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2 Political Economy and Macroeconomic Policymaking, 1952–87

In this chapter we review the major trends in Bolivian growth and development between 1952 and 1987. We have chosen 1952, the year of the Bolivian Revolution, as the relevant starting year for the analysis because the changes wrought by the Revolution shaped Bolivian economic and political development for the next thirty-five years. The review in this chapter will help to establish the links between foreign borrowing and the main macroeconomic developments.

The developments in the export markets (and the attendant changes in foreign indebtedness) could have been used to define the main temporal phases of the economy. We have chosen instead to divide the 1952–87 period using the criteria of political economy, according to the degree and character of state intervention in the economy. Given that this period encompasses several subperiods of intense political turmoil that seriously affected economic policymaking, the issues of state intervention in the economy and political instability receive more attention in our analysis than is perhaps typical of a country study.

In view of this emphasis on the political economy of Bolivian economic development, we begin this chapter with a detailed account of the major political developments since the Revolution of 1952, with a stress on their effects on the macroeconomy. Then, we turn to a summary of the main dimensions of economic performance, including growth, inflation, trade, and debt management, in the context of the political-economic history.

2.1 Bolivian Political Economy, 1952–87

This period witnessed a variety of policy phases that clearly deserve separate treatment. While the fundamental strategy of development set after the Revolution of 1952 did not change substantially until the end of 1985, the degree and the nature of state intervention in the economy differed significantly among the phases. Economic policy was shaped as much by political considerations as by macroeconomic objectives. Noneconomic objectives were very much present, and political turmoil itself left a deep mark on the period.

Table 2.1 gives a brief political chronology of Bolivia since the Revolution of 1952. The most striking aspect of the chronology is the instability of constitutional rule in the country. The Revolution was led by the National Revolutionary Movement (the MNR), which governed Bolivia

Table 2.1 Political Chronology of Bolivia, 1952–89

Year	Political Event
1952	Bolivian Revolution, carried out by Nationalist Revolutionary Movement (MNR), under the leadership of Dr. Víctor Paz Estenssoro.
1952–56	Presidency of Paz Estenssoro; important reforms, but sharp rise in inflation, reaching 178.8% in 1956.
1956–60	Presidency of Hernán Siles Suazo (MNR); economic stabilization under U.S. and IMF supervision and finance.
1960–64	Second presidency of Paz Estenssoro.
1964	Third presidency of Paz Estenssoro; Paz deposed in military coup led by General René Barrientos Ortuno.
1964–66	Co-presidency of Alfredo Ovando Candía and Barrientos Ortuno.
1966–69	Civilian presidency of Barrientos (dies in helicopter crash, April 1969).
1969	Vice President Luis Siles Salinas becomes president; Siles Salinas deposed in coup by Ovando Candía.
1970	Ovando Candía deposed by General Miranda; Miranda deposed by General Juan José Torres.
1971	Torres rules left-wing radical government; Torres deposed in coup, jointly sponsored by the military party Bolivian Socialist Phalange (FSB) and the MNR.
1971–73	General Hugo Banzer Suarez rules with MNR and FSB support.
1974–78	Banzer presidency under military rule; MNR and FSB withdrawal from government in 1974.
1979	General Juan Pereda becomes president in election marked by accusations of fraud; Pereda deposed by General David Padilla, who calls for 1979 election.
1979	Election results in stalemate (no majority); Senate President Walter Guevara Arze serves as interim president; Guevara deposed by Colonel Natusch Busch; Natusch Busch resigns in 15 days; president of Chamber of Deputies, Lidia Gueiler, becomes interim president.
1980	Electoral stalemate; Gueiler deposed in coup by General Luis Garcia Meza.
1981	Garcia Meza forced to resign in favor of General Bernal; Bernal resigns in favor of General Celso Torrelio.
1982	Torrelio deposed in coup by General Guido Vildoso; Congress reconvenes and names Siles Suazo as president.
1985	Siles Suazo announces early elections; Paz Estenssoro becomes president; new economic policy declared on 29 August 1985.
1989	Paz Zamora of the Movimiento Izquierda Revolucionario (MIR) elected president; governs in coalition with the Acción Democratica Nacionalista (ADN) party led by General Banzer.

for twelve years, winning elections in 1956 and 1960. The military toppled the civilian regime in 1964 and ruled without interruption until 1978. A period of political chaos followed during 1978–82, with a rapid alternation of military and civilian rule. Civilian rule was restored in 1982, with the accession to power of Siles Suazo, and then was continued with the presidency of Dr. Víctor Paz Estenssoro, which began in August 1985.

