Ten days to stop a hyperinflation

Bolivia's Decree 21060 and the New Economic Policy, 1985-1990

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ABSTRACT

Bolivia in August 1985 had the world's fastest inflation: prices rose twenty thousand percent in twelve months, the treasury collected one percent of GDP in taxes, and the dollar had become the country's unit of account. Three weeks after taking office, President Victor Paz Estenssoro - the seventy-seven-year-old founder of the party that had nationalized the mines - signed Decree 21060, floating the currency, freezing public wages, raising fuel prices to world levels, and keeping a debt moratorium the IMF disliked. Prices stopped rising within two weeks. Then world tin prices halved, and more than twenty thousand miners lost their jobs; an emergency social fund, created three months after the decree and rebuilt a year later, ran employment projects for them. Growth returned in 1987, but per-capita income kept falling. This case study examines how the decree worked, what it cost, and what Sri Lanka's post-2022 stabilization could conditionally borrow.

WHY THIS CASE FOR SRI LANKA

Sri Lanka knows the early chapters of this story: a government borrowing from its own central bank, subsidies priced for politics rather than costs, revenue eroding faster than budgets can adapt, and an IMF programme signed only after the reserves were gone. Bolivia in 1985 is what the unchecked version of that sequence looks like - and, more usefully, it is among the best-documented cases of how such a spiral can be stopped. Not gradually, and not painlessly: prices steadied as the government's cash constraint became real and public prices were raised to meet it, though economists still debate exactly why the stop was so fast. Sri Lanka's 2022-23 stabilization stopped far earlier on the curve, at roughly seventy percent inflation rather than twenty thousand. The Bolivian case shows both the machinery that works at the extreme and the bill that arrives with it.

THE STARTING POINT: A TREASURY THAT HAD STOPPED COLLECTING

Bolivia's hyperinflation was a fiscal event long before it was a monetary spectacle. After the 1982 return to democracy, the Siles Zuazo government faced the Latin American debt crisis with a broken revenue base and no access to voluntary credit. It financed itself from the central bank, and the central bank financed itself from printing. The mechanics fed themselves through the Olivera-Tanzi effect: because taxes are assessed on yesterday's income but paid tomorrow, accelerating inflation destroys the real value of collections. Treasury revenue, 12 percent of GDP in 1976, fell to 2.8 percent in 1984 and to about 1 percent of GDP in the first quarter of 1985. A state collecting one percent of GDP cannot pay anyone without printing, and printing fed the inflation that destroyed the next month's collections.

Prices rose 20,000 percent in the twelve months to August 1985, and at an annualized 60,000 percent over May-August 1985; by Phillip Cagan's classic definition (50 percent per month) it was the world's only true hyperinflation in thirty-five years. But Jeffrey Sachs, who advised the stabilization, records the detail that made the ending possible: by August 1985 the US dollar, not the peso, already performed two of money's three jobs - unit of account and store of value. Bolivians priced in dollars and saved in dollars; the peso was a hot coin passed hand to hand. Elections in July 1985, called a year early, produced no majority; Congress chose between two former presidents and picked the runner-up, 77-year-old Victor Paz Estenssoro - the man whose party had nationalized the mines in 1952 - for a fourth term.

THE DECISIONS: CLOSE THE CASH GAP, ALL AT ONCE, IN PUBLIC

Three weeks after taking office, on 29 August 1985, Paz signed Decree 21060, the New Economic Policy. Its design rested on a diagnosis: hyperinflations run on the expectation that the state's bills will be printed, so the program had to make that expectation false immediately and visibly. Four elements were explicit. First, the exchange rate was unified and floated, with full convertibility on current and capital accounts - ending the multiple-rate system in which the state bought dollars cheap and sold reality dear. Second, the fiscal deficit was cut on impact: public-sector prices, above all fuel, were raised toward world levels (raising revenue by several percent of GDP within weeks), public wages were frozen, and public investment effectively stopped. Third, a tax overhaul - VAT, patrimony taxes, uniform income taxes - was sent to Congress, enacted in May 1986. Fourth, an IMF standby was negotiated, signed in June 1986, with Paris Club rescheduling to follow.

