

Discussion of the History of Bolivia

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The chapter on Bolivia by Timothy Kehoe, Gustavo Machicado, and José Peres-Cajías presents an illuminating analysis of Bolivia's economic history since 1960. As the authors tell us, this history is, unfortunately, characterized by extremes. During this time, Bolivia experienced episodes of both dismal economic growth and economic expansions. On the monetary side, it featured episodes of hyperinflation as well as periods during which inflation was moderate. On the fiscal side, Bolivia's government accumulated extreme levels of external debt, with several defaults throughout this period.

The chapter's starting point is that, in order to explain the uneven economic performance of Bolivia, it is necessary to take into account its fiscal and monetary policies, as well as the large accumulation of external public debt by the Bolivian government. Another important point raised by this chapter is that this debt accumulation was not just the result of actions taken by the central government; public enterprises also contributed significantly to the dynamics of the stock of publicly guaranteed debt.

The authors divide the history into several periods. To begin with, Bolivia entered the late 1970s with a significant amount of external public debt (see Figure 1). The global shocks that followed severely limited the financing choices of the government, resulting in a large reduction in GDP per capita, which was accompanied by a major debt crisis as well as a dramatic hyperinflation episode. In the subsequent period, from 1986 to 1998, Bolivia's government implemented several domestic reforms and received significant external help, which allowed the economy to recover. Important elements were a debt renegotiation, an increase in foreign direct investment inflows, and the privatization of several public enterprises. External public debt continued to be an issue, and Bolivia defaulted again in 1995, 1996, and 1997. At the end of this period, Bolivia became part of the Heavily Indebted Poor Countries (HIPC) Initiative by the International Monetary Fund and the World Bank—a debt forgiveness program that ended up significantly reducing Bolivia's external obligations by 2007. During the 2000s, another remarkable feature of the public finances is the large foreign reserve accumulation undertaken by the Central Bank.

The authors focus much of their attention on the behavior of Bolivia's fiscal deficit and the accumulation of external public debt, and they are right to take this approach.

The theory of debt overhang emphasizes that high levels of external public borrowing can lead to subsequent low investments and growth. The dismal performance of Bolivia during the Latin American debt crisis, as well as its recovery afterward, is broadly consistent with this theory, as is the behavior of foreign direct investment (FDI) flows, which did not become significant until after the external debt public stock had been significantly reduced. The theory of debt overhang also provides a justification for Bolivia’s inclusion in the HIPC Initiative: the reduction in external indebtedness could be a source of subsequent economic growth and stability.

In addition to the effects of debt overhang on investment and growth, external public borrowing can have other costs. First, a large accumulation of debt distorts the spending allocation toward the present while shifting its costly repayment toward the future. By allowing the government to borrow in good times rather than bad, access to external borrowing may make government policies procyclical—amplifying rather than mitigating shocks. Finally, high levels of external debt also expose the country’s citizens to the risk of future costly default episodes. Given all these costs, why would the governments of poor countries borrow large amounts externally? Political economy models point out that political turnover may generate myopic decision-making, and as a result, policy makers may borrow too much from the perspective of their citizens. Weak governance and institutions make this problem worse, as external borrowing may be channeled toward low return projects or foreign bank accounts.

In this context, debt reduction initiatives may provide valuable relief. Their effects may be temporary, however, if the political economy problems that led to the high external levels of borrowing in the first place are not permanently resolved. In Bolivia’s case, the

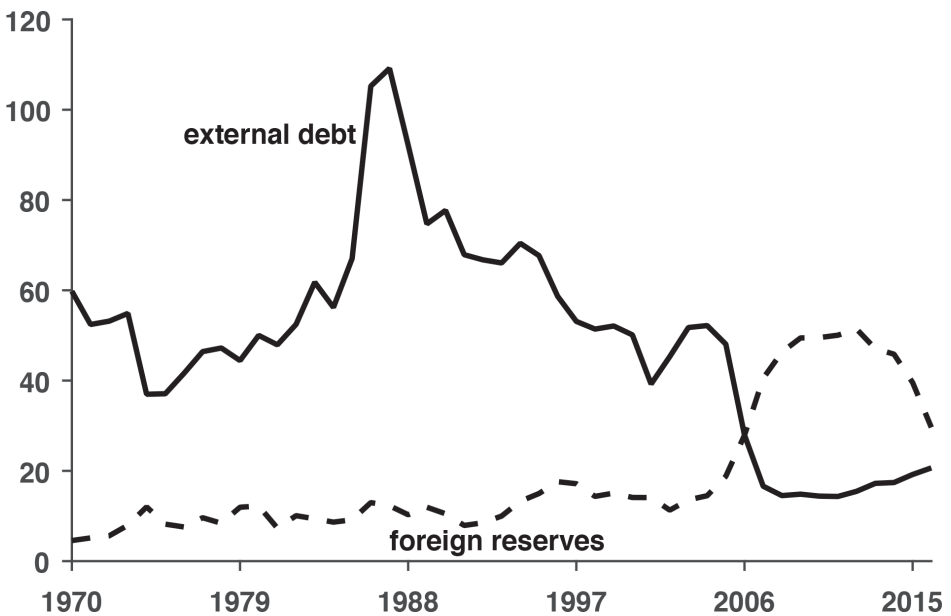


Figure 1. External debt and foreign reserves in Bolivia

Source: World Bank, World Development Indicators

HIPC Initiative appears to have been successful up to 2012. Debt was reduced to levels under 20 percent of GDP. In addition, international reserves were accumulated at a rapid pace, reaching 50 percent of GDP by 2012. But did these facts represent a permanent shift away from debt financing in Bolivia? Or were they just the result of a temporary combination of favorable external conditions, as highlighted in the chapter? One would hope that it is the first that holds true, and that the lessons from past overborrowing have been learned. But the last few years offer a note of caution. Since 2012, Bolivia's government has increased its external borrowing while reducing its international reserves. If the trend continues, the negative effects of external borrowing could again become part of Bolivia's economic history.¹

This chapter contains a comprehensive description and analysis of Bolivia's economic performance and policies. It collects and aggregates data from several sources. And it documents the dynamics and characteristics of Bolivia's external debts (including the several ways in which Bolivia and its creditors tried to manage that debt: through debt renegotiations, buybacks, and forgiveness). As the authors make clear, there is a lot to learn from Bolivia's complex economic history. This chapter provides a much needed and helpful guide.

Note

- 1 This note of caution is further strengthened when we compare Bolivia with other countries that also obtained debt relief within the HIPC Initiative and found themselves facing external debt problems soon afterward. For example, the Republic of Congo also reduced its external debt and accumulated large foreign reserves (reaching 40 percent of GDP in 2010). But soon afterward, with the decrease in oil prices, foreign reserves were reduced (down to 5 percent of GDP), the external public debt was increased, and default occurred once more.