As in other Latin American nations, intense conflicts over income distribution contributed to a chronic alternation of power between populist and anti-populist politics. In Bolivia, however, this alternation has been particularly sharp. Generally, the military rule was anti-populist and especially anti-labor. There was, however, a brief populist phase of military rule under General Ovando and then General Torres in 1969–71, which coincided with the leftist military government in Peru under Juan Velasco. The civilian governments have all drawn their leaders from the MNR, though these governments have varied widely in their policies, with populist phases during 1952–56 and 1982–85, and conservative phases during 1956–64 and 1985–89.

The leaders of the Revolution of 1952 drew inspiration from the Mexican Revolution and from Mexico's Institutional Revolutionary Party (the PRI) in the formation and policies of the MNR. The experience under the Rosca (the disparaging name given to the pre-Revolution oligarchy) had thoroughly discredited private wealthholders as a class capable of leading national development. The leaders of the Revolution looked to the public sector as an engine of growth that would be more broadly based and equitable. They put in place an economic system which can broadly be called state capitalism, which assigned the bulk of capital formation to the public sector, both for infrastructure and for industrial production in state enterprises. The leading state enterprises were COMIBOL, the national mining company, and YPFB, the state petroleum company.

The whole concept of more equitable growth through a large state sector collapsed in a mass of inconsistencies over the thirty years between the Revolution and the onset of the Bolivian hyperinflation. During the post-Revolution period, leftist leaders were always too weak politically to satisfy their distributional aims. To the extent, for instance, that they aimed to raise public sector salaries or to increase public sector investment and employment, they lacked the capacity to tax income and wealth, which was essential to finance the larger state sector. If necessary, the Bolivian army was prepared to intervene to forestall populist or redistributionist actions, as it did in 1971. For these reasons, leftist or populist leaders have been constantly forced to rely on inflationary finance or foreign aid and foreign borrowing to carry out their distributional and developmental goals. The first high inflation in Bolivia came in the wake of the Revolution, and the second came with the left-wing government of Siles Suazo in 1982.

Leaders on the right, such as Barrientos and Banzer, were not interested to limit the power of the state, but rather to use the state to satisfy their own agenda. While governments on the left sought redistribution through higher wages and a larger role for public sector workers, governments on the right often sought to bolster favored segments of the private sector through generous government subsidies. Governments of the left have generally paid for higher public salaries through printing money (i.e., the inflation tax) or through foreign borrowing, since they have been forestalled from raising taxes. Governments of the right, on the other hand, have rejected higher taxes outright and have instead sought to finance the government through a reduction of public sector wages (often with overt repression of labor) and also through foreign borrowing. Note one common theme of both types of governments: let the foreigners pay!

We now turn to a more detailed look at several key subperiods in Bolivia's political history since the Revolution. In doing so, we use a taxonomy that borrows heavily upon Malloy and Borzutsky (1982) and Malloy and Gamarra (1988).

2.2 The Revolutionary Period, 1952–56

The Revolution of 9 April 1952 that swept the Movimiento Nacionalista Revolucionario (MNR) into power, with Dr. Víctor Paz Estenssoro at the head, brought profound changes to the Bolivian economy and political structure.[1] Four important economic changes should be highlighted: (1) the three largest mining concerns were nationalized; (2) a very broad land reform program was initiated; (3) import substitution and export diversification became official policies; (4) a march to the hitherto underdeveloped eastern lowlands was begun through various government-sponsored colonization projects.[2]

The nationalization of mines was a natural outcome of a process of greater taxation and control of the private mining enterprises that had been underway for decades. Before nationalization, taxation occurred directly but also indirectly, through manipulations of the export exchange rate. With increased taxation and controls, the mining enterprises sought ways, legal and illegal, to evade them. As the government exhausted its taxing power, it was natural for the issue of nationalization to arise.

