian alike, independent of their political orientation.

2.6 General Hugo Banzer's government stands out among the military governments, not only because it lasted seven years (1971-78), but also because it gave a strong impetus to the modernization of the economy. The heyday of the state capitalism model was reached during his reign. This seems paradoxical in view of his conservative and strongly anti-Communist stance. Ironically, the possibility of obtaining loans in private capital markets in that period gave a further impetus to state involvement in the economy.

2.7 Despite his notorious disrespect for human rights, Banzer's administration and the other long-lived authoritarian governments enjoyed the support of ample segments of the population, particularly in the middle and upper classes, with their calls for order. These authoritarian governments had some legitimacy and clearly exerted power over society.

2.8 For short periods (1970-71 and 1978-82), all indications of governance capacity were lost. During a populist military government in 1970-71, lack of social discipline manifested itself in illegal occupations of private property, wildcat strikes, and many attempts at coups d'etat. The second period, 1978-82, was characterized by interim civilian presidents and a succession of military governments. The nadir of this critical period was in 1980, when a military junta, with close ties to the cocaine traffic, took power.

2.9 Democracy returned to Bolivia in the last quarter of 1982, after eighteen years, with only short interruptions by authoritarian governments. The first democratic government (1982-85), headed by Mr. Hernán Siles-Zuazo, was backed by a coalition of leftist parties, including the Communist Party of Bolivia. The labor unions initially favored Siles-Zuazo, but later in his term withdrew their support and were among his more violent opponents.

2.10 Siles-Zuazo inherited a very difficult economic situation, prompted largely by the foreign debt crisis. Unable to address the economic predicament and all the pressures that went with it, he had to resign the presidency one year before the end of his constitutional mandate. It was during his term in office that hyperinflation erupted. By mid-1985, Bolivia's economy was in complete disarray, and the accompanying social and political unrest threatened democracy.

2.11 President Siles-Zuazo had to call anticipated elections, which took place in July 1985. After the elections, Congress chose Mr. Víctor Paz-Estenssoro as president. He came with the support of his aging populist party, MNR. As mentioned above, the MNR was the party of the Revolution of 1952, when the state capitalism model started. In a turnaround, Paz-Estenssoro and the MNR decided on a radical transformation of the development model, putting in place very ambitious structural reforms.

2.12 The MNR signed a pact, the Pact for Democracy, with the Democratic Nationalist Alliance (henceforth, ADN, the Spanish acronym), a rightist party led by General Banzer, to carry on the liberal revolution. Since this initial signing, pacts have become a permanent feature of Bolivian politics.

2.13 Paz-Estenssoro was succeeded in 1989 by Mr. Jaime Paz-Zamora. He also formed a coalition government between his formerly leftist party, the Revolutionary Leftist Movement (MIR, the Spanish acronym), and ADN. Paz-Zamora pursued the policies set by his predecessor. The change in MIR's stance was as surprising as the change of course of the MNR.

2.14 The current president of Bolivia, Mr. Gonzalo Sánchez de Lozada, began his presidency in August 1993. He governs with his party, the MNR, and three smaller parties; in this group, the Free Bolivia Movement (MBL), a dissident segment of intellectuals of MIR, stands out. Sánchez de Lozada was the Minister of Planning (actually, the Minister of the Economy) during the government of Paz Estenssoro and the main architect of the changes.

Hyperinflation

2.15 Bolivia suffered a dramatic episode of hyperinflation between 1982 and 1985. There is a professional consensus that the hyperinflation was prompted by the accumulation of large fiscal deficits between 1975 and 1981, financed with foreign loans. The general situation of the Latin American debt, and the particular exposure of Bolivia, triggered an external crisis in 1982 that almost immediately led to hyperinflation. Numerous disruptive factors converged. First, accumulated trade surpluses were needed to service the foreign debt. The available instrument was the depreciation of the currency, which not unexpectedly was strongly resisted by the workers. On the path to a higher real exchange rate, strong inflationary pressures emerged. Second, and more important, the financing of the fiscal deficit with foreign loans was replaced with credits of the Central Bank, which required excessive issuance of money. Since the government could no longer roll over its debt to the foreign creditors, and there was no domestic market for government paper,[4] the Central Bank loans became almost the only source of financing of the fiscal deficit.

2.16 As the public finance models of inflation predict, this mode of deficit financing interacted with the public's demand for money, and resulted in high rates of price growth. In addition, inflation itself further aggravated the fiscal deficit through Olivera-Tanzi effects.

2.17 Bolivia found itself very rapidly in a high and accelerating inflation path. Government attempts at control by fixing prices and the exchange rate were futile; worse, they became counterproductive. Black markets soon appeared. The premium on the black market for foreign exchange over the official rate was especially notorious: at times, it went up to 1,300 percent. Together with supply shortages, this led to frequent incidents of severe social unrest.

2.18 Contrary to the diagnosis of inflation in neighboring Argentina, Brazil, and Peru, for most of this period the government, its economists, and the public were convinced that the

[4] The domestic market for government bonds disappeared in the early 1930s, in the aftermath of the Great Depression. In 1987 the Central Bank started offering certificates of deposit to domestic savers. Open market operations with Treasury bills started in 1994.

pillar of stabilization was fiscal correction.[5] Between 1982 and mid-1985, there were at least six attempts to stabilize. Except for the first attempt, all were "orthodox" in the sense that fiscal and monetary restraints were the main intermediate targets (the ultimate target, of course, was the control of inflation). They all failed. Their failure was not attributed to an incorrect conception, but to having been halfhearted measures, with a gradualist approach to a condition that required a shock treatment.

2.19 By 1982 the illegal trade in cocaine had become a major disruptive factor to politics and economic management. The failures of the Bolivian government to take action against the drug traffic, as evaluated by the United States government, directly interfered with the design of economic policy between 1982 and 1985. For instance, independently of the technical merits of the successive stabilization plans, crucial financial support from the United States was withheld. Cocaine continues to play a major role, even after the reforms of 1985, both in Bolivian politics and in economic policymaking.

Stabilization and Reform with S.D. 21060

2.20 Three weeks after his inauguration, President Paz-Estenssoro announced a stabilization plan in S.D. 21060. The plan was prepared, in great secrecy, by no more than seven persons. Also, the process of carrying out the program was the responsibility of only a few people.

2.21 Exchange rate unification was central in the program. This measure was supported by very tight fiscal and monetary policies. The fiscal measures were especially strong. On the revenue side, the price of fuels was hiked by a factor of seven. This increased the tax collections on fuel consumption by the same factor. In addition, the state-owned petroleum enterprise, YPFB, was obliged to deposit all of its sales proceeds daily in an account in the Central Bank. Subsequent use of the deposit was then tightly controlled by the government. The deposits worked as a powerful brake to the expansion of money; later, a significant portion of the deposits was transferred to the Treasury. To this day, taxes on fuels, particularly transfers from YPFB, are among the most important sources of Treasury revenue.

2.22 On the expenditure side, the measures were also drastic. Approximately 10 percent of the labor force in the public sector lost their jobs. The policy of dismissals was extremely crude, with no consideration of age or reemployment possibilities. Wages and public sector investment were frozen for an initial period of six months. To give a clear message to the public of the government's commitment to fiscal correction, the budget was managed on a cash-flow basis in the first years of the stabilization program.

2.23 To mitigate the costs of the adjustment, the government created the Emergency Social Fund (ESF) in 1987. ESF has received considerable attention and praise for its accomplishments in the international financial institutions (IFIs). It was very efficiently run, and

[5] The inability to formulate a heterodox stabilization plan reflected, to a large extent, the lack of domestic analytic talent. Orthodoxy had the advantage of being a well-known recipe.

for a while it became an example for other countries to follow. Yet, like all narrowly targeted policies, ESF suffered from political isolation. The very poor are not the main losers in adjustment; it is the politically vocal lower-middle-classes and unionized workers that suffer the higher drops in both take-home income and government transfers in an adjustment process. There was no mitigation program for them, except through larger than usual severance payments.

2.24 The markets for goods and factors, except land, were greatly liberalized. Price controls were lifted, import tariffs were lowered, and most quantitative restrictions on imports and exports were eliminated.

