BOLIVIA

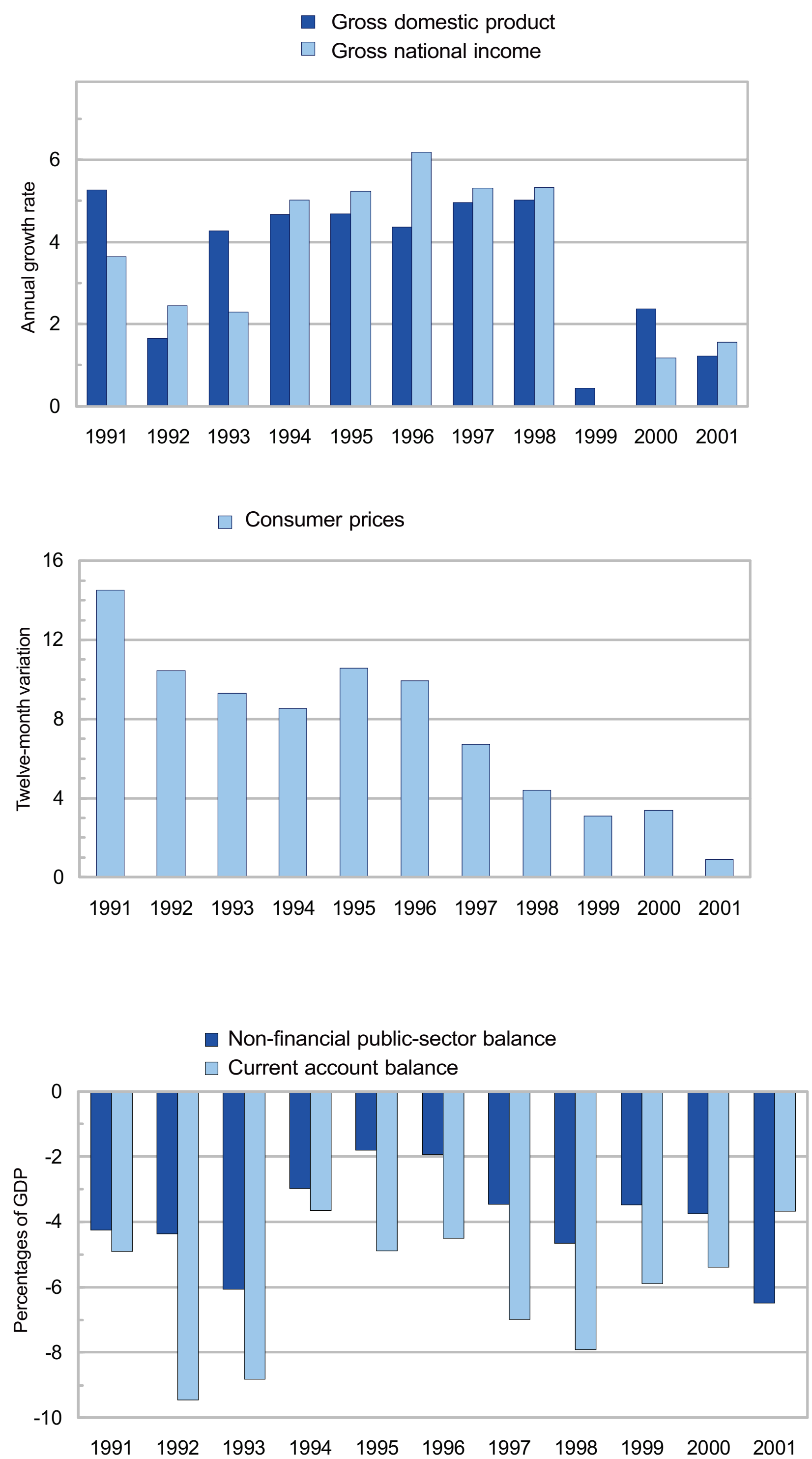
1. General trends

In 2001 the Bolivian economy racked up a third year of sluggish growth that fell far short of the rates of between 4% and 5% seen in the 1990s. The rate of 1.2% recorded in 2001 represented a further drop in per capita GDP. The main engine of economic growth was the production of natural gas for export, while domestic demand remained slack, especially in the area of investment, which continued to trend rapidly downward. In these circumstances, inflation came in at under 1% and the current-account deficit narrowed; this meant that the Central Bank could allow liquidity to expand slightly while maintaining a stable real exchange rate. At the same time, however, the fiscal deficit widened to 6.5% of GDP and open unemployment reached 8.5%.