An occupation of the mines by their workers in 1952 pushed the MNR leadership to undertake the nationalization. The MNR leaders, who were by and large moderate reformers with middle-class roots rather than extreme revolutionaries, thought that government control of the mines, as urged by the miners, was better than workers' controversy. Land reform also went beyond the intentions of most MNR leaders and again was a policy imposed on them by the squatting by landless peasants.

Export diversification, import substitution, and the march to the East were, however, deliberate development policies. Two instruments had an important role in those policies. First, through overtaxation of the mining sector with differential rates of exchange, resources were transferred to the new activities, especially in the East. Second, many public sector investment projects were financed with forced savings, that is, the inflation tax.

A point of some importance about the Revolution should be noted. In spite of the official rhetoric of "anti-imperialism," the government was generally supportive of foreign capital, as long as it was not from the Tin Barons. After 1955, following changes in the legislation governing the petroleum sector, Bolivia received significant amounts of foreign direct investment in petroleum. Substantial American mining interests belonging to W. Grace Co. were never threatened with nationalization. It should also be mentioned that, to the surprise of the neighboring countries, a close cooperation with the United States developed during the revolutionary period.

At the same time that the MNR was undertaking development projects, it tried to satisfy the demand of its support groups for increased consumption. There was a clear inconsistency between these two claims that exacerbated the distributive problems. Malloy and Borzutsky (1982, 46) correctly point out:

> The Bolivian revolution quickly demonstrated some inescapable facts of the reality of the situation of economic backwardness and structural dependency, namely that (a) a relatively backward country cannot follow a simultaneous policy of economic development and popular consumption and (b) any process of restructuring for development demands that some social groups pay the "cost of the new course."

2.3 Stabilization and the Beginnings of State Capitalism, 1957–64

The revolutionary process entered into economic chaos by mid-1956. The period was marked by high inflation rates, foreign exchange rationing, a rapidly rising black-market premium for foreign exchange, shortages of food and other essentials, stagnant output in the mines and in traditional agriculture, and a decline in tin prices following the end of the Korean War boom.

The deteriorating situation clearly required a drastic stabilization program. Such a program was announced on 15 December 1956. The program shares many elements with the one enacted almost thirty years later in August 1985: exchange rate unification, a sharp reduction in public expenditures (around 40 percent in real terms), complete price liberalization and elimination of all subsidies, and a wage freeze after an initial limited rise in compensation. All policies directed toward diversification in production and exports came to a halt with the anti-inflationary package of 1956. A shortage of funds in the public sector and the strictures of an IMF agreement forced a sharp cut in government investment. A planning board for state sector investment was created, but its role was very modest.

The stabilization effort was largely sustained with donations from the United States, using food aid (Public Law 480 funds) and direct budgetary support. The world recession of 1957 and a substantial fall in tin prices in that year made things even more complicated and increased dependency on foreign aid. In exchange for U.S. support, the government of Bolivia committed to resume payments on foreign bonds that had been defaulted on in 1931 (see Ugarteche 1986; Baptista 1985). Notwithstanding the commitment, Bolivia defaulted again on this debt in 1960.

In regard to development policies, the government tried to rehabilitate COMIBOL, the state mining enterprise. The other two principal state enterprises, YPFB (oil) and the Development Corporation of Bolivia (CBF), were at that time relatively well-run enterprises that could stand on their own. COMIBOL, on the other hand, had been left completely decapitalized by the government management during 1952–56 and suffered from many ailments ranging from inadequate machinery to labor indiscipline. In 1961 the Triangular Plan was established with funds from the U.S. government, the newly created Inter-American Development Bank (IDB), and a consortium of West German mining firms. The plan called for extensive mechanization of the mines, the dismissal of several thousand workers, and the elimination of worker control of the activities of COMIBOL. Not surprisingly, the plan met strong labor opposition.

It is interesting to note a significant change in declared export policy in this second phase, compared with the policies immediately after the Revolution. Mining again received high priority, and hopes for export diversification were reduced to the undertakings of the foreign oil companies. Active policies of import substitution were also largely forsaken.

The second phase coincided with the beginning of the Alliance for Progress, a development program for Latin America created by President John Kennedy. The Bolivian government grasped right away the opportunities offered by this new program and became one of the main beneficiaries. The government under took extensive infrastructure investment, financed mostly with Alliance for Progress funds.