2.25 Liberalization seemed at odds with the prevailing thought on stabilization. On purely technical grounds, the onus of stabilization had to fall on fiscal and monetary restraint; liberalization was not necessary, and could even be counterproductive. The foreign trade liberalization could--and did--deteriorate the trade balance. The deregulation pushed steeply upward, in an once-and-for-all movement, the prices of wage goods, which fueled labor requests for higher wages. Had it not been for the extraordinary resistance of the government to pressures to raise wages, the program would have capsized.

2.26 The program checked inflation very rapidly, unified the exchange rates to the market-determined rate, and substantially reduced the fiscal deficit, at least in the first years. On purely technical grounds, a less drastic plan would probably have achieved the same results. The overkill essentially had an announcement value. The government needed to differentiate its program from the previous ones that, although similar in content, had failed. The package of stabilization cum liberalization, a bit by accident, integrated correct economic policy ingredients and the right political announcement features to convince the public of the government's commitment to stop inflation.

2.27 An unorthodox but crucial step was included in the program -the suspension of payments on the foreign debt to commercial banks until a definite arrangement could be reached with them. Loan service to official lenders continued.

2.28 The IMF accepted the stabilization plan, although it had some disagreements on the management of the exchange rate and the suspension of the commercial debt service. The World Bank offered its support to the program from the very beginning. More generally, the external agencies have played a very important role in the stabilization and subsequent reforms. Bolivia has enjoyed (sometimes endured) their technical and financial support since the first measures in 1985.

3

State of the Structural Reforms

Tax Reform

3.1 Once the high inflation seemed to be receding, the reconstruction of taxation appeared to be the next step necessary to consolidate the program. Remember that a main victim of the hyperinflation had been the tax system. Besides the inherent deficiencies in the previous tax structure, Olivera-Tanzi effects had destroyed the tax administration. A new tax law was passed in June 1986 to enhance the stabilization package.

3.2 The tax reform of 1986 featured only eight taxes, if the special treatment to small taxpayers is excluded.[6] The most important tax, by far, is the value added tax (VAT), which currently has a uniform rate of 13 percent (it started at 10 percent). Wages and income from assets receive a similar treatment to that of any sale subjected to VAT. (Note that there was no tax on profits but on presumed income.) They bear a complementary VAT, from which VAT payments made on expenditures can be credited. This tax carries the same rate as the VAT on personal saving. It can be observed in tables 6 and 7 that the real value of VAT collections and its share in the current revenue of the National Treasury have been steadily increasing.

3.3 Following the launching of tax reform, a great effort was devoted to enforcement and administration. The registers for taxpayers were updated, a mechanism for cross-checks of VAT was created, and the system was fully computerized.[7] Many, particularly small, businesses were closed by the authorities for fiscal fraud. The contribution of tax reform to the fiscal position was undoubtedly significant, yet the most important taxes to that end were the "taxes" on fuels, which were included in S.D. 21060.

3.4 Was the tax reform of 1986 necessary on intrinsic technical grounds? The subject is debatable, because once inflation had abated, a reversed Olivera-Tanzi effect would have increased revenues. Also, the previous tax system was not without merits. It is true that a myriad of taxes (400?) existed before 1986, but the ones that raised revenue in significant amounts were no more than ten. The remaining 390 were a nuisance, but they did not really impair tax administration, nor were they a source of corruption. The most important criticism

[6] The tax law of 1986 was fully reformed in December 1994. Between 1986 and 1994, it had suffered some minor changes.

[7] Bolivia now has one of the most modern tax registers in region.

that can be made of the tax structure before 1986 is that the weight of taxes on foreign trade (tariffs, and on exports of the mining and oil sectors) was too high.

3.5 It is also true that tax compliance was very low during hyperinflation, but this was not necessarily caused by an increase in corruption in tax administration. This effect was, again, a byproduct of inflation and demoralization in the internal revenue services and in the public enterprises selling services. The employees felt that to enforce the tax laws was not worth the trouble, given that what they collected from taxpayers and for service fees was so little in real terms. Tax reform was needed essentially because of its announcement value. The government had to send the message that rebuilding tax collections had a top priority in its agenda of fiscal correction, the latter being the most important component of the stabilization package.

Trade Reform

3.6 Both economic and political causes explain Bolivia's success in trade liberalization. Among the former, the low degree of industrialization stands out. Among the latter, one can identify the correct assessment of the forces of the potential opposition, as well as tenacity in government.

3.7 The steps taken to liberalize trade were forceful. S.D. 21060 eliminated almost all quantitative restrictions and lowered tariffs. Later, further reforms led to a tariff structure consisting of flat *ad valorem* tariffs, with a rate of 10 percent, except for a small list of capital goods, whose rate is 5 percent.

3.8 Trade liberalization was very quick and, as with many of the first reforms, met little hostility. The opposition came from businesses in the manufacturing sector and from large agriculturalists. The National Chamber of Manufacturers hired a consulting company to compute effective rates of protection, and based on this technical report pressed for changes in the tariff structure. Similarly, the powerful Eastern Chamber of Agriculture (henceforth, CAO, the Spanish acronym) lobbied for changes. The government adamantly refused.

3.9 It must be said that the pressures were not very strong, given that there were conflicting views among the diverse sectors. On the one hand, almost everybody wanted the "model" to succeed, avoiding a return to the ominous years of 1982-85. On the other hand, while they perceived liberalization as costly, they were uncertain of the scope of the prereform protection, and even more unsure of the proposals from their umbrella organizations. In addition, many sectors were accustomed to competing with contraband imports, and what they resented was not so much the lowering of tariffs on their final products, as the increase in tariffs for their inputs. They felt that the fall in effective rates of protection was caused by the uniformed tariffs rather than the lower tariffs for competitive imports.

3.10 Contrary to the expectations of many Bolivian economists, output in the manufacturing sector strongly and positively reacted to the stabilization program.[8] The beneficial

[8] Unfortunately the growth of the manufacturing sector was not reflected in the overall GDP rate of growth, because of the small initial contribution of the sector.

effects of the reduction in uncertainty more than compensated the dismantling of trade barriers. The government correctly anticipated this reaction. Still, results varied across subsectors. In some branches there were many closings. The manufacturing sector, because of its smallness, traditionally had little voice in influencing policies. Enterprises in many sectors opted for exit, given that their voice was unlikely to be heard.

3.11 CAO's lobbying was more effective. Their associates suffered from higher tariffs on imported inputs and from agricultural imports whose competitive edge was provided by the very rapid exchange rate depreciations in neighboring Peru, Argentina, and Brazil. The government did not yield to the demands of the CAO, but it went to significant lengths to compensate CAO's associates. Since many of them were exporters, a subsidy of 10 percent of the free on board (FOB) value of exports was granted, allegedly a drawback for taxes on imported inputs. Moreover, transportation fees in the state-owned railroads were reduced, to CAO's benefit. In 1991 the export subsidy was lowered to 2 percent for agricultural exports, a rate that is closer to a true drawback than the previous higher rate.

3.12 The most significant concession, however, was the reestablishment of lines of credit, among them an important IDA loan, labeled "Eastern Lowlands Project." The IFIs went full force to help in the development of agricultural exports, particularly of soybeans.[9] This program partially silenced CAO's demands.

Financial Sector Reform

3.13 Another area where considerable statecraft was exerted was in the reform of the financial, mainly banking, sector. The banking sector had known a considerable rate of growth between 1964 and 1982. Their lending operations were made increasingly from sources other than their deposits, either long-term loans refinanced at the Central Bank or borrowing abroad, especially in the second half of the 1970s.

3.14 The long-term loans (called "development loans"), discounted at the Central Bank at highly subsidized interest rates, caused great inefficiency in the allocation of scarce credits and were also a source of quasi-fiscal deficits. Still worse, the borrowers of these loans were notoriously delinquent.[10] The state-owned development banks exhibited the worst delinquency rates. The beneficiaries, especially in the agricultural areas of east Bolivia, came to believe that the loans were grants, and did not need to be repaid.[11] Access to highly subsidized credit was one main manifestation of clientelism in the old regime. It was actually a perverse instrument of wealth distribution to favor the privileged groups that captured the state.