The fifth element was implicit and, in Sachs's telling, essential: Bolivia kept its complete moratorium on commercial-bank debt service despite active IMF pressure to resume payments. Stabilization had to be financed by the domestic cash balance, not by new obligations. The decree's companion measures - import quotas abolished at once, tariffs unified at a flat 20 percent in August 1986, price controls removed outside public transport and utilities, private wage and hiring restrictions scrapped - were labelled long-run liberalization, but the government believed they also underwrote the stabilization: an open economy disciplines any minister's temptation to print. The central government drew no central-bank credit in the last months of 1985 or at all during 1986. The bill was signed by the founder of Bolivian economic nationalism, which made it harder to caricature as foreign imposition.

THE MACHINERY: A PACT, A POLICE ACTION AND A SEVERANCE SCHEDULE

Passing the decree was a political operation with three moving parts. First, a pact: with no majority, Paz's MNR struck the Pact for Democracy with Banzer's ADN - the party that had outpolled it - trading municipal governments and state-corporation posts for congressional backing of the New Economic Policy and the tax law. The pact held from 1986 through 1988 and gave the program what minority governments usually lack: a legislature that could not claim surprise. Second, confrontation: when unions answered with a general strike, the government temporarily detained dozens of labour leaders and broke the action; historians record little actual violence, but the signal was unmistakable. Third, compensation followed fast and in law rather than in a later communique. Decree 21060 itself carried a baseline 'relocalisation' benefit of three months' salary, or six months paid over six months (Article 56). Three months afterward, on 30 November 1985, Decree 21137 created the Fondo Social de Emergencia - an emergency fund for labour-intensive public works, food programmes and employment projects, financed by UN contributions, compulsory domestic contributions and foreign donations through a special central-bank account - and, for central-administration and teaching staff, raised the severance schedule to twelve months' salary for those out by end-1985, sliding to four months by May 1986. State-enterprise workers, the category the miners would fall into, received their statutory benefits instead. A year later, in November 1986, a further decree rebuilt the fund as an independent agency reporting directly to the president, with a three-year life (1987-89) and a program of roughly fifty to seventy million dollars a year, backed by the World Bank and donors.

The architecture compressed the usual sequence of adjustment: rather than promising protection after the pain, Bolivia legislated an enhanced severance schedule, a payment procedure and a funding account within three months of the decree that caused the pain - and before the mass layoffs the tin crash would bring. The World Bank later devoted a book to the FSE as a template for adjustment-era social funds. None of this made the program gentle: public real wages were frozen at depressed levels, and the price of fuel and food jumped before wages adjusted. It made the program survivable - for the state.

MEASURED OUTCOMES I: PRICES, AND THE STRANGENESS OF DAY TEN

The price data are the case's core exhibit. Inflation ran at 182.8 percent in February 1985 and 56.5 percent in September 1985, the month the decree took effect - yet that average hides the fact that prices stopped rising by 9 September, within two weeks of signature. October 1985 recorded negative 1.9 percent. A relapse followed: a year-end money emission pushed December to 16.8 percent and January 1986 to 33 percent, but it was contained by mid-January, and prices rose just 9 percent between 20 January and 3 November 1986. Through 1987 monthly inflation sat between 0.4 and 2.5 percent; for 1987-90 inflation averaged about 16 percent a year - elevated, but not hyperinflationary, in a country that had just recorded five digits.

Why it stopped so fast is itself the scholarly debate, and the case keeps both readings. Thomas Sargent's canonical account says credible regime change rewrites expectations and prices follow. Sachs's Bolivian amendment is more mechanical: the economy was already dollar-priced, so once the fiscal inflow to the printing press closed - fuel revenues up, wage bill frozen, debt service suspended, no central-bank credit - there was nothing left to reprice. The fiscal side confirms the mechanism: the deficit fell to 3.3 percent of GDP by 1990, tax collection recovered after the 1986 reform, and three Paris Club reschedulings plus a donor-funded buyback retired two-thirds of the commercial debt at eleven cents on the dollar. A 20,000-percent inflation ended months before the IMF standby was signed in June 1986.