By 1964 the remnants of the Revolution, including heightened political mobilization, worker participation in the management of public enterprises, and redistributive policies, had been all but abandoned. By the early 1960s, a form of state capitalism developed, controlled and exploited by various competing groups of the middle classes. As we shall note, the state enterprises became a source of enrichment for these private factions, some civilian and some military.

2.4 The Resurgence of the Private Sector, 1964–65

In 1964 President Paz Estenssoro, who was at the beginning of his third term, was deposed in a coup d'état staged by his vice president, General René Barrientos Ortuno. The coup itself reflects the collapse of unity of the governing MNR, which had ruled since the Revolution. The party had by 1964 splintered into a myriad of factions and personalistic cliques, all organized to extract patronage and other spoils from the Treasury and from the state enterprises. When Paz attempted to maintain power for a third administration, many of the splinter groups of the MNR, which felt deprived of their share of the spoils, coalesced in support of the coup.

General Barrientos continued the big push to modernize the public sector which had begun in Paz's second term (1960–64). Significant effort and money were spent on the public sector, much of it financed by the Alliance for Progress. The domestic private sector, which had played a limited role in the economic developments of the previous twelve years, resurged as a result of two strong impulses. First, fresh investment funds were made available, at subsidized interest rates and with a high grant element, to private producers. A new group of producers formed a nascent entrepreneurial class that began to play an important political role in the late 1970s and early 1980s. The investment funds came mostly from international aid, with IDB and the World Bank being the principal sources. Second, many managers and middle-class professionals who had left the country during the MNR reign returned and engaged themselves in industrial and mining activities. As a result of this surge in public and private activity, economic growth was very high, reaching 6.6 percent during 1965–69.

Foreign direct investment flowed into the mining and petroleum sectors. The expansion of petroleum production and exports was largely due to the investments of the Bolivian Gulf Oil Corporation. Very important natural gas deposits were discovered, and the construction of a gas pipeline to Argentina was started. At the same time, investments made in Santa Cruz, in the eastern portion of the country, during the MNR period (1952–64) started to pay off during the Barrientos era. Commercial agriculture increased in output very significantly. More importantly, economic development meant a larger political influence for an emerging class of Santa Cruz businessmen.

It should be underlined that while foreign borrowing was high during the sixties, investment rates were also very high. Unlike during the 1970s, foreign borrowing indeed translated into higher domestic investment, and without a subsequent debt crisis. The nature of the credit sources in the 1960s might help to explain this fact. Official creditors then were both more careful in screening their loans and more generous in their terms than the banks proved to be in the 1970s.

Bolivia joined the Latin American Free Trade Association (LATFA) in 1966 and in 1969 signed the Cartagena Agreement, which created the economic integration scheme of the Andean Pact (to be discussed in detail in chap. 4). The Bolivian government at that time held considerable expectations of the benefits of this association, expectations that failed to materialize.

2.5 The Populist Interlude of 1969–71

Barrientos was killed in a helicopter crash in April 1969, and the civilian vice president, Luis Adolfo Siles Salinas, assumed the presidency. In September 1969 he was overthrown in a coup led by General Alfredo Ovando Candía, who in turn was overthrown by General Juan José Torres in 1970. Ovando and Torres represented the phenomenon of a left-wing, populist military regime, which mirrored the political developments in Peru at the same time (with the ascension to power of General Juan Velasco).

During the presidency of Ovando Candía, three important economic policy decisions were made: (1) the Bolivian Gulf Oil holdings were nationalized; (2) very costly, and ultimately uneconomical, tin smelters were built; and (3) the very influential Socioeconomic Strategy for National Development (SSND) was prepared. Even today, the reasons for the nationalization of Bolivian Gulf Oil are not very clear, except as a populist measure to garner political support. On the other hand, the construction of the tin smelters was a response to a long-held Bolivian aspiration: the exportation of metallic tin instead of ores. This could indeed have been profitable to the country by saving heavy costs of transportation and charges for processing in foreign smelters, but unfortunately the tin smelters were built very inefficiently.[3] The SSND will be discussed in chapter 3.

