



Latin America EconoMonitor

Why Is Bolivia Doing (Relatively) Well?

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Many observers of the Latin American economies are wondering why these vulnerable commodity exporters, including the smaller South American economies, are showing more resilience to the current crisis than economies in other parts of the world. Is it because the crisis just has not hit them hard yet, but will eventually? Or could it be that the Latin American economies are benefiting more than we thought from good policies and adequate financial reserves.

One case in point is Bolivia. Bolivia has navigated the turbulence surprisingly well suffering only some glancing blows, at least so far. The Central Bank of Bolivia attributes this benign outcome to favorable "initial conditions", including a high level of international reserves accumulated during the commodity boom.

Policy choices must also have something to do with the outcome in Bolivia, including management of its crawling peg exchange rate. For all the homage paid to floating exchange rates in Latin America and the consequent fall from grace of fixed exchange rates, Latin economies with inflation targeting frameworks and floating exchange rates are really not coping any better with the crisis than the countries with less fashionable fixed or semi-fixed exchange rate regimes such as Bolivia. (Bolivia's system can be described as an "incomplete crawling peg". Translation: an exchange rate that is fixed, but which undergoes high frequency readjustments which are not pre-announced to the public.)

Some Background on Bolivian Policy

Following the Asian crises of the 1990s and the Argentine devaluation crisis in 2001-02, fixed exchange rates fell distinctly out of favor in Latin America. The trend everywhere was to inflation targeting and floating rates, e.g., in Chile, Colombia, Brazil, and Mexico. Bolivia did not follow the trend in the rest of Latin America, preferring to stick to its exchange rate regime, one that had been in place since 1985.

Bolivia's monetary policy has been based on an exchange rate anchor and, moreover, its financial sector is still highly dollarized making a move to a floating exchange rate a risky proposition, notwithstanding the advice of the IMF. The Bolivian Central Bank has not been rigid in administering the rate, which may explain the longevity of the exchange regime. During the Latin American regional crisis of 1999-2003, for example, the Bank accelerated the rate of crawl (depreciating the currency) which may explain why Bolivia came through that tumultuous period for Latin America relatively unscathed.

Other stylized facts help us to explain why Bolivia seems to be faring relatively well in the current meltdown. During the commodity price boom, Bolivia accumulated an enormous stock of international reserves - 41 percent of GDP in 2008, twice as high as the corresponding level in Brazil. Note, also, that in Bolivia's case the reserve gains came from high trade and current account surpluses with little or no contribution from capital flows. Bolivia clearly was better off for being off the investor radar screen: no foreign resident capital flows to begin with, no risk of sudden stop. Fiscal policy has also played an important role in Bolivia with the public sector generating significant savings, erasing a common source of Latin American demand for financing.

The government is not feeling any type of debt distress as the public external debt to GDP ratio is very low (13 percent in 2008) in the wake of debt cancellations, including the Highly Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI), which benefited Bolivia substantially prior to the crisis. Given the low level of government debt, potential declines in official aid flows now are not going to have a large impact. (Bolivia was receiving only limited flows of official development assistance in any case because of its institutional weaknesses and the lack of a current program with the IMF.)

Fast Forward to the Global Crisis

Bolivia today challenges the common wisdom about the impact of the global crisis on Latin America. The conventional story is that the fall in commodity prices has to produce current account deficits, barring a sharp reduction in domestic demand which does not appear to be taking place in Bolivia. (The numbers for GDP of the fourth quarter 2008 are not available, but coincident indicators do not suggest a strong slowdown in Bolivia, let alone a recession.) In the absence of capital flows, these current account deficits are usually financed by drawing down on international reserves. The consequent depletion of these reserves undermines consumer confidence, delays investment decisions, and touches off capital flight.

But the "facts on the ground" in Bolivia do not match these pre-conceived ideas. Since the collapse in natural gas and other commodity prices, the Central Bank of Bolivia has lost only a fraction of its huge stock of international reserves. (See Figure 1 below.) Just as surprising, perhaps even puzzling, deposits in the Bolivian banking system have continued to grow, a sign that investor confidence in the economy may be holding up despite the populist rhetoric of the Morales administration. (See Figure 2 below.)