3.15 The macroeconomic instability of 1982-85 brought significant distress to the balance sheet of the banks. After the stabilization, banks rapidly recovered deposits, almost all

[9] CAO continues to be a powerful lobby. Its efforts in the recent past have been addressed to measures of debt alleviation for their highly indebted associates.

[10] The Central Bank was, in addition to its monetary role, a second-tier bank. It lent to the commercial banks from funds obtained abroad, normally from the IFIs or foreign government agencies and by printing money.

[11] The loans to the cotton growers in the eastern region of Santa Cruz in the late 1970s epitomized this situation.

denominated in dollars, by offering very high interest rates. They increased their lending rates *pari passu* with those for borrowing. The high rates rapidly deteriorated their loan portfolio, however, and by mid-1987, two years after the stabilization program, Bolivia faced a banking crisis in which four banks had to close.

3.16 Thus, a clear case for prudential regulation and more supervision appeared. Several steps were taken in that direction. First, the minimum reserve requirement for dollar time deposits was raised to 10 percent (it had been 0). Second, banks had to abide by a rule of a minimum ratio of equity capital to loans, in line with the Basle accords. Third, the supervision of banks was severed from the Central Bank and established in an independent Superintendency of Banks, accountable to the legislative branch. Later, as a component in the package of financial reform, the state-owned banks were closed.

3.17 The domestic banks are now more regulated and supervised than ever in their history. The Superintendency of Banks rapidly established its power, which helped to attenuate the banking crisis of 1987-88. Many of the financial sector reforms, in spirit if not in letter, have been incorporated in the Banking Law of 1993. This law resulted from long negotiations in Congress; the lobbying of the Association of Bolivian Banks had significant influence, but it did not change the main tenets of the policies set between 1987 and 1992.

3.18 Development credits are now intermediated by private financial institutions. The Central Bank auctions the credits among them. While there are some technical criticisms of the auction process, the principle that all allocation of resources should be market-based is indeed correct. The auctions, as a market mechanism, also provide a signal of fairness that contrasts with the administrative allocations used in the past.

Incentive Regimes and New Investment Codes

3.19 Around 1990 the government authorities started to think that the liberalization of goods and factor markets was a necessary step to promote investment, but it was not sufficient. A new investment code and sectoral codes for the investments in mining and oil were enacted by Congress in 1990 and 1991.

3.20 The new investment code adds few elements to the prevailing economic policy. It reiterates the guarantees for investment that are in the Constitution and the Civil and Commercial Codes. It tries to cement in legislation the reforms that had been ruled in administrative acts of the executive, such as Supreme Decrees, that legally are transitory in nature. It has to be seen as a precommitment device to reduce the likelihood of policy reversals. Although it is true that laws can be changed, in the current institutional context it takes a two-thirds majority to repeal a law; the reforms undertaken since 1985 have thus been given more permanent support through the investment code. It is important to underscore that the code does not offer tax concessions, as used to be the case in previous codes.

3.21 The laws on mining and hydrocarbons are important to the attraction of foreign investment. The treatment of the property rights of the concessions was clarified, and a profits tax, set at a very low rate, was introduced to replace the previous system of output taxes. The new mining law also allows the formation of joint ventures between the state-owned mining corporation COMIBOL and private enterprises. In hydrocarbons, the possibility was opened to extend the system of production-sharing between the state-owned oil company and foreign firms that had been in place for many years to include joint ventures--that is, to schemes of risk sharing. With these reforms, Bolivian legislation in nonrenewable natural resources is among the most liberal in Latin America.

3.22 The formation of joint ventures with COMIBOL has been far from smooth because of the opposition of the miners. They have been able to block almost all attempts. Although COMIBOL has been in disarray for many years, the government could not convince the union of miners to acquiesce to the joint ventures. The promise of very high severance payments has produced little result to date. The mishandling of the labor problem in the state-owned mines appears as a clear governance failure.

Pending Reforms

3.23 Bolivia still has to undertake some important and difficult structural reforms, including the areas of privatization; the Social Security system; increasing the flexibility of the labor market; decentralization of public education and health; liberalization of the legislation on land tenure; and the independence of the Central Bank. For the sake of brevity I will concentrate on the two most controversial reforms: privatization and Social Security reforms.

3.24 In 1991 the executive obtained passage of a law of privatization for small SOEs from Congress, but no more than twenty-five of over one hundred have been privatized to date. Even if the small SOEs were insignificant in employment and investment, their privatization has met strong opposition.

3.25 The urgency of the reforms of the Social Security system cannot be underestimated. The system as it stands, with its twin features of a pension fund and medical insurance, could not be in a sorrier state. Pensions are dismally small and are paid late. Similarly, the medical services are of a very poor quality. Yet opposition to change is so strong that the authorities do not feel confident enough to send the draft laws to Congress.

3.26 The government of Sánchez de Lozada, more forcefully than its predecessor, is trying to give a new momentum to the reforms. It has two innovative proposals: capitalization and popular participation. The idea behind capitalization, in brief, is to convert the state enterprises into joint-stock companies, then increase their capital by issuing new shares and selling them to the private sector. The new shareholders will control the companies, regardless of the shares they own. Once the companies are capitalized, the government shares will be distributed, free of charge, to all adult Bolivians, in a pattern similar to that followed in some countries of Eastern Europe. The distribution of shares, however, will not be direct. They will go to the pension funds, in which all Bolivians are supposed to be enrolled. Capitalization is actually a convoluted process to circumvent opposition to privatization of the large SOEs.

3.27 Popular participation is an ambitious plan to decentralize the national government's social services to the local governments and to enhance participatory democracy.

At first, funds will be channeled to the municipalities, which will be given the task of providing health, education, and other services of lesser importance. It is expected that municipalities will be able to raise a portion of the necessary taxes to provide for those services locally at a later time.

3.28 The capitalization and popular participation proposals have been approved in Congress and have become law. The implementation of the laws, however, is lagging.

Table 1: Bolivia's Key Indicators after Reform
(percent)

Indicator	1986	1987	1988[c]	1989[c]	1990[c]	1991[c]	1992[c]
Real GDP growth	-2.5	2.6	3.0	2.7	2.7	4.1	2.0
Real per capita GDP growth	-4.5	0.5	0.8	0.6	0.6	2.0	-0.1
Consumer price changes (Dec. to Dec)	66.0	10.7	21.5	16.6	18.0	14.5	10.5
Terms of trade index (1980 = 100)	85.5	69.6	61.1	67.8	59.2	49.8	43.4
M1 growth (Dec. to Dec.)[a]	82.9	39.3	30.9	-2.4	28.3	25.2	19.0
Interest rate on dollarized time deposits	15.0	15.6	15.0	15.1	13.4	10.1	11.2
Real exchange rate (December 1987 = 100)[b]	n.a.	100.0	85.7	85.1	127.5	127.6	125.2
Service on public and publicly guaranteed debt as percent of exports of goods and services	29.6	24.7	41.9	27.7	32.8	27.3	n.a.
Percent of GDP							
Private fixed investment	4.7	4.0	4.2	4.1	4.3	4.3	5.6
Consolidated NF-public sector deficit	2.8	7.7	6.5	5.1	3.3	3.6	4.7
Exports + imports	32.3	29.8	29.2	35.2	39.9	34.6	33.8
BOP current account deficit	10.3	11.8	11.1	8.5	8.3	9.5	14.3
Total external debt	107.6	113.1	100.8	84.7	92.1	81.2	81.7
Net transfers on debt	3.3	2.2	1.0	3.0	-0.6	0.6	n.a.
Total official development aid	8.3	7.4	8.9	12.1	13.3	12.1	11.8
Memo							
GDP at current prices (US$ millions)	3,903	4,306	4,422	4,509	4,499	5,014	5,263
Exports of goods and services (US$ millions)	685	667	690	891	998	942	798

Notes:

n.a.= Not available.

[a] Growth of M1 in domestic currency.

[b] Increase in index indicates increase in competitiveness.

[c] Preliminary.

Source: Author's elaboration with data from Central Bank, National Institute of Statistics, Ministry of Finance, and the World Bank.