2.6 The Banzer Era, 1971–78

A coup d'état in August 1971 installed General Hugo Banzer in the presidency. He was supported in the coup by civilians and members of the military discontent with the left-wing course of the Ovando and Torres regimes and afraid of emerging guerrilla threats.[4] Banzer's supporting civilian force reunited the MNR of former president Paz Estenssoro with the far-right party Bolivian Socialist Phalange (FSB). In a turnaround, not uncommon in Bolivia, some party members of the Marxist-Leninist Party of the Revolutionary Left (PIR) entered government. In the military, commanders of the anti-guerrilla units had acquired the upper hand.

Banzer's government lasted seven years. From the end of 1971 until the first half of 1974, he governed with the political parties mentioned above; thereafter he relied essentially on the military and some technocrats and businessmen.[5] During his administration, Banzer faced strong opposition from organized labor, the leftist parties, and the intellectual elites; but he enjoyed, owing in part to great improvements in the economy, a high degree of popularity among the middle classes, small businessmen, and even in some favored "unions," such as that of the railroad workers. Some peasant organizations also gave support to the regime, though on the whole, the peasant community was not favored by the Banzer regime. The emergent Confederation of Private Enterprises (CEPB) generally supported Banzer's economic policies. Prominent businessmen held the key position of Minister of Finance during most of his term.

It is important to realize that support and opposition to Banzer were established also along regional lines. Santa Cruz and, more generally, the eastern part of the country, constituted his strongest political base. Santa Cruz was not only Banzer's home province, but the region also greatly benefited from his economic policies, including various rent-grabbing opportunities made available by the government.

Economic growth had the highest priority in Banzer's economic policies. Real GDP grew at an average 5.4 percent during his term. But the apparent prosperity had several profound economic weaknesses, a point that was to become painfully evident in the 1980s. First, much of the prosperity in the 1970s was based on a temporary commodity boom and heavy capital inflows. Once the inflows slowed, as was inevitable, the economy faced a sustained period of austerity. Moreover, a persistently overvalued exchange rate during the 1970s prompted investment in the nontradable sectors of the economy and in capital flight, so that there was little basis laid for a more dynamic export sector in the 1980s that would be necessary to service the debts accumulated during the Banzer years.

Second, Banzer pushed growth in part by granting large subsidies to the vested interest groups that supported the regime. Friends of the government, particularly in the military and among the private business community, were frequently favored with property rights over hitherto public lands, with mining concessions, and, most importantly, with highly subsidized credits. The rationale of these policies was that above-normal profits, if saved and reinvested in the country, could be conducive to the desired high rates of growth.

2.7 The Years of Political Instability, 1978–82

There was another profound weakness of the Banzer years: the absence of a legitimate succession. In 1977 and 1978, General Banzer faced growing pressure from the Carter administration for a return to democracy. An election was called, and Banzer's handpicked successor, General Juan Pereda, was named president in an election marked by massive fraud. When the results of the election were challenged, Banzer decided to remain in office, but was quickly ousted by Pereda himself. There ensued a period of intense political instability that brought to power no less than eleven heads of state between 1978 and 1982. There were several stalemated elections, which produced interim civilian presidents, and several coups. Just a listing of the heads of state captures the political instability of the period:

1979: Pereda (military), Padilla (military), Guevara (civilian), Natusch (military), Gueiler (civilian);
1980: Gueiler (civilian), Garcia Meza (military);
1981: Garcia Meza (military), Bernal (military), Torrelio (military);
1982: Torrelio (military), Vildoso (military), Siles Suazo (civilian).

The events of 1979 deserve some notice. After two brief military governments, new elections were held in the summer of 1979. These elections ended in stalemate, with no candidate receiving 50 percent of the popular vote and no candidate being able to command a majority in Congress. Walter Guevara, then president of the Senate, was chosen as interim president. He was quickly overthrown in a violent coup by Colonel Natusch Busch, who in turn was forced to resign shortly after. Another interim president came to power, Lidia Gueiler, who was then president of the Chamber of Deputies. She in turn was overthrown the following year, but not before she had launched a tough, coherent stabilization plan that, alas, did not have time to take effect.

An attempt to elect a president failed in 1980 when the elections again ended in stalemate. At that point, the country reached its political nadir, with General Luis Garcia Meza deposing President Gueiler. The Garcia Meza regime was deeply implicated in the burgeoning cocaine industry in the country and, therefore, never received U.S. diplomatic recognition. The regime was nearly universally condemned for massive corruption and violence and was internationally isolated, except from the Argentinian military government which had helped in the coup and provided some financing, leaving behind debts that haunted Bolivia until the late 1980s.