UNDOUBTEDLY, lower export earnings –as a result of the drop in international prices– have been partly to blame for the slack domestic demand recorded in recent years. But a part has also been played by domestic factors, such as the impact on informal-sector earnings of the coca eradication plan and of measures to reform customs and combat smuggling, the social disturbances that took place in 2000 and the bursting of a financial bubble that affected the construction sector. In this situation, there was little leeway for macroeconomic and especially monetary measures, which shifted the burden onto fiscal policy. In this regard, microeconomic measures, including an economic recovery programme, an emergency employment plan and a poverty reduction strategy, turned out to be more effective in softening the impact of the domestic crisis.

Early 2002 brought some signs that the economy was moving back onto a more positive growth track, with economic activity up by 2.8% in the first two months of the year. But political uncertainty continued to hamper investment plans in the run-up to the presidential elections and the change of government scheduled for August. It therefore seems unlikely that the economy will reach the lower end of the range of official growth projections for the year, which vary between 2.5% and 3.5%. Inflation fell even further in the first four months of 2002.

Figure 1
BOLIVIA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

2. Economic policy

Economic policy had to rely largely on fiscal measures, given the limited effectiveness of monetary policy in reactivating a highly dollarized economy within a financial system that did not lack liquidity and would not readily respond to a reduction in lending rates. Bolivia's Central Bank easily met its inflation target with the support of a foreign exchange policy that kept the currency stable. On the other hand, the bulky fiscal deficit prevented the government from meeting the targets agreed upon in June with IMF as a condition for a soft loan within the framework of the poverty reduction programme.

In December that loan was therefore rescinded and replaced by an IMF informal monitoring arrangement, which generated satisfactory results in the early months of 2002 and cleared the way for loans from other multilateral institutions.

(a) Fiscal policy

Because fiscal management was seriously hampered by the economy's lacklustre performance, the year ended with a large non-financial public-sector deficit equivalent to 6.5% of GDP, which was higher than the figure of 3.8% recorded a year earlier. The worsening of the deficit was attributable to a contraction in fiscal revenues of almost three GDP percentage points, since spending as a percentage of GDP was no greater than in 2000.

The government sought to boost the economy by increasing investment expenditure, with an emphasis on social spending to improve the situation of low-income groups. In consequence, investment expenditure rose by one GDP percentage point, while social spending accounted for over half of total outlays. The wage bill and interest payments on domestic debt also rose. To offset those increases, in view of its decreasing revenues, the government opted to cut back on procurement of goods and services.

Nevertheless, the ratio of spending to GDP remained close to the high of 38% recorded in 2000. Fiscal spending has increased steadily since 1997 owing to the reform of the pension system, which generated a transition cost that will continue to burden public finances for years to come. In 2001 that cost was the highest yet, at 4.8% of GDP.

Income was around 31% of GDP, with decreases in all items of current income. This was due not only to the economic slowdown, but also to an increase in non-payment of taxes in the context of a partial fiscal amnesty announced by the government and to the incentives provided under the Economic Recovery Act. The authorities' decision not to increase gasoline prices also had an impact.

The gap between expenditure and income was bridged in part (46%) by resources for specific projects, particularly infrastructure, provided by multilateral institutions such as the Inter-American Development Bank, the World Bank and the Andean Development Corporation. The remaining 54% was financed by the issuance of domestic debt instruments (Treasury bills and bonds), which took advantage of the relative abundance of liquidity in the financial system.

(b) Monetary and foreign exchange policy

The banking system had focused on improving its liquidity position as a precaution in the light of the uncertain external situation, particularly the changing expectations in Argentina and Brazil, and the slowdown in domestic economic activity. Banks' loan portfolios shrank as the economy's sluggishness increased the rate of default.

Given that banks were less willing to extend loans and that demand for them declined in the face of poor domestic expectations, the Central Bank allowed the liquidity in the system to expand just enough to avoid undermining its foreign exchange policy, which hinges on a gradual but moderate nominal depreciation of the currency. This policy sought to keep the boliviano's real exchange rate constant with respect to the currencies of Bolivia's seven main trading partners, while avoiding the sort of sharp fluctuations that could push up domestic inflation and jeopardize the numerous holders of foreign-currency-denominated debt, in the context of a highly dollarized economy. Accordingly, the boliviano depreciated by 2% in real terms between 2000 and 2001. This, however, meant that the currency appreciated with respect to the currencies of Argentina, Brazil and especially Chile. In nominal terms, the mean annual value of the dollar increased from 6.2 to 6.6 bolivianos over the period.