Overall Measures of Adjustment Success

3.29 It can be observed in Table 1 that the achievement in controlling inflation (measured by percentage changes in the Consumer Price Index) is truly remarkable. The inflation rate for 1993 was 9.5 percent, and for 1994, 8 percent. Similarly, the evolution of the real exchange rate has been favorable. This result was brought about by the combination of a correct domestic policy and external developments, such as the high exchange rate appreciations in important trade partners. Bolivia is now a reasonably open economy, as shown by the (exports + imports) ratio to GDP, despite a poor export performance.

3.30 The other indicators of economic performance have been modest. Bolivia has been running very high trade deficits for several years, and their effects on the domestic economy have been attenuated only by substantial amounts of foreign aid. The contribution of gross foreign savings to the formation of capital is very substantial, possibly higher than in any other country at the same stage of development. The high BOP current account deficits are partially explained by debt service. Despite the substantial relief negotiated from the largest creditors, foreign debt continues to be very high in relation to the size of the economy.

3.31 Only since 1991 has the per capita real GDP growth reached the range of 0-2 percent.[12] More troublesome than the low GDP growth rates are the very low rates of investment of the private sector, which are even lower than in some of the hyperinflation years. Several factors explain the low investment rates.

3.32 First, with a more open economy and fundamental changes in the international context and in our close neighbors, the effects of the lack of infrastructure and of skilled labor are felt more strongly than in the past, when the economy was more closed. In other words, the deficiencies in basic infrastructure and skills showed more sharply once the economy opened.

3.33 Second, Bolivia's traditional exports have faced very low prices since 1985, well below historical levels. The fall in the export prices of minerals, especially tin, and of natural gas has caused a huge drop in the terms of trade; the index in 1992 was only 43.4 percent of the 1980 index. The resulting loss of income has affected the saving rate, and therefore the investment rate. The substantial flow of foreign aid has not been able to compensate for this. Also, the low export prices have affected the decisions of foreign investors.

3.34 Third, the high real interest rates from 1986 to 1993, partially caused by the stabilization effort, inhibited the investment of the small and medium-size enterprises that can only borrow in the domestic market. Also, the high interest rates pulled entrepreneurial talent from production activities toward financial speculation or commerce with a rapid turnover of inventories.

3.35 Fourth, the taxation of enterprises in the tax law of 1986 was clearly deficient. A presumed income tax was imposed on business, with their net worth as reported in their books as the tax base. The tax penalized capital-intensive industries, while enterprises intensive in intangible assets, such as the services sector, went almost untaxed. In addition, enterprises had to pay the tax regardless of the rate of utilization of installed capacity and current profits.

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[12] Preliminary estimates for 1994 show a per capita real GDP growth of over 2 percent.

3.36 Last, there is an enduring perception that some of the reforms may be reversed, which would punish investments already undertaken and irreversible. The incomplete credibility of the reforms is based on two factors. The slow growth and low investment feeds back on the investment decisions through an expectation channel. The recurrent social unrest, caused by the high underemployment rates and the low wages, awakens fears of political instability. Investment is usually a cumulative process, where sufficient previous investment is needed to bring more investment. Otherwise, new investors fear that taxation would fall out of proportion on the capital expenses of the few that have invested. This creates a coordinating role for the government; its absence can be thought of as a shortage of governance capacity.

3.37 The qualitative effects of the reforms, however, are probably more favorable than the numbers indicate. There is no doubt that economic policy is now significantly more orderly than before. In addition, the country has developed more resilience to external shocks. One proof of this is the robustness of the anti-inflation program in the face of the severe external shocks caused by the extraordinary fall in the terms of trade, as previously mentioned.

Measures of Success in Fiscal Adjustment

General Measures of Fiscal Stance

3.38 The best picture of the Bolivian fiscal stance is given by the accounts of the consolidated nonfinancial public sector (NFPS). The structure of the NFPS, as well as its relation with the financial public sector, is shown in Figure 1. The budget of the consolidated NFPS merges the accounts of the general government and the SOEs.

3.39 Table 2 shows that, except in 1986, in the immediate aftermath of the stabilization program, the overall fiscal deficits (deficits of the consolidated nonfinancial public sector) have continued to be high, certainly higher than expected for a country that has stabilized inflation. In 1990 and 1991 the deficits came down to more acceptable levels, but again in 1992, and especially in 1993 (not shown in the table), there was a significant slippage, with the deficit reaching 5.8 percent of GDP. The deficits in the past two years were not as much caused by a decline in tax effort as by an expansion of expenditures, mainly for investment.

3.40 A partial explanation of the high overall deficits is given by the interest payments that continue to weigh heavily in the fiscal accounts. If the fiscal effort is measured by the primary balance, the results between 1986 and 1991 are not that worrisome. Since 1986 there have been some modest surpluses or small deficits (1987 provides an exception). It must also be mentioned that since 1986 there generally have been surpluses in the current account balance, although they were not large enough to finance the public sector's investment program. A structural (and undesirable) feature is that most capital expenditure is externally financed.

Figure 1: Structure of the National Budget

- Public sector
  - Nonfinancial
    - General government
      - Central government
        - Central administration
        - Decentralized institutions
      - Departmental governments
        - Prefectures
        - Regional development corp.
      - Local governments
        - Municipalities
      - Social Security
    - Nonfinancial public enterprises
      - National
      - Regional
      - Municipal
  - Financial
    - Central Bank
    - Nonbank institutions

3.41 Table 2 also illustrates significant structural changes regarding the size of the public sector in the economy. The fall in total expenditure, as a percentage of GDP, from the high levels at the start of last decade is very significant. The fall has been caused by a reduction in the purchases of goods and services of the SOEs. The wage bill, after a significant reduction in 1986-87, has returned to prereform levels.

3.42 If the deficits have not been inflationary, it is because they have been financed mainly with external resources. This method of financing, which leads to the accumulation of foreign debt, may have future, unwanted consequences.

The Structure of Public Spending

3.43 Table 2 offers a first breakdown of the expenditures of NFPS; unfortunately, there are no more detailed breakdowns. These exist only for the accounts of the central government. As can be seen in Table 3, the financing of the National Treasury to social sectors shows a declining share between 1987 and 1992, contrary to public statements. Among the social sectors, only urban affairs has increased its participation somewhat in the total expenditure of the central government. In an unwelcome development, there is rising share of expenditure for non-social services in the total financing by the Treasury.

Table 2: Operations of Nonfinancial Public Sector (percent of GDP)

Item	Average 1980-81	Average 1982-85	1986	1987	1988	1989	1990[b]	1991[b]
Current revenue	35.8	26.3	29.2	25.3	26.5	27.5	29.4	29.6
Tax revenue[a]	9.0	3.4	6.2	8.2	8.2	7.4	8.0	7.4
Sales of the SOEs	25.1	21.2	22.0	15.9	17.0	17.9	18.7	19.8
Domestic sales	12.0	7.5	12.1	9.6	10.3	10.6	11.2	13.7
Exports	13.1	13.8	9.9	6.3	6.7	7.3	7.6	6.2
Other revenue	1.7	1.7	1.0	1.2	1.2	2.2	2.7	2.4
Current expenditure	36.6	32.1	27.7	27.1	25.2	25.4	26.5	25.7
Wages and salaries	11.5	10.6	7.3	8.1	9.7	10.5	11.0	11.1
Goods and services	15.7	12.6	9.9	8.4	7.5	7.7	7.6	7.5
Interest	3.5	4.9	6.1	4.4	4.2	3.8	3.3	3.3
Transfers to private sector	2.4	1.9	1.8	2.1	1.1	2.1	3.5	2.4
Other	3.5	2.1	2.5	4.1	2.7	1.3	1.0	2.2
Current account balance	-0.8	-5.8	1.5	-1.8	1.2	2.2	2.9	3.9
Capital revenue	0.5	0.2	1.2	0.2	0.9	0.7	1.3	1.7
Capital expenditure	6.5	4.9	5.5	6.1	8.1	8.0	7.5	9.2
Capital account balance	-6.0	-4.7	-4.3	-5.9	-7.2	-7.2	-6.1	-7.5
Other expenditure	0.6	6.6	0.0	0.0	0.5	0.0	0.0	0.0
Total revenue	36.3	26.5	30.4	25.5	27.3	28.3	30.7	31.4
Total expenditure	43.6	43.6	33.2	33.3	33.8	33.3	34.0	35.0
Primary surplus/deficit	-3.9	-12.3	3.3	-3.3	-2.3	-1.3	0.1	-0.3
Overall surplus/deficit	-7.3	-17.2	-2.8	-7.7	-6.5	-5.1	-3.3	-3.6
Total financing	7.3	17.2	2.8	7.7	6.5	5.1	3.3	3.6
External	4.4	1.6	6.6	2.5	4.8	2.1	2.4	3.4
Internal	2.9	15.5	-3.8	5.2	1.7	2.9	0.9	0.2
Memo								
GDP in millions of current Bs			7,462	8,856	10,394	12,136	14,274	17,974

Notes:

[a]: Tax revenues do not include taxes paid by SOEs.
[b]: Preliminary.
Source: Elaborated with raw data from UDAPE.