Indeed, it would appear that some amount of capital has been flowing *into* Bolivia since the onset of the global crisis, quite possibly in the form of repatriated capital of Bolivian residents. The inflow is boosting the dollar deposits of the commercial banks. [1]

Yes, the trade balance has swung into negative territory, but the small current account deficits which are implicit in the monthly trade data are probably being financed without recourse to the Central Bank reserves. That is why international reserve levels in Bolivia are holding up so well. [2]

We believe that the pre-crisis level of international reserves has created sufficient confidence that this time “it will be different” in Bolivia as the crisis plays out. In a twist on the economic models that predict a run on the reserves well before reserves hit bottom as investors fear being the last out the door, this time Bolivia’s high level of reserves made possible only a very limited loss despite the adverse exogenous shocks. This reinforces in our judgment the argument for “rainy day” funds in the context of the Latin American economies.

The Bolivian Central Bank authorities are also claiming that the boom-era policy of very limited appreciation of the exchange rate adjustments, when almost all the other exchange rates of the region were significantly appreciating against the dollar, positioned the Bolivian currency to be very competitive level now while its neighbors, such as Brazil and Argentina, have seen their currencies depreciate. In this view, the Bolivian experience would also vindicate the merits of a fixed exchange rate and of a policy of small discretionary adjustments. [3] However, the optimism of the Central Bank is not fully justified as some real appreciation, while small, has taken place in recent months. We believe that the pre-crisis level of international reserves has created sufficient confidence that this time “it will be different” in Bolivia as the crisis plays out. In a twist on the economic models that predict a run on the reserves well before reserves hit bottom as investors fear being the last out the door, this time Bolivia’s high level of reserves made possible only a very limited loss despite the adverse exogenous shocks. This reinforces in our judgment the argument for “rainy day” funds in the context of the Latin American economies. If we turn to fiscal policy, it once again seems as though Bolivia should be able to withstand the pressures of the global shock. The collapse in commodity prices has major implications for the government budget as taxes on hydrocarbons, mainly on natural gas exports, have accounted for over 40 percent of the revenues (12 percent of GDP). Yet the Morales government seems confident it can manage the fiscal gap by drawing on its savings or by borrowing in the domestic market.

Conclusions: Resilience in Latin America?

Bolivia’s passage through the global turmoil suggests a more resilient policy framework and more favorable initial conditions than outside observers may have realized. The fixed rate exchange rate system may be unfashionable, but it appears to have contributed to relatively moderate inflation, financial stability, and a very high level of international reserves. Fiscal policy in Bolivia will be affected by the decline in hydrocarbon taxes, but the government has created a cushion of deposits and maintained a virtually spotless record of repaying domestic debt, hence retaining access to internal financing. President Morales’ occasionally fierce rhetoric notwithstanding, Bolivian fiscal policy has remained in his administration quite restrained.

So what lies ahead for Bolivia? The government is betting on a five percent rate of GDP growth for 2009, only slightly lower than the rate for 2008, with internal demand as the main driver. Private analysts, meanwhile, are predicting a sharp contraction as only a matter of time when the full impact of the collapse in natural gas prices works its way through to domestic demand.

Whatever the impact on short-term GDP, our judgment is that Bolivia has some important lessons to teach the emerging world on how to withstand a global financial shock. The new populism in Latin America has many faces, it turns out. Populists such as Morales may be governing with a better sense of budget constraints than others in the hemisphere or the more infamous populists of Latin America’s past. And deliberate policy actions led to a large accumulation of international reserves and stable levels of bank deposits. Enormous problems remain, of course, but Bolivia has some reasons to be optimistic about the medium-term growth outlook. In other words, the particular Bolivian version of Latin American populism may be worth a closer look.

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[1] As Bolivia is highly dollarized, capital movements are not perfectly tracked by the Central Bank, so we cannot say for sure.

[2] Recent current account numbers are not yet available, but we can observe in big declines in the trade balance data and an actual deficit in January 2009. This usually implies that the overall current account has swung into a deficit.

[3] While the possibility to use the crawl is still there the Central Bank has completely stopped adjusting the currency.