MEASURED OUTCOMES II: THE TIN CRASH WAS THE STRESS TEST

Six weeks after the decree, the test arrived from outside. In October 1985 the International Tin Council - the 22-nation body that had propped up tin prices - ran out of money, owing about £900 million; the tin price halved from £8,000 to under £4,000 a tonne, and the London Metal Exchange ended tin trading the following March. For Bolivia, tin was not a commodity but a ministry: the state miner COMIBOL and its smelter carried the public accounts. The government held the program and cut the mine. The World Bank's 1987 project documents put the displaced at 21,000 miners; the company magazine's bitter retrospective says 23,000 "relocalized" - roughly four-fifths of the mining workforce by Britannica's count. The rebuilt fund's first documented programs ran employment projects aimed at the displaced miners and their families, in towns that had one employer.

The macroeconomic record afterward is genuinely mixed, and the case does not smooth it. GDP fell 2.5 percent in 1986, then grew 2.6 percent in 1987 - the first positive year in nearly a decade - and averaged 2.7 percent through 1990, below population growth of 2.8 percent: per-capita income kept falling even in recovery. Exports grew 18 percent a year from 1987 to 1990, but from a collapsed base, and much of the "dynamism" of the informal economy was coca. The stabilization held - that is the core finding. Prices stayed ordinary, the treasury stayed funded, the exchange rate stayed convertible, through a severe terms-of-trade shock arriving six weeks into the program. The Bolivian record suggests a hyperinflation can be stopped durably, at modest foreign-exchange cost, under an elected government - and that stopping it is not the same as prospering.

TRANSFER LIMITS: WHAT BOLIVIA DOES NOT PROVE

First, the ten-day ending is hyperinflation-specific. It worked because prices were already set in dollars; an economy that prices in its own currency - as Sri Lanka does - cannot expect a one-week disinflation, and Bolivia itself took until 1987 to reach ordinary double-digit inflation. Second, the decree's politics are not a template anyone should want to copy whole: a congressional bargain with the runner-up, a pact that swapped patronage for votes, and detained labour leaders sit inside this success story. Third, the social fund softened severance, not structure: in the miners' own magazine's account the mining towns never recovered, the tin-crisis literature tracks migration to coca regions, and per-capita income was still falling in 1990 - the program stopped the bleeding; it did not heal.

Fourth, the external hand was luck as much as design. Donor money financed the debt buyback at eleven cents; the IMF came late and was defied on the moratorium; and the tin crash could have broken the program had it arrived before, not after, prices stabilized - the counterfactual is unknowable. Fifth, the numbers carry their era's fog: miner layoff counts differ between the company's own bitter retrospective (23,000) and encyclopedic estimates (four-fifths of miners), and annual 1985 inflation is quoted across sources within a wide band - this case uses only the monthly series and twelve-month figures its sources print. Finally, liberalization measures rode along with stabilization, so attributing later outcomes to one or the other is impossible from the record alone; the case treats them as a package, which is how the decree sold them.

CONDITIONAL LESSONS FOR SRI LANKA

These are design observations, not prescriptions.

1. The case draws attention to the fiscal inflow alongside the interest rate: Bolivia's prices steadied as fuel prices, wage freezes and the debt moratorium closed the treasury's cash gap - the printing stopped because the reason for printing stopped. Whether Sri Lanka's 2022-23 disinflation followed the same mechanism is a hypothesis to weigh, not a settled finding.

2. Put the compensation in the law, not the communique. Bolivia's enhanced severance schedule and social fund were legislated in November 1985, before the mass layoffs the tin crash brought - a sequencing choice, not an afterthought.

3. Build the coalition before you need it. The Pact for Democracy was cynical and durable: the program's opponents were inside the room, on payroll, defending it.

4. Expect the stress test early. Tin halved six weeks in; stabilization programs should be stress-designed, not stress-surprised.

5. Stabilization is a floor, not a recovery. Bolivia stayed below population growth through 1990; Sri Lanka's debate about what comes after stabilization is exactly the debate Bolivia postponed into the 1990s.

Sri Lanka stopped its own slide at double-digit inflation, an achievement the Bolivian record does not diminish. What Bolivia adds is evidence for a mechanism worth weighing: prices tracked the treasury's cash, compensation was legislated, and a coalition carried the programme through confrontation.

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