Table 3: Distribution of Central Government Expenditure by Sector, 1987-92 (percent)

Sector	1987	1988	1990	1991	1992
Social sectors	32.7	35.5	27.3	22.2	23.5
Education	21.7	22.9	18.2	15.7	15.9
Health	10.8	12.4	8.6	6.2	7.0
Urban affairs	0.2	0.1	0.6	0.4	0.6
Other administration	67.3	64.5	72.7	77.8	76.5
Central government	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Finance and Economic Development.

3.44 Table 4 completes the picture of the spending of the central government. There is an increasing share of foreign contribution to the budget of the social sectors, especially to the budget of the health sector.[13] Also, as mentioned above, most public investment is financed by foreign sources. The comparison of Tables 3 and 4 thus suggests that the financing of the social sectors by the National Treasury is being replaced by foreign aid, another unwelcome development.

[13] Also, public health services are increasingly financed by user's fees.

Table 4: Distribution of Central Government Expenditure by Source of Financing and Sector, 1987-92 (percent)

Sector	National Treasury	Other Domestic Sources	Total Domestic	Total External
1987				
Social sectors	82.5	11.5	94.1	5.9
Education	88.4	10.9	99.3	0.7
Health	74.1	12.9	87.0	13.0
Urban affairs	36.9	0.4	37.3	62.7
Other administration	87.3	7.6	94.9	5.1
Central government	85.7	8.9	94.6	5.4
1988				
Social sectors	83.3	10.7	94.0	6.0
Education	87.3	12.6	99.9	0.1
Health	77.1	7.5	84.7	15.3
Urban affairs	60.8	4.8	65.6	34.4
Other administration	88.9	7.5	96.4	3.6
Central government	86.8	8.7	95.5	4.5
1990				
Social sectors	92.1	0.0	92.1	7.9
Education	99.5	0.0	99.5	0.5
Health	79.1	0.1	79.2	20.8
Urban affairs	100.0	0.0	100.0	0.0
Other administration	96.7	1.5	98.2	1.8
Central government	95.4	1.1	96.5	3.5
1991				
Social sectors	84.4	5.0	89.4	10.6
Education	97.1	0.7	97.8	2.2
Health	62.9	12.1	75.0	25.0
Urban affairs	99.6	0.4	100.0	0.0
Other administration	95.4	3.2	98.6	1.4
Central government	92.7	3.6	96.3	3.7
1992				
Social sectors	84.4	5.3	89.7	10.3
Education	94.8	1.4	96.2	3.8
Health	67.2	11.6	78.8	21.2
Urban affairs	94.3	4.9	99.3	0.7
Other administration	95.5	3.8	99.4	0.6
Central government	92.7	4.2	96.9	3.1

Source: Ministry of Finance and Economic Development.

3.45 Table 5 provides a rough idea of the current transfers to the private sector by the central government. These transfers have never surpassed 2 percent of GDP. Before reaching definite conclusions, however, more work is needed on the data. The accounting conventions often changed between 1987 and 1993. In addition, the numbers have to be reconciled, with the required adjustments, with the numbers in Table 2, which show substantially higher values for the transfers of the NFPS.

Table 5: Current Transfers from Central Government to Private Sector (percent of GDP)

Category	1987	1988	1989	1990	1991	1992	1993
Pensions, donations, and prizes	0.83	0.72	0.68	0.58	n.a.	n.a.	n.a.
Pensions	n.a	n.a	n.a.	0.57	n.a	n.a	n.a
Donations and prizes to persons	n.a	n.a	n.a	n.a	***	n.a	n.a
Scholarships	0.01	0.01	0.01	0.04	0.03	0.02	0.02
Welfare aid	0.02	0.59	0.87	0.22	n.a.	n.a.	n.a.
Other subsidies	0.02	0.59	0.87	0.00	n.a.	n.a.	n.a.
Total current transfers	0.86	1.32	1.57	1.42	0.58	0.64	0.68

Notes:

n.a. = Not available.

Source: Elaborated with data from the Ministry of Finance and Economic Development.

4

Statecraft in the Reforms

Initial Weakness of the Government

4.1 The government of Paz-Estenssoro started without a majority in Congress. The lack of a majority could have been a roadblock to reform. Although the Bolivian system is presidential, and usually the executive enjoys a large degree of autonomy, support in Congress is crucial for governance. In Bolivian history, democratic governments that have not paid attention to Congress have fared badly.

4.2 S.D. 21060 was hotly debated in Congress right after it was announced, but with the support of ADN, the main opposition party, the government won after a short period. In concert with the skirmishes in Congress, a confrontation in the streets was taking place. The riots and the strikes were not strong enough to overturn the government's decisions, but the government clearly benefited from the public's demand for stability. The combination of a severe economic and political crisis, the political will, and the acumen of President Paz-Estenssoro and Minister Sánchez de Lozada created the government capacity to overcome all political obstacles to the reforms.

4.3 In a master political move, the MNR entered a pact with ADN, the party of former President Banzer, the so-called Pact for Democracy. ADN didn't take cabinet posts, but it agreed to hold middle-level positions in the administration and in the SOEs. It is important to underscore that Paz-Estenssoro's reforms would have been impossible without the support of ADN. Gamarra (1994, p. 107) notes that "the *Pacto* was one of the most significant attempts at institutionalizing a working arrangement between the government and the principal opposition party. In my view, this was key to ensuring the continuity of the NPE."[14]

4.4 The pact was crucial, not only for some of the reform measures, such as the tax and budget reforms, but also in its contribution to blocking extended, debilitating hearings in Congress. The Bolivian tradition is that Congress, calling upon its oversight powers, permanently summons ministers for hearings. Taken to the extreme, the process can paralyze the executive.

[14] The acronym NPE stands for New Economic Policy in Spanish. NPE was the name given by the government to the package of measures in S.D. 21060 and the reforms that immediately followed.

4.5 President Jaime Paz-Zamora, emulating the Pact for Democracy, constituted the Patriotic Accord again with ADN, a former political enemy. The current government of President Gonzalo Sánchez de Lozada, although counting among it supporters a large number of senators and deputies, has also needed the support of other parties to strengthen its majority. It has formed the Pact for Governability.

4.6 The procedures for election of the president in the Bolivian Constitution force, in a multiparty system, the formation of coalitions or political pacts. Mayorga (1993, p. 335) asserts that "political pacts have become, in fact, the fundamental mechanisms of political stability and of the state Governability since 1985." Notwithstanding the trend toward a more parliamentary form, Bolivia continues to be strongly presidential. Since 1985 the discipline of the parties in government has been strong in Congress; it is very rare that the executive sees its proposals blocked.[15]

4.7 The Bolivian democracy turns to a "delegative" democracy on the electoral and, to a greater extent, the congressional strength of the president.[16] Once the president enjoys a majority in Congress, he feels entitled to govern as he sees fit, constrained only by existing power relations and by a constitutionally limited term in office. This differs only slightly from the characterization of O'Donnell (1994, p. 60): "The president is taken to be the embodiment of the nation and the main custodian and definer of its interests. . . . In this view, other institutions--courts and legislatures for instance--are nuisances that come attached to the domestic and international advantages of being a democratically elected president. Accountability to such institutions appears as a mere impediment to the full authority that the president has been delegated to exercise." The government is run by the president and a coterie of trusted advisers. Still, in contrast with authoritarian regimes, the Congress and the press are free to voice their criticisms, and they sometimes make a dent in policymaking. Delegative democracy is not a permanent feature; rather, it is a recurrent phenomenon. The Paz-Estenssoro and Sánchez de Lozada governments are more of the "delegative" type, while Paz-Zamora's was less so.

