1 The Approach of this Book to the Study of External Shocks and Policy Analysis

1.1 Introduction

As explained in the introduction, this book argues that adjustment to external shocks, in a less developed country like Bolivia, crucially depends on the institutional features that determine the macroeconomic functioning of the country, as well as on the socioeconomic structure that determines the direction of adjustment. This chapter analyses how these institutional settings, that are particular to the functioning of the Bolivian economy, have determined macroeconomic adjustment to external shocks in the country over the last two and a half decades.

Section 1.2 briefly discusses the trends followed by the main macroeconomic variables during the 1970s, 1980s and 1990s. Those trends have strongly been determined by the external shocks that the country faced over these two and a half decades. Section 1.3 analyses the interpretations given by different observers of the Bolivian economy regarding the main causes that determined the country weak macroeconomic performance. These observers' interpretations differ with respect to the origin of the high rates of indebtedness and inflation, the low rates of growth and the high levels of poverty the country has exhibited over the long-term. Section 1.4 discusses the general features of the Bolivian economic structure that are crucial to explain macroeconomic events in the country. Section 1.5 puts forward a disaggregated approach to the study of external shock and macroeconomic adjustment. The ways this
approach mitigates the shortcomings of the more traditional neo-classical and structuralist approaches are explained in this section. Finally, section 1.6 puts forward some concluding remarks to this chapter.

1.2 The Bolivian Economy in the 1970s, 1980s and 1990s

There are two characteristics that have distinguished the Bolivian economic performance over the last two and a half decades: the high dependency on foreign capital inflows and the large participation of the government in economic activity. Figures 1.1 and 1.2 show that while the country benefited from positive transfers of foreign resources during the 1970s, the economy grew fast, fuelled by public investment, and inflation was kept low. When transfers of foreign resources became negative during the first half of the 1980s, growth was negative and the country suffered hyperinflation. When Bolivia regained access to foreign finance after the 1985 stabilization program, positive growth was regained and inflation was brought under control.

The large and rapid changes that occurred in the international financial markets during the 1970s, 1980s and 1990s brought about strong external shocks to the Bolivian economy. The country very quickly moved from a period of relatively abundant foreign exchange and external finance availability (during the 1970s) to a period of extremely acute foreign exchange shortage (in the 1980s) and once again started to

\[ \text{Figure 1.1 Net Resource Transfers to Bolivia from the ROW} \]
\[ \text{(Millions of constant 1980 US$)} \]