The monetary base expanded by almost 9% in 2001, as the local-currency value of international reserves increased and net credit to the public sector expanded, while the Central Bank engaged in moderately

Table 1
BOLIVIA: MAIN ECONOMIC INDICATORS

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
	Annual growth rates [b]								
Growth and investment									
Gross domestic product	4.3	4.7	4.7	4.4	5.0	5.0	0.4	2.4	1.2
Per capita gross domestic product	1.8	2.2	2.2	1.9	2.5	2.6	-1.9	0.1	-1.0
Gross domestic product, by sector									
Goods	4.6	5.1	5.0	4.2	4.0	3.4	-0.9	2.5	0.7
Agriculture	4.1	6.7	1.4	6.7	4.5	-4.4	2.5	3.8	1.1
Mining	5.9	3.4	7.3	-2.0	6.1	5.5	-4.5	7.2	2.7
Manufacturing	4.1	5.4	6.8	4.9	2.0	2.5	2.9	1.7	1.1
Construction	5.7	1.2	6.0	9.0	4.9	35.7	-16.8	-10.5	-8.6
Basic services	6.0	6.8	6.4	6.3	8.5	6.3	0.1	2.3	1.4
Electricity, gas and water	15.5	11.4	8.6	3.4	4.7	2.4	4.9	1.5	0.2
Transport, storage and communications	4.4	6.0	5.9	6.9	9.2	7.1	-0.8	2.4	1.7
Other services	4.2	3.9	3.1	5.1	7.0	5.9	5.8	1.5	0.7
Commerce, restaurants and hotels	3.1	3.5	2.8	5.1	4.1	2.0	0.8	2.2	0.7
Financial establishments, insurance, real estate and business services	6.7	6.0	3.7	8.5	12.6	12.5	13.3	-0.1	-0.6
Consumption	3.2	3.0	3.4	3.2	5.1	5.0	2.8	2.2	1.7
General government	2.5	3.1	6.6	2.6	3.4	3.8	3.2	0.7	3.2
Private	3.3	2.9	2.9	3.3	5.4	5.2	2.8	2.4	1.5
Gross domestic investment	-0.1	-10.6	12.3	18.8	30.2	28.5	-18.8	-10.2	-20.5
Exports of goods and services	5.3	15.1	9.1	4.1	-2.1	6.5	-12.8	14.5	4.9
Imports of goods and services	-0.7	-0.6	8.9	7.9	13.5	22.3	-17.1	2.6	-7.4
	Percentages of GDP [c]								
Gross national income	99.3	99.6	100.1	101.7	102.1	102.4	102.1	100.9	101.2
Gross domestic investment	16.7	14.2	15.2	17.3	21.7	26.3	21.3	18.7	14.7
National saving	8.2	9.3	10.7	13.4	14.4	14.6	12.6	11.0	10.5
External saving	8.5	4.9	4.6	3.9	7.3	11.7	8.7	7.7	4.2
	Percentages								
Employment and wages									
Labour force participation rate [d]	52.5	53.7	55.1	56.5	52.5	...	...	...	...
Open unemployment rate [e]	5.8	3.1	3.6	3.8	4.4	6.1	8.0	7.5	8.5
Real average wage (index: 1995=100)	91.2	98.5	100.0	98.5	104.5	108.0	113.7	114.8	119.4
	Growth rates								
Prices (December-December)									
Consumer prices	9.3	8.5	10.6	9.9	6.7	4.4	3.1	3.4	0.9
External sector									
Terms of trade (index: 1995=100) [c]	88.3	102.5	100.0	111.7	115.6	109.9	109.8	112.0	110.5
Nominal exchange rate (bolivanos per dollar)	4.3	4.6	4.8	5.1	5.3	5.5	5.8	6.2	6.6
Real effective exchange rate for imports (index: 1995=100)	92.8	97.8	100.0	93.8	92.2	88.5	87.5	90.0	90.8
	Millions of dollars								
Balance of payments									
Current account	- 506	- 218	- 328	- 333	- 553	- 667	- 489	- 447	-292
Trade balance (goods and services)	- 537	- 244	- 334	- 399	- 649	- 845	- 678	- 608	-475
Exports	897	1,216	1,239	1,317	1,413	1,355	1,310	1,470	1,521
Imports	1,433	1,460	1,573	1,716	2,062	2,200	1,989	2,078	1,996
Capital and financial accounts [f]	525	228	421	624	656	792	515	408	255
Overall balance	20	10	92	292	103	125	27	- 39	- 37
Variation in reserve assets (- indicates an increase)	100	- 26	- 147	- 310	- 76	- 133	- 32	39	34