4.8 The most telling manifestation of "delegative democracy" in Bolivia is expediency, which is often boasted of by the government as efficacy. Part of the pressure to implement adjustments rapidly, sometimes disregarding what is right, comes from the IFIs. In most cases the executive agrees with the IFIs to a set of reforms, without any previous consultation with Congress. Afterward, Congress is pressured to hastily approve the reforms. Dissident voices are silenced with the use of majority and strong party discipline.

4.9 The costs of governing this way should be apparent. Congressional approvals are rapidly won, but the acceptance by the public and the sustenance of the reform process are

[15] The debate over whether the system has more features of a parliamentary system or a presidential one is not completely settled. Article 90 of the Bolivian Constitution grants to Congress the decisive power to elect the president of the republic if no candidate has obtained a majority in the popular elections. Congress chooses the president from among the three most voted candidates in the elections. According to Mayorga (1993, p. 336), this defines a strong parliamentary dimension to the constitutional system. At the same time, voters cannot chose the president, the vice-president, the senators, and deputies of different slates. This reinforces the presidential features.

[16] The term delegative democracy was coined by G. O'Donnell. A full characterization is given in O'Donnell 1994.

impaired. The probability of carrying out the reforms is reduced, as the discussion shifts from Congress and the press that covers it to the extra-parliamentary opposition and the press that opposes the reforms. The pedagogical value of discussions in Congress is lost, and extra-parliamentary opposition gets an undeserved boost, frequently by a lack of complete information, a lack that could have been avoided had more discussion taken place in Congress. In addition, there is a high probability of making gross mistakes through lack of sufficient attention to the pros and cons of the reforms. Finally, it concentrates all responsibility on the president, mortgaging his administration to the success of a handful of reforms.

Businessmen and Technocrats in Power

4.10 The government that launched the reforms in 1985 was formed, to a significant extent, by representatives of the business community. The Confederacy of Bolivian Private Entrepreneurs (henceforth, CEPB, the Spanish acronym), which had heatedly opposed the first democratic government, became the flag bearer of reform, despite the contradictions among its federated groups.[17] In exchange for their support of the government, former top representatives of the CEPB entered the cabinet. The practice of incorporating business representatives into government somewhat diminished in the Paz-Zamora administration, but has surged again during the current government.

4.11 The seizing of ministries by representatives of the business community, as such, deserves attention. The main questions concern their role in the enhancement of governance. Have the businessmen-politicians brought with them some universal values and rules, and a healthy distrust of state's encroachment, or have they directly captured the state for their own ends, without mediation, as they used to do?

4.12 Before answering the questions above let me mention that business has had to share power with a more traditional group: the technocrats. They are the most fervent reformers. They also share the language of the avidly courted IFIs: efficacy, efficiency, priority to macroeconomic management, liberalization, and privatization. Many of the technocrats have been educated in schools in the United States (up to master's degrees), which obviously establishes a direct line of communication with their peers in the IFIs. Even more to the point, very frequently the salaries of middle-level technocrats are paid with foreign aid funds.[18]

4.13 The bipartite corporatism, established between the businessmen and the government's technocrats, excludes organized labor (and the urban poor), which has given rise to criticisms among the intellectuals and in the press. It is indeed a potential source of political instability. Yet much of the current controversy over businessmen in high government positions does not focus on the potential conflict of interest between public functions and private

[17] As mentioned above, sometimes the National Chamber of Manufacturers and the Eastern Chamber of Agriculture opposed the trade liberalization policies.

[18] A main victim of the fiscal crisis of the 1980s was the public sector. With the prevailing salaries, the result of fiscal stringency, the ablest government officials left or were planning to leave. The reconstruction of a badly needed competent corps of civil servants would have been impossible without foreign aid. This is clearly a second-best solution, given that it creates a problem of allegiances.

undertakings, but rather on the failure of the businessmen-politicians to deliver the managerial skills that were expected. Especially with the administration of Sánchez de Lozada, there was quick disillusionment of the public regarding the government's administrative capacity. The disappointment was not completely groundless. The public's judgment was on efficacy in government, which was offered but not delivered. This would show that business competencies are not necessarily the best choice to run a smoothly functioning public administration. On behalf of the government, it must be said that the second-generation reforms are more demanding in skills than stabilization and the first reforms.

The Weakening of Organized Labor

4.14 The success of the stabilization program was in no small part the result of the weak state of the labor unions, which had been so powerful in earlier times. Their weakness was a byproduct of their virulent opposition to all stabilization attempts of the Siles-Zuazo government.

4.15 In a deft maneuver, the government of Paz-Estenssoro blamed the wage demands of organized labor as the main, if not the only, cause of the hyperinflation. This blatantly exaggerated contention was accepted by the public. When the government took strong action against the unions, it was applauded by many segments in the population. In an ironic twist, the public associated the labor unions with the Siles-Zuazo government and the leftist parties that supported it. Furthermore, the discourse of the labor leaders, impregnated with Marxist and Trotskyite rhetoric, seemed outmoded even in 1985. Doubtless, the unions paid the price of their excessive politization. They were disempowered under the new government, along with the other leftist groups that were important in the previous regime.

4.16 The labor unions retain some power to convoke beyond their ranks because they represent the only organized opposition to what some Bolivians derogatorily call "neo-liberal" policies, and they command a nostalgic respect for their crucial role in the restoration of democracy. The unions have systematically opposed the reforms, and on occasion they have been able to block some of them, despite their weakness. Their power to block was brought about by a haphazard coincidence between their opposition and the public's mood. Also, they have acted in a very opportunistic fashion, riding on issues that they perceived to be popular, even if they were unrelated to labor's specific concerns.[19]

[19] For instance, the labor unions strongly supported the cocoa producers when the police forces took strong action against them at the beginning of 1994.

5

Governance Capacity and the Second Generation of Reforms

5.1 This section presents three policy cases of governance capacity, or the lack of it. The first case relates to fiscal reform, which can be considered generally successful, even if its implementation is still incomplete. The other two cases--privatization and Social Security reform--have been significantly less fortunate. The deficits in governance capacity show very tellingly in these two reforms.

Governance Capacity and Fiscal Reform

5.2 With the liberalization of markets, the opening of the economy, and the pursuit of a restrictive monetary policy, the importance of fiscal policy has to increase. The strengths and weaknesses of the government will often show in the conduct of fiscal policy, understood in a broad meaning and including taxation and expenditure.

5.3 The problems of governance are to a large extent problems of fiscal governance. It is important to look at the conditions needed for the fiscal authority to implement the policy it has designed in a sustained manner, with a minimum cost in public resources and foregone investment expenditures, and without lowering public sector wages to a point where efficiency is impaired.

5.4 Most problems, some of them seemingly unrelated to the fiscal accounts, on closer examination are found to have important fiscal implications. From a political economy view, it is in the fiscal sector that most conflicts converge. It is also on the fiscal front where the reforms have been most successful relative to the other reforms.

5.5 The clearest tests of the governance capacity appear in the field of tax policy. The main questions concern the structure of taxation and the administrative efficiency in collecting them. A structure of taxes that falls on a broad base, and away from easy handles, such as taxes on foreign trade and fuels, would show governance capacity. Of course, the question of whether the government can collect the stipulated taxes is equally important.

5.6 Tables 6 and 7 provide an illustration of the structure of taxes. Next to the collections of the Internal Revenue Services are the royalties and other transfers of the state-owned petroleum enterprise YPFB to the Treasury (Tables 6 and 7). The transfers include both explicit taxes and hidden taxes, because much of the government revenue derived from the sale of fuels has not been legislated. Observe in Table 7 that YPFB royalties and transfers are close to 40 percent of the total current income of the National Treasury.