Capital flight reached new heights in the period, with errors and omissions in the balance of payments of 1980 and 1981 totalling $590 million, or about 10 percent of 1980 GNP, a remarkably high amount that probably understates the full extent of capital flight. The international commercial banks stopped all lending and negotiated an emergency rescheduling agreement in 1980, upon which the regime soon defaulted. The diplomatic isolation also had important financial consequences: the multilateral creditor organizations, including the IMF, the World Bank, and the Inter-American Development Bank, withdrew their support and new lending, leaving the country without any effective access to world capital markets.

Bolivia started in 1980 to build up arrears with the commercial banks, skipping amortization payments. At the same time, the economy was feeling the stress of higher interest rates on the foreign debt. The need to normalize relations with the international commercial banks led to the debt rescheduling agreement of April 1981, but even with debt rescheduling, Bolivia again fell into arrears in 1982.

Short-term Argentinian loans and some swaps provided by Latin American central banks allowed the Garcia Meza government to overcome the most pressing liquidity problems and provided some transitory alleviation of the financial squeeze. The government was also helped by a short-lived export boom in 1980 with important price increases for many nontraditional exports. In addition, Bolivia was able to negotiate better prices on its sales of natural gas to Argentina.

Garcia Meza met enormous difficulties in his exercise of government and faced strong opposition even among members of the military who had conspired with him. His brutal ways alienated him from the business organizations and middle-class constituencies that had originally supported his coup. By mid-1981, it became clear that he had to step down. In August 1981, he resigned to a junta of commanders of the Armed Forces and, after a short interval, was replaced by General Celso Torrelio.

Torrelio's presidency coincided with the onset of the world recession and of the Bolivian economic crisis. Unable to control the economy, he was deposed in favor of General Guido Vildoso in the second half of 1982. Vildoso lasted only a few weeks, but in the meanwhile he prepared a stabilization plan, trying to make it palatable both to the IMF and to the public. Political fatigue owing to the deterioration of the economy and, especially, the instability of the military governments forced him to reconvene the Congress elected in 1980, which, in turn, acting as an electoral college, named the civilian Hernán Siles Suazo as president.

The political chaos between 1978 and the end of 1982 had a paralyzing effect on the economy. The uncertainties that arose from this situation delayed recognition of the external disturbances that the national economy faced and obstructed the process of decisionmaking needed to take appropriate action. Political antagonists attributed the effects of external shocks to their political foes, instead of looking to the true causes. Quite unfortunately for Bolivia, the internal political chaos overlapped with the onset of high world interest rates and world recession during 1980–82. Had opportune action been taken to redress the external imbalances, it is likely that the toll exacted on Bolivia by the world crisis would have been lighter.

Bolivia remained largely isolated from the ongoing discussion in international academic and official circles about the way to cope with the crisis. Some of the macroeconomic mistakes that were made can be attributed to this isolation. The courageous attempt at stabilization of President Lidia Gueiler in November 1979 stands out as an exception. Her stabilization plan contained the following elements: (1) a 20 percent devaluation of the peso; (2) increases in prices of publicly provided goods and services (e.g., a 36 percent rise in gasoline prices, and a 30 percent increase in electricity rates and railroad fares); (3) a reduction in subsidies on imported staples; (4) a reduction of export taxes that had been created in 1972; and (5) strong regulations on dollar-denominated time and savings deposits in the domestic banking system. The package was completed with a small wage increase.

In January 1980 an Extended Fund Facility loan was agreed upon with the IMF for U.S. $66.4 million, and in June of that year a Structural Adjustment Loan was obtained from the World Bank for U.S. $50 million. Both of these programs subsequently fell into abeyance, after the coup which brought Garcia Meza to power. It is worth noting that the agreement with the IMF was reached very rapidly after Gueiler's stabilization plan was announced. This contrasts sharply with what happened in the ensuing years, when negotiations with the Fund would be protracted for several months.

It is difficult to assess the effects of the stabilization plan and the IMF and World Bank loans of those years. The Garcia Meza coup clouded the picture. Had the democratic process continued and the new government followed the economic policies set forth by President Gueiler, results probably would have been better than those observed.

