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SM/84/141
Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

July 12, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Bolivia - Staff Report for the 1984 Article IV Consultation

The following correction has been made in SM/84/141 (6/20/84):

Page 9, after second full para.: add "3. External sector policies"

A corrected page is attached.

Att: (1)

Other Distribution:
Department Heads

indicated that it had initially been their intention to renegotiate the arrangement with the labor unions after one year, but that no such negotiations had taken place so far in 1984.

Under the wage formula, general wage increases were granted in March, August, and November 1983, and January 1984. The last two increases were retroactive to the preceding month and exceeded substantially the awards required under the adjustment formula. The application of the wage formula has added significantly to the fiscal deficit and thereby to demand pressures, which resulted in a marked acceleration of inflation. Following a reduction in the monthly rate of inflation from close to 20 percent during the second half of 1982 to less than 8 percent during the first half of 1983, inflation moved up again, reaching 20 percent a month in the second half of 1983. This occurred despite the freezing of certain prices and the introduction of larger subsidies for a number of basic commodities. A further consequence of the application of the wage formula with its provision for equal absolute wage increases above specified salary levels was a significant narrowing of wage differentials. In recognition of the undesirability of a further compression of wage differentials, the authorities began to grant part of wage adjustments in the form of equal relative increments with effect from December 1983.

Price controls currently apply to goods and services which comprise over one half of the cost of living index. However, their effectiveness is questionable since an increasing proportion of products subject to price control is being channeled to the black market. Also, smuggling to neighboring countries has increased, thus giving rise to shortages in Bolivia. The authorities recognized that delays in price and tariff adjustments were an important factor in the misallocation of resources, the irregular spurts of inflation, and the high public sector deficits. Nevertheless, the Government declared an additional 120-day price freeze on five basic commodities in January 1984 in response to demands from labor.

3. External sector policies

In November 1982, when the official exchange market was reunified and comprehensive exchange controls were imposed, the Bolivian authorities had indicated their intention to rely more heavily on exchange rate adjustments to correct balance of payments disequilibria. The exchange rate of the peso was to be altered in accord with external developments and with the relative movement of domestic and foreign prices. However, because of political pressures and the fear that devaluations would trigger demands for large salary adjustments, the rate was not modified until November 1983. This resulted in a real effective appreciation of the peso of more than 130 percent in the official market from November

1982 to November 1983 (Chart 2).1/ On November 21, 1983, the official buying rate was changed from $b 196 per U.S. dollar to $b 500 per U.S. dollar. At the same time the exchange rate in the illegal but tolerated parallel market was around $b 1,600 per U.S. dollar.

The authorities recognized that the long delays between exchange rate adjustments during highly inflationary periods had adverse effects on production and caused distortions in resource allocation. The failure to maintain a realistic level for the peso was a major factor for the weak financial performance of some public enterprises. It also encouraged over- and under-invoicing and unrecorded trade; while private exporters delayed the surrender of export receipts, importers could not obtain foreign exchange from the Central Bank and turned to the parallel market.

The outstanding external public debt at the end of 1983 amounted to about US$3.2 billion, equivalent to 55 percent of GDP (Table 4). After rising at an average annual rate of over 15 percent in 1980 and 1981, the outstanding debt rose by less than 2 percent in 1982. The debt rose by 13 percent in 1983, but this reflected the deferment of scheduled amortization payments and the medium-term conversion of short-term debts of the Central Bank mentioned above. Notwithstanding the accumulation of large payments arrears (described below) and an agreement with a consortium of foreign commercial banks to defer and reschedule payments of about US$475 million falling due in 1980-83, the public sector's debt service remained at about 30 percent of exports of goods and nonfactor services in those years except for 1983 when it rose to 38 percent. Including unpaid debt service obligations, the debt service ratio would have increased from 33 percent in 1979 to 90 percent in 1983. To a large extent, this increase resulted from the decline in export earnings and from substantially higher international interest rates.

During 1982 and early 1983 large external payments arrears were accumulated, including arrears on the debt which had been renegotiated with the foreign banks in 1981. Arrears reached US$180 million by April 1983, and in May 1983 Bolivia agreed with the commercial banks on a schedule for the complete elimination of arrears and for payments of all interest obligations due in 1983.2/ Bolivia broadly complied with the agreed schedule for arrears payments until April 1984.

1/ From November 1983 to March 1984, the real effective appreciation of the peso amounted to approximately 75 percent. In late March 1984, the exchange rate in the parallel market reached $b 3,100 per U.S. dollar compared with $b 500 per U.S. dollar in the official market. On April 13, 1984, the buying rate was moved to $b 2,000 per U.S. dollar (see Section III, below).

2/ For details of the debt renegotiations with foreign commercial banks, see Appendix II in SM/84/100.