Table 6: Current Revenue of the National Treasury, 1988-92 (percent of GDP)

Revenue source	1988	1989	1990	1991	1992
Total internal revenue taxes	6.0	6.5	7.5	8.0	9.9
Value added tax	3.4	3.4	3.3	3.8	5.3
Specific consumption tax	0.4	0.7	0.6	0.8	0.8
Tax on transactions	0.6	0.6	1.1	1.4	1.5
Income taxes	0.7	0.8	0.9	1.0	1.0
Estimated corporate profits tax	0.3	0.4	0.4	0.5	0.5
Complementary tax to VAT	0.5	0.5	0.4	0.5	0.5
Other internal revenue taxes	1.0	1.0	1.6	1.1	1.2
YPFB royalties and transfers	4.4	4.9	4.3	6.4	5.7
Mining royalties	0.1	0.1	0.1	0.0	0.0
Custom duties on imports	1.4	1.1	1.0	0.9	1.0
Non-tax revenues	0.1	0.1	0.1	0.1	0.1
Total current revenue	12.0	12.8	13.0	15.4	16.8

Source: Elaborated with data of the Ministry of Finance and Economic Development.

Table 7: Structure of the Current Revenue of the National Treasury, 1988-92 (percent)

Item	1988	1989	1990	1991	1992
Total internal revenue taxes	50.4	50.8	57.9	51.9	58.9
Value added tax	27.9	26.6	25.7	24.4	31.7
Specific consumption tax	3.7	5.2	4.5	5.1	5.0
Tax on transactions	4.7	4.9	8.5	8.8	9.0
Income taxes	6.2	6.5	6.6	6.2	6.1
Estimated corporate profits tax	2.3	2.9	3.3	3.1	3.0
Complementary tax to VAT	3.9	3.6	3.4	3.1	3.1
Other internal revenue taxes	7.9	7.6	12.7	7.4	7.0
YPFB royalties and transfers	36.8	38.6	33.5	41.7	33.9
Mining royalties	0.6	1.1	0.6	0.3	0.2
Custom duties on imports	11.3	8.9	7.5	5.8	6.2
Non-tax revenues	1.0	0.6	0.4	0.4	0.8
Total current revenue	100.0	100.0	100.0	100.0	100.0

Source: Elaborated with data of the Ministry of Finance and Economic Development.

5.6 There are no studies of incidence across income categories after the reform, but the presumption is that the structure is at best neutral and, more likely, regressive. Most taxes are of the indirect kind. Moreover, taxes on fuels have a disproportionate weight in total collections. High incomes are clearly taxed at a low rate in the international context. Yet the question of whether the current tax structure is more regressive than the previous one is difficult to answer if evasion is considered. While in principle the tax structure before the reform of 1986 was progressive, generalized evasion in the private sector probably turned around the feature. The current tax system seems less prone to evasion.

5.7 A major institutional change in the administration of public resources is given in Law 1178 of July 1990, which governs the administration and control of the public accounts (henceforth, SAFCO, for the Spanish initials with which is known). The SAFCO law and the budgetary process described below are the offspring of the consensus of virtually all political parties on the need for fiscal correctness. The whole idea was to establish a system of checks and balances conducive to the goal of having low deficits and the best use of public resources.

5.8 The SAFCO law is comprehensive and takes a systems' approach to tackle the problems of programming of operations, accounting procedures, organization of the administration, budgeting, treasury operations, internal and external audits and ex-post control of the public sector accounts. The SAFCO law completes the legal framework for budget formulation and execution, given mainly in the Bolivian Constitution.

5.9 All budgetary activities, except the ex-post control, are in the different undersecretariats of the Ministry of Finance. The ex-post control is in the extremely powerful General Comptroller's Office ("Contraloría General de la República"). The "Contraloría" is an office, independent of the executive branch, and accountable only to Congress. The general comptroller is appointed for a term of ten years. In principle and in actuality, the Contraloría is immune to the influences of political and interest groups. It is the supreme judge of fiscal propriety.

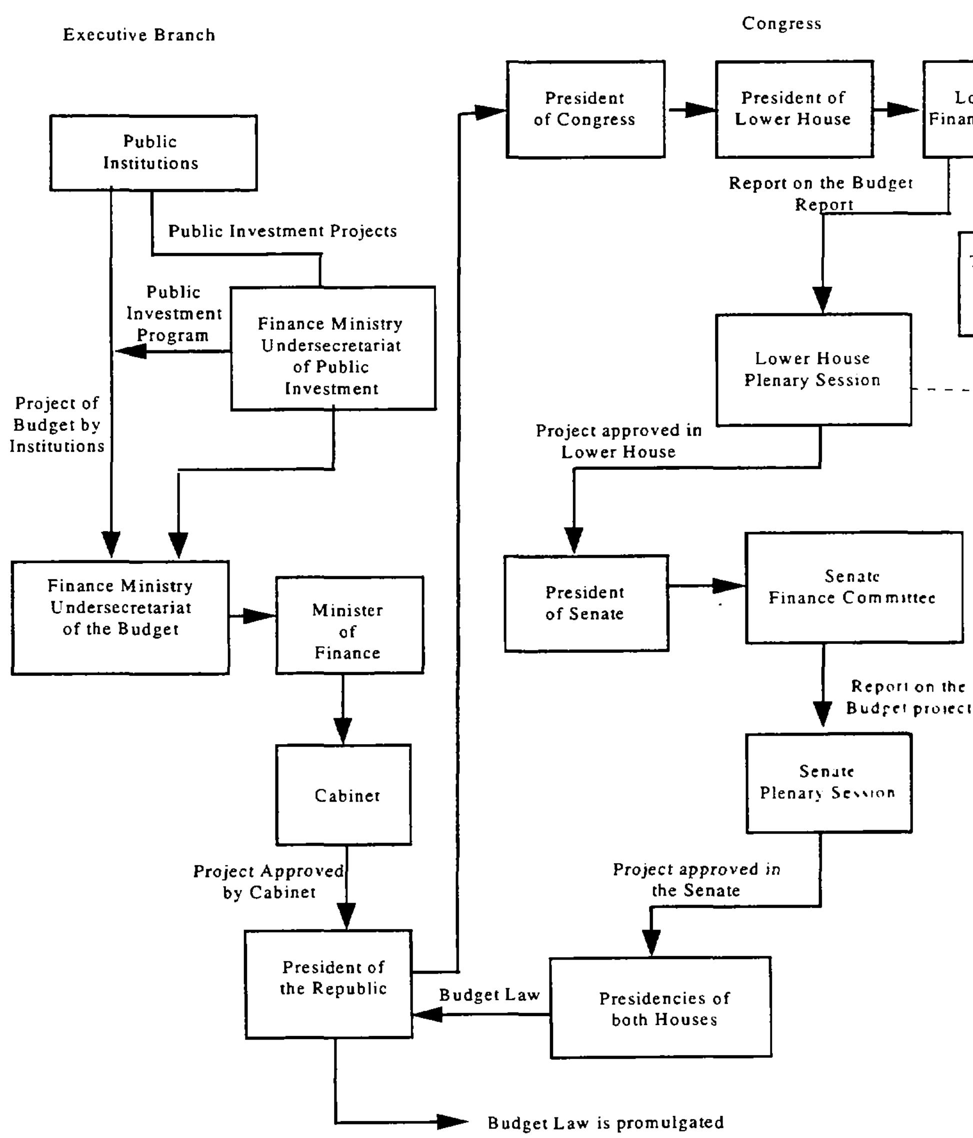
5.10 An important innovation of the SAFCO law is that all public servants, regardless of position in the bureaucratic hierarchy, are fully responsible for their decisions and are accountable not only for the resources that were entrusted to them, but for the results and the use of these resources. This implies that public servants could be prosecuted not only for malfeasance, but also for errors of judgment or professional malpractice.

5.11 The SAFCO law has increased the sense of responsibility in the bureaucracy, but it also has caused unwarranted delays in decisionmaking. The law has not prevented the petty corruption of low-level employees, but it is feared by high-level officials, and consequently has the potential to stop the most harmful cases of abuse of public resources.