2.8 The Return to Democracy and the Outbreak of Hyperinflation, 1982–85

As in other Latin American countries in the early 1980s, economic deterioration prompted the military to retreat to the barracks. In 1982, Hernán Siles Suazo, who had been the president to preside over the IMF stabilization program of 1957 and who had received the plurality of votes in the stalemated 1980 elections, was called on by a newly reconvened Congress to accept a four-year term of office.

It is important to appreciate the political implications of Siles' accession to power. The new administration represented the first elected government in eighteen years, so that pent-up social and economic aspirations were sure to boil over early in the term. Moreover, Siles represented the left wing of the MNR and governed in a coalition that included the Communist party, the left-wing MIR (Movimiento de Izquierda Revolucionario), and for part of the time, the centrist Christian Democrats. In the early phase of the administration, the union movement gave strong support to the new government, but demanded large real wage increases and other political concessions in return. Ultimately, when successive wage increases did not keep ahead of the accelerating inflation and when various political concessions were not granted, the unions turned sharply against the government. Indeed, labor unrest in 1984 and 1985 killed the final two stabilization attempts of the Siles administration.

It is not unusual for inflation to accelerate sharply upon the accession of leftist governments, particularly if the left has been denied power for many years. The same phenomenon occurred, to a lesser extent, in Bolivia in the 1950s, in Chile under Allende (1970–73), and in Portugal in 1974 after the collapse of the right-wing regime in that year. The price explosion is typically due to a rise in government spending in favor of the new government's key constituencies (e.g., real wage increases for trade union members or increases in social spending) and to the inability of the government to achieve a national consensus on raising taxes to cover such spending (with the right wing blocking tax increases). In the case of Bolivia, though, it was not only that the new government forced through large increases of public spending, but also that it was unable to reduce the huge deficit that it had inherited from earlier governments and was unable to attract noninflationary forms of finance. The coalition members of the Siles government were never able to agree on policies to restrain spending (the

Communists, for example, rejected any kind of policy that implied a drop in public sector employment or real wages), while the government's opponents in the Bolivian Congress opposed all tax reform proposals to stabilize or enlarge the shrinking tax base.

Siles was unable to stop the economic decline, and indeed many of his policies (and sometimes his lack of action) aggravated the situation. The inflation rate jumped in the second quarter of 1984 to hyperinflationary levels. The detailed economic analysis of these events is postponed to chapter 4.

A complete understanding of what precluded the necessary policy adjustments would take us deeply into the Bolivian political system and, therefore, is beyond the scope of this study. An excellent political analysis of the period is available, in any event, in Malloy and Gamarra (1988). A few general points can be raised. First, a key condition for the eventual outbreak of hyperinflation was the cutoff in access to foreign borrowing in 1982: only a credit-constrained government would choose to finance current expenditures with a hyperinflation rather than with more foreign borrowing.

Second, interest group politics were crucial in the process. At a fundamental level, an inflation tax is a highly regressive tax that affects a general and poorly organized part of the population, while cuts in government expenditures or increases in other kinds of taxes often affect better organized or more influential interest groups. Third, many well-connected, rent-seeking individuals made considerable fortunes in the course of the hyperinflation. Anybody with access to official foreign exchange from the Central Bank could become wealthy almost instantly during the period by purchasing cheap dollars at the Central Bank and selling them at a several hundred percent profit in the black market. Similarly, commercial bankers, who took deposits at zero interest rates and lent at high nominal rates, shared in the government's seignorage gains during the hyperinflation. Moreover, the government extended a large number of low interest loans during the period, which effectively became grants as a result of the inflation. Price controls on public sector goods, such as on petroleum and even flour, generated opportunities for lucrative smuggling operations. All of these opportunities for gain from the price distortions provided a natural constituency of powerful individuals who wanted to see the hyperinflation process continue.

Fourth, there was a continuing and sometimes profound misunderstanding of the costs of stabilization. One of the most important checks on the stabilization process was the government's political inability to impose real wage "decreases," however transitory, on the union sector. The unions resisted any cuts in measured real wages as part of a stabilization program, despite the fact that the gains in reducing the inflation tax for the workers could have exceeded any direct real income losses from a reduction in public sector pay. The problem is that real wages are measured as a nominal wage,

W, deflated by a consumer price index, P, that does not include the price (i.e., opportunity cost) of holding money. Thus, while a rise in oil prices that allows the government to eliminate inflationary finance could well leave real wages *net of the inflation tax* higher than under the hyperinflation, the policy will almost surely reduce measured W/P, and therefore would typically be resisted by the unions.