Table 1 (concluded)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	66.0	63.1	62.8	61.1	55.1	50.2	52.9	52.2	53.2
Net interest (as a percentage of exports) [g]	21.2	14.3	16.6	8.7	9.2	7.6	5.7	6.8	4.2
					Percentages of GDP				
Central government									
Current income	17.2	17.8	17.4	17.4	17.7	21.5	21.3	20.4	21.0
Current expenditure	20.9	21.5	19.6	19.8	23.3	23.7	22.7	23.1	26.1
Saving	-3.7	-3.7	-2.2	-2.4	-5.6	-2.2	-1.4	-2.7	-5.1
Capital expenditure (net)	5.0	5.4	3.7	3.6	2.5	2.5	3.4	3.9	4.9
Financial balance	-4.5	-2.5	-1.2	-1.2	-2.8	-3.3	-3.7	-4.4	-7.2
Non-financial public sector balance	-6.1	-3.0	-1.8	-1.9	-3.5	-4.7	-3.5	-3.8	-6.5
					Growth rates				
Money and credit									
Net international reserves	8.8	24.4	50.0	97.7	10.1	38.3	33.3	30.1	34.2
Net domestic credit to public sector	29.9	6.0	-84.6	-2.7	96.7	4.8	-35.3	163.2	85.2
Domestic credit to private sector	39.3	24.0	12.6	28.2	21.6	23.4	3.0	-1.3	-5.8
Money (M1)	14.6	33.4	23.5	10.6	18.6	7.0	-3.8	4.2	12.8
Local currency savings and time deposits	7.8	74.6	-22.4	115.0	15.4	5.6	0.6	3.7	14.7
M2	14.0	37.0	18.3	18.3	18.2	6.8	-3.2	4.2	13.1
Dollar deposits	41.8	18.7	7.5	49.1	19.8	15.3	3.6	6.0	6.0
					Annual rates				
Real interest rate (annualized, %)									
Deposit rate	12.6	9.8	7.9	5.9	9.5	4.8	9.9	6.1	7.8
Lending rate	41.8	44.3	37.1	38.6	43.3	30.7	32.5	28.7	17.6
Equivalent interest rate in foreign currency [h]	22.0	18.3	18.8	19.1	15.8	12.9	12.2	10.9	9.7

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 bolivianos. [c] Based on constant 1995 dollars. [d] Percentages of the working-age population. [e] Percentages of the economically active population. [f] Includes errors and omissions. [g] Refers to net interest as shown in the balance of payments, divided by exports of goods and services. [h] Interest rate on deposits, deflated by the variation in the exchange rate.

expansionary activities, including open market operations, repurchase arrangements and liquidity credits. The performance of net credit to the banking system, however, had a contractionary effect on the monetary base. The expansion of the monetary base was transmitted in almost the same proportion to the supply of broad money (M3), which includes dollar deposits. Within this aggregate, however, there was an upsurge in liquid assets, as sight deposits increased while time deposits contracted. As a result, narrow money (M1) expanded at a higher rate (13% in local currency and 18% including holdings in dollars). This upsurge reflected a preference for more liquid assets in view of changes in money yields.

In the context of abundant bank liquidity, the measures taken by the Central Bank brought intervention interest rates down to historically low levels. The banks did not fully reflect this decline in their rates structure, however. The margins between lending and deposit rates actually widened because of higher risk premiums in a context of higher default rates. The monthly average lending rate in local currency decreased from 19.8% in January to 19% in December 2001, while the rate on time deposits dropped from 10.9% to 8.5% over the same period. Rates on dollar loans and deposits decreased from 15.3% to 13.5% and from 6.9% to 2.8%, respectively.