5.12 The draft budget goes through several filters in the executive. The project is discussed in the Cabinet of Ministers, where late changes can still be made. Once the project is approved in the Cabinet of Ministers, it is sent to Congress.

5.13 When the draft budget is received in Congress, it is then discussed in committees and in plenary sessions (see Figure 2 for a picture of the process). Once approved by the Chamber of Deputies and the Senate, the budget is sent back to the executive, which promulgates it as law. It is readily seen that the final version of the budget results from a delicate system of checks and balances between the executive and the legislative. The process is cumbersome, but it has the advantage of precluding major mistakes.

Figure 2: The National Budget Process



Source: Minstry of Finance and Economic Development

5.14 The president could, in principle, veto the budget, but this has never been done. Congress is usually cautious in modifying the draft sent by the executive without its agreement. Neither the executive nor Congress would find it profitable to enter into a conflict of powers. This acts as a deterrent to Congress should it wish to amend the draft unilaterally. Congress has a deadline to approve the budget; if it does not meet the deadline, the executive's draft automatically becomes law.

5.15 During the preparatory phase in the executive, and while in Congress, the government negotiates with the main interested parties, mainly the labor unions, the regions, and the public universities. Negotiations with the regions, which primarily involve the public investment budget, are conducted with local authorities and are particularly concerned with the views of the so-called "civic committees," associations of local interests involving business and labor groups, community associations, and private persons, usually retirees. In some regions, civic committees are very powerful.

5.16 A feature of the Bolivian budgetary process is the very significant amount of social and political unrest in the first quarter of each year, right before the budget is presented to Congress and while it is there. The wage guidelines in the draft budget trigger the reaction. Claims on the budget are sometimes introduced by violent means: street riots, general and hunger strikes, road blockades, and so on. The budget process becomes the focus of political activity during these months.

5.17 The upheavals illustrate the importance of the budget and how binding it is. At the same time, the budget is not fully immune to political pressure, and often the expenditure allocations are higher than a controlled deficit would warrant. This has caused parallel or shadow budgets, negotiated with the other major player, the IMF. Actual disbursements of the amounts budgeted by Congress follow the accords between the executive and the IMF.

Problems with Privatization and Social Security Reforms

5.18 Most of the pending second-generation reforms have met strong hostility, but the greatest challenges have been to privatization and Social Security reform. I will concentrate on these.

5.19 Although almost everybody has a complaint about the functioning of the public enterprises, the private enterprises do not fare better, especially in the services sector. The latter, having been sheltered from foreign competition for years, more because of natural barriers than as a result of policy, offer services that are as poor or poorer than in the public sector. To some, privatization is yet another form of corruption to favor the cronies of top officials.[20]

5.20 Also, it should be recognized that there is a deep distrust of the traditional Bolivian private entrepreneurs in Bolivian social and political culture. Race and social considerations are not absent in the suspicion: many among the traditional entrepreneurs are of

[20] The first privatizations were, to say the least, controversial. For instance, a sugar mill was sold in an auction for US$10 million. One year later, a private mill similar in fixed assets and technology to the privatized mill is offered for sale for US$36 million.

the white and whitened, mixed-blood upper classes, with a history of privileged access to public resources. The hard lobbying of the CEPB for privatization has been counterproductive in many ways. Had the CEPB stayed out of the debate, opposition to privatization probably would have lost steam.

5.21 Organized labor is opposition to the reform of the Social Security system is even stronger than to privatization. Why, given the blatant deficiencies of the Social Security system, is there such resistance to reform? A partial answer is that the reform of the pension system through individual capitalization, instead of the current system of "pay as you go," is seen as contradicting the deeply ingrained value of solidarity.[21] Also, workers resent that the government will decide on their saving, without consulting them. There is also a problem with the packaging of the measure. It has been presented by government as if the creation of a large capital market were the only objective.

5.22 The failure to obtain progress in privatization and Social Security reform would suggest that the initial strength of the government, gained after its success in controlling hyperinflation, has suffered erosion. Two explanations may be given for this. The first requirement of governance, at least initially, is a "vision." Structural adjustment, in its Bolivian incarnation, tried to mobilize society around "engineering" values, such as efficiency and the optimal allocation of resources, while ignoring more traditional values in the political culture, such as solidarity and common destiny. This agenda was too narrow.[22]

5.23 Second, the slowness in the resumption of growth has affected the public's assessment of the reforms. Contrary to what happened with stabilization, when the sharp drop in inflation and the increase in welfare were almost immediately felt, the public doesn't yet see concrete and significant improvements in employment, real wages, or the quality of the social infrastructure. As a result, public opinion has become apathetic toward the reforms and the most visible institutions: all branches of government, the bureaucracy, the political parties, the business associations, and the labor unions.[23] Opinion polls show that only the church and the press command some credibility. The apathy has translated into a lack of conviction of the necessity (or even the desirability) of the reforms, rather than overt opposition. The absence of popular support has allowed small and unrepresentative groups to block many proposals.

5.24 The coalitions supporting the reforms do not possess the necessary strength and do not go beyond the elites. Their restricted reach cannot push reform in a democratic society. This can be partially explained by failures in governance, or at least in statecraft. The governments have not succeeded in finding ways to compensate the citizens who feel, maybe without reason, that they will bear most of the costs of the reforms.

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[21] Solidarity in the Social Security system is enshrined in the Bolivian Constitution.

[22] The need for "self-reliance," a liberal value, could have been shared by many. That point was not emphasized in the official discourse, perhaps because this argument would have been seen to be at odds with governments that were more dependent on foreign aid than ever before in the history of Bolivia.

[23] See the opinion polls of the Catholic University of Bolivia, in Salinas 1994.

5.25 Although no identifiable social group has captured the state, some political and interest groups are powerful enough to impede the changes. The results are surprising, given that the political parties that support reform have usually won the elections with strong pluralities. Yet once in power, they were unable to push more vigorously for their agenda. It is also true that in the last two campaigns, the main parties--MNR, ADN, and MIR--made extravagant promises. When these promises were not fulfilled after they took power, it hindered both the credibility and the feasibility of the other, sensible, policies.

5.26 The sporadic veto power of small and unrepresentative groups needs some explanation. Unfortunately, only conjectures can be provided now. One idea is that there is a lack of conviction in the government itself on the merits of the reforms. On many issues the economic teams have been divided, and the opposition of any small group outside government has been taken as an excuse for inaction.

5.27 Regarding privatization and Social Security reform, top officials in the government have hesitated to take measures that may be politically attacked as favoring a privileged group of people. Even if the now reluctant factions in government eventually agree on the reforms, they will proceed very slowly and with extreme prudence.

5.28 There is also a problem with the packaging of the policies. The case for reform has been argued to date through historical comparisons (always referring to the hyperinflation of 1982-85), with arguments that are contradicted by evidence (for example, that all SOEs lose money), or because all our neighbors are doing the same. The government's messages are recast by the opposition as if the benefits of the reform were only for particular interest groups. Little use has been made of the compelling argument that without the reforms the country risks being left without saleable products in world markets, with evident losses of welfare.

5.29 The polls reveal that the proposal of popular participation enjoys wide acceptance in the public. It indeed has the potential to mobilize society and stir some enthusiasm for the reforms. Yet while popular participation is undisputed, this doesn't imply that there are broad coalitions that would stand for it should a movement to reverse the measure appear.

6

Concluding Remarks

6.1 The purpose of this paper was to show in detail how the dynamics of the first generation of reforms have been very different from those of structural adjustment in the Bolivian experience. The implementation of the stabilization policies and the first reforms showed considerable statecraft. In contrast, later initiatives for more complex structural adjustments have met little success.

6.2 The first generation of reforms have left important legacies. There is now a consensus in the main political parties on some basic points: first, the need to maintain price stability; second, not unrelated to the first point, the need to keep deficits low and to allocate the scarce public resources primarily to spending in the social sectors; and third, but less forcefully, the need to transform the economy into a market economy, without forsaking equity.

6.3 Based on this legacy, the second generation of reforms could have proceeded more smoothly than has been the case. One nevertheless can be optimistic on their chances of implementation in the future if a more flexible approach is taken, both by the government and the IFIs. One can foresee many tests in the coming years on the governance capacity to promote further reforms.

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