It should also be noted that much of the union movement's opposition to the Siles government's policies was not limited to narrow calculations about short-run movements in real wages, but rather to a broader agenda to push the country to the extreme left. The main union organization, the COB (Central Obrero Boliviana), pursued a strategy of insisting on co-government, with a goal of pushing the left-wing coalition toward a model of state socialism (see Malloy and Gamarra 1988 for an extensive discussion of this point). This was much farther than most of the other coalition partners, and the president, were willing to go. Therefore, after failing to convince the government from the inside, the COB took to active and vocal external opposition.

2.9 Stabilization and the End of the State-Capitalism Model, 1985–88

By November 1984, President Siles admitted defeat in his government's attempts to control inflation, and he called for new elections to be held in July 1985, one year before his term was due to expire. During the last year of the Siles government, inflation reached 24,000 percent (August 1985 compared with August 1984). Former presidents Hugo Banzer and Víctor Paz Estenssoro were the front-runners in the national elections of 1985, but neither of them received a majority of votes. While Banzer had a plurality of votes, Paz Estenssoro was voted in by the newly elected Congress on 4 August 1985, with the support of left-wing representatives who opposed Banzer's attempt to return to power.

Three weeks after Paz's inauguration, on 29 August 1985, the center-right government of Paz Estenssoro unveiled a wide-ranging program, known by its decree number, 21060, which encompassed not only plans for macroeconomic stabilization but also for trade liberalization, administrative and tax reform, and deregulation of domestic markets. The scope of the program is remarkable in that it attempted to address deep and politically sensitive structural issues in the economy at the same time that it battled against the hyperinflation. Hyperinflation was ended shortly after the program was announced. Details of how this was accomplished will be considered in chapter 5.

In the set of structural reforms, announced in the program of 29 August 1985 and implemented during the following year, the most important were: (1) a tax reform that simplified a complicated structure, replacing it with one where valued added and wealth taxes loom large; (2) reform, decentralization, and expenditure cutting in the state enterprises, especially in the mining company COMIBOL; (3) reform in the trade regime, aiming at the elimination of most barriers to international trade and the implementation of a flat tariff schedule; and (4) normalization of Bolivia's access to international financial flows from the official creditor community (i.e., the IMF, the World Bank, the IDB, and bilateral creditors).

The political base for implementing this enormous program was established in a crucial Pact for Democracy signed by Paz's MNR and Banzer's party, Acción Democratica Nacionalista (ADN). This agreement established a congressional majority sufficient to put through the Congress the key features of Supreme Decree 21060. The pact allowed the decree to take effect in the context of democracy, a remarkable accomplishment in view of Bolivia's volatile political institutions and its vulnerable position amongst politically unstable neighbors in the region. With the pact, the Paz government reserved important positions in state enterprises for members of Banzer's ADN party. In addition to the political base of the MNR and ADN, Paz also had strong support in the business community. Several prominent businessmen, some who had been head of the CEPB, were given top Cabinet posts.

The structural reforms did away with the state-capitalism model, with its several variants, that had been followed since the Revolution of 1952. The reforms were carried out with a remarkable smoothness. Of course, there was some bitter opposition, particularly in the labor unions and in the parties of the left, as well as lively criticism in the press, but the changes were peaceful and in the framework of democratic institutions. At no point during Paz's administration was the process of reform imperiled.

3 State Capitalism and the Operation of the Public Sector

This chapter focuses on the strategy of state capitalism as the model of development in Bolivia during 1952–85 and particularly on the role of public finances, public investment spending, and trade policy in that period. We have already stressed that the Bolivian debt crisis in the 1980s, and the economic crisis more generally, can be traced largely to insufficient domestic savings and to a very weak public sector, despite the central role assigned to the public sector in the development strategy.

The main point that we emphasize is that while the government faced large and politically urgent demands for spending—on, for example, the wages of public sector workers, social objectives (e.g., health and edu-