The decrease in deposits primarily affected the banking sector, where the total volume of deposits contracted, while deposits increased in the rest of the financial system (financial funds, credit unions and savings and loan associations). The downturn in bank deposits reflected the reduction in loans, particularly to

Table 2
BOLIVIA: MAIN QUARTERLY INDICATORS

	1999				2000				2001 [a]				2002 [a]
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Consumer prices (12-month variation, %)	2.0	1.5	2.6	3.1	4.6	4.2	5.9	3.4	1.8	2.7	0.0	0.9	1.5
International reserves (millions of dollars)	812	838	844	917	837	823	768	824	688	774	730	767	685
Real effective exchange rate [b] (index: 1995=100)	86.1	87.4	87.8	88.5	89.6	90.3	90.2	89.9	90.8	90.4	90.0	91.8	83.9
Real interest rates (annualized, %)													
Deposit rate	9.7	11.1	9.5	9.1	6.9	5.8	5.9	5.8	8.1	8.0	7.2	9.1	5.1
Lending rate	35.3	30.6	33.6	30.5	31.4	30.9	32.1	20.3	16.6	18.4	17.8	19.9	14.2

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Refers to exchange rate for imports.

the agricultural and construction sectors and, in general, to small business and microenterprises, which bore the brunt of the economic slump and the effects of increased default rates. The government created an economic recovery fund to help distressed borrowers by rescheduling their debts, in conjunction with the financial entities involved.

(c) Structural reforms

Within the framework of National Dialogue 2000, a forum for negotiation between the government and civil society representatives, in July 2001 the government adopted the Bolivian Poverty Reduction Strategy (BPRS). BPRS constitutes a framework for steering domestic policies in combination with external actions and contributions, such as the resources provided by multilateral institutions and those released under the enhanced Heavily Indebted Poor Countries Debt Initiative (HIPC II), which was approved for Bolivia in June 2001. In December the authorities established institutional machinery to implement and monitor BPRS.

The challenge facing BPRS is illustrated by the results of the National Population and Housing Census of 2001, according to which 58.6% of the Bolivian population –almost 4.7 million people – lives below the poverty line. This percentage had been as high as 70.9% in 1992 and 85.5% in 1976. In 2001, poverty was concentrated primarily in rural areas, where the poor accounted for 90.8% of the population, as against 39% in the cities.

3. The main variables

The government's policies could not prevent a third year of poor economic growth, especially since the downward trend of private investment proved impossible to reverse, as the difficulties faced by businesses (revealed by the increased incidence of default, for example), especially small firms, prevented them from responding to the stimuli provided by the administration's economic policy. That policy may, however, have played a part in containing the increase in unemployment, promoting a favourable trend in wage levels and, clearly, in keeping inflation very low in a context of a balanced foreign exchange market, though this was basically attributable to slack demand.

(a) Economic activity

The factors that affected economic activity in 2000 continued to influence performance in 2001. The most significant was a further decline in private investment, which sent the economy's gross fixed capital formation plunging by more than a fifth. In consequence, the share of gross fixed capital formation in GDP dropped below 14%, almost 10 percentage points below the admittedly high figure recorded in 1998, before the crisis hit. The decline was attributable entirely to domestic private investment, including construction, since both public investment and FDI recorded an upturn. FDI has been expanding strongly since the mid-1990s; in the last few years it has been the mainstay of private investment, accounting for nearly 90% in 2001.

The fact that shrinking investment did not translate into a decline in GDP (which grew by 1.23%) was due, as in 2000, to the influence of external demand, particularly the continued increase in the extraction of natural gas for export to Brazil. Exports of goods and services, which accounted for a quarter of GDP, were up by almost 5%. This had a positive impact on economic activity and was complemented, albeit to a small degree, by a slight increase in aggregate consumption. A decline in demand for imports also helped, as this increased the share of GDP in the economy's total supply of goods and services from 78% to nearly 80%.

The results by sector bear out the various influences at work on the supply and demand sides of economic activity. There were considerable downturns in construction and public works, financial services, mineral production, agribusiness products and coca. The coca harvest declined again, although by only 2%, after three consecutive years of heavy losses; coca output in 2001 was barely more than a fifth of the figures recorded in the early 1990s. Construction had already lost all the ground gained in the extraordinary boom phase prior to the crisis, so that the sector's output returned to its pre-1996 level. Several tertiary sectors, such as electricity, gas and water, commerce, transport and storage, practically stagnated.

The only sectors to see substantial improvements in output were forestry, hunting and fishing, food processing and, particularly, communications and extraction of natural gas and crude petroleum. Communications expanded by 6.5%, thanks to the opening of the market to competition in November 2000. Hydrocarbon extraction output climbed by more than 9% and was the main engine of overall GDP growth.

The hydrocarbon sector's increased output was due mainly to natural gas. The volume extracted in 2001 was 46% higher than the previous year's figure, in response to demand from the growing Brazilian market. Natural gas has become the leading resource of Bolivia's diversified extractive sector and has tremendous potential for expansion in the short and medium term. Exports to Brazil should continue to increase steadily into 2003, and the existence of substantial reserves –the largest in the region– has encouraged the government to seek new markets. Plans are being laid for the sale of liquefied natural gas to Mexico and the United States (State of California). Given that Bolivia has lacked access to the sea since the late nineteenth century, this would require the installation of a liquefaction plant on the Pacific coast of a neighbouring country.

(b) Prices, wages and employment

In 2001 the consumer price index (CPI) rose by 0.92%, which meant that inflation posted its lowest rate in 40 years. This was due in particular to depressed domestic demand. Moreover, gasoline prices held steady, having been frozen since 2000.

The main factor behind the small CPI rise was the increase in utility rates and in the cost of some imported inputs, given the depreciation of the nominal exchange rate. The exchange rate affected the non-tradable services sector because of the extent to which utility rates are indexed to the dollar. The utilities price index rose by 2.85%.

Low inflation helped to maintain the purchasing power gained through wage increases, which were larger in the public sector than in the private sector –6.1% as against 5.4%. These figures, which refer only to the formal sector of the economy, also show that the largest wage increases in the private sector corresponded to the most highly skilled and best paid jobs; this had an adverse impact on income distribution. The opposite effect, however, was produced by the increase in the national minimum wage, which rose from 355 bolivianos per month in 2000 to 400 in 2001.

Sluggish economic growth prevented any improvement in the rate of employment, especially given the contraction recorded in some labour-intensive sectors such as construction, in which the number of employed workers decreased by 22%. Employment in the formal private sector was down by over 5%, while in the public sector employment increased slightly as a result of the implementation of an emergency employment plan. The rate of open unemployment increased from 7.5% to 8.5% in the space of a year.

(c) The external sector

The divergent trends in domestic and external demand had the effect of narrowing the deficits on the trade balance and on the balance-of-payments current account. These deficits would have been still further reduced were it not for the deterioration of Bolivia's terms of trade, which were down by 5.5%.

The external accounts actually reflected both the expansion of exports and the contraction of imports. Exports expanded because of increased sales of natural gas; the rest of the export sector contracted in response to slow economic activity and slack world demand, which pushed down both commodity prices and export volumes. This limited the growth of total merchandise exports to around 3%.

Sales of natural gas (mainly to Brazil) almost doubled, as greater volumes combined with higher prices; the increase in these sales over the last two years has made this segment Bolivia's second largest exporter. By contrast, earnings from most other exports were lower. The leading export, soybeans and soybean derivatives (flour and oil), declined by 8%; zinc, silver and tin, as well as wood and wood manufactures, saw declines of between 20% and 30%; and jewellery items recorded a downturn of 16%. Sales of gold and of leather and leather products grew only slightly.

Merchandise imports were down by almost 6% (f.o.b. value), mainly because of lower import volumes, with domestic demand largely accounting for the composition of these purchases. The steepest drop was seen in imports of capital goods, which lost a third of their c.i.f. value. Imports of consumer goods fell by 15%, owing mainly to reduced purchases of durables. Imports of raw materials and intermediate goods were down by 10% but, among these, construction materials plunged by 23%.

As a result, the negative balance on the trade account narrowed. The deficit on the factor income account also decreased, thanks to lower interest payments on the external debt under the HIPC and Paris Club initiatives, while current transfers increased. The current-account deficit therefore narrowed from US$ 447 million in 2000 to US$ 292 million in 2001, which was equivalent to 3.7% of GDP.

The financial account, however, suffered a deterioration that offset the gains in current transactions. The main item, FDI, increased slightly after having declined in 2000. In addition, the government received about US$ 100 million more in loans than in 2000. Even so, Bolivia's external debt decreased to some US$ 4.2 billion, thanks to the cancellation of part of the debt and to a change in its dollar value as a result of the depreciation of the euro and the yen against the United States currency.

Capital inflows were more than offset by outflows in the form of investment by banks seeking opportunities abroad and by increased direct investment outside the country. The traditional financial account surplus therefore declined for the third year running, this time to US$ 334 million. The overall figure on the balance of payments, including errors and omissions, was US$ -37 million, which obliged the authorities to draw on US$ 28.5 million in international reserves. By the end of 2001 the Central Bank's reserves stood at US$ 1,076 billion, which was enough to finance six and a half months' worth of goods and services imports.