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Country Economic Report 2008:6

Bolivia: Integrated Economic Analysis

Foreword

This country economic report explores the main challenges, constraints and opportunities for sustainable pro-poor economic development in Bolivia. Starting from the assumption that improved employment and income opportunities for the poor provide the main avenue for reducing material poverty, the study applies an integrated approach to economic analysis by linking employment analysis with analyses of the business environment and of the macro-economic situation. The main binding constraints on pro-poor growth are found to be a low level of investment, a limited capacity of the Bolivian public institutions to provide an adequate regulatory and institutional framework, and somewhat ambivalent policies for private sector development. The study is a product of a methodological work within Sida aimed at achieving a sharper poverty focus in economic analysis.

The study is part of a series of country studies, undertaken by Sida itself and by various universities and research institutes in collaboration with Sida. This study was conducted by Juan Carlos Aguilar, Javier Comboni, Carlos Romero and Rodolfo Erostegui, all of them related to Strategy Advisors for Government Reform -SAXgr. The main purpose of these studies is to enhance our knowledge and understanding of current economic development and challenges in Sweden's main partner countries for development cooperation. It is also hoped that they will have a broader academic interest and that the collaboration will serve to strengthen the academic resource base in the field of development economics.

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Acronyms

ACOBE	Association for Bolivia Spain Cooperation
AFP	Pension Fund Management Office (Private Pension Fund)
ALBA - ACP	Bolivarian Alternative of the Americas
ANC	National Agrarian Commission
ATPDEA	Andean Trade Promotion and Drug Eradication Act
BCB	Bolivian Central Bank
BDP	Productive Development Bank
BFECA	Seasonally Adjusted Structural Fiscal Balance
CAD	Regional Agrarian Commission
CAN	Community of Andean Nations
CEMLA	Centre for Latin American Monetary Studies
CNRA	National Council for Agrarian Reform
CONADAL	National Commission for Alternative Development
CONAPE	National Council for Economic Policy
COPROCA	Company to promote products of the "Camelus" family animals
DFI	Development Finance International
DIRECO	National Directorate for Agricultural Substitution
EAP	Economically Active Population
EEU	Environmental Economics Unit
EEUU	United States of America
EIC	Economically Inactive Population
FDI	Foreign Direct Investment
FELCN	Special Force against Drug Traffic
FFP	Private Financial Fund
FINRURAL	Financing organisations for Rural Development
FUNDAEMPRESA	Foundation for the Development of Entrepreneurial Initiative
FUNDAPRO	Foundation to Promote Production
FUNDES	Foundation for Sustainable Development
GDP	Gross Domestic Product
GPS	Generalised Preference System
HIPC	Heavily Indebted Poor Countries
IBCE	Bolivian Institute for Foreign Trade

IDB	Inter American Development Bank
IEA	Integrated Economic Analysis
IEHD	Special Hydrocarbons Derivatives Tax
IFC	International Finance Corporation
ILO	International Labour Organisation
IMF	International Monetary Fund
INC	National Institute for Colonisation
INE	National Institute of Statistics
INRA	National Institute for Agrarian Reform
LA	Latin America
NAFIBO	Bolivian National Financing Agency
NBI	Unsatisfied Basic Needs
NGO	Non Governmental Organisation
OCDE	Organisation for Economic Co-operation and Development
ONAMFA	National Organization for the Protection of Minors, Women, and the Family
PEDIPP	Strategic Integral Development Plan for Small Producers
PND	National Development Plan
PNDA	Alternative Development National Plan
PPP	Parity Purchase Power
PRODEL	Programme for the Advancement of Labour Rights
PyME	Small and Medium Enterprise
RA	Agrarian Reform
SBEF	Superintendence of Banks and Financial Institutions
SCAN	General Secretariat of the Community of Andean Nations
SD	Supreme Decree
SENADEPRO	National Productive Development Service
Sida	Swedish International Development Agency
SIN	National Taxes Service
SMN	National Minimum Salary
SNRA	National Office for Agrarian Reform
SPNF	Non-Financial Public Sector
TAN	National Agrarian Tribunal
TCO	Land under Originary Communities Ownership
TCP	Peoples Trade Agreement
TGN	National Treasury
TGP	Global Participation Rate
UDAPE	Economic and Social Policies Analysis Unit
UFV	Unit for the Development of Housing
UN	United Nations
UNDP	United Nations Development Programme
UPC	Productivity and Competitiveness Unit
VIPFE	Vice Ministry for Public Investment and External Finance
VMM	Vice Ministry for Women
WAP	Working Age Population

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Executive Summary

Bolivia experienced several changes in the direction of its economic policies in the course of the past century. At the beginning of the 20th century, the country was a liberal state with an economy heavily concentrated on the mining sector, which by 1952 had introduced important structural changes into society. Those changes run the gamut from a greater participation of the State in the economy to the nationalization of its strategic natural resources. By 1971, Bolivia had espoused state capitalism, which by the mid 80s was in serious disarray. In 1985, with the passing of Supreme Decree 21060, a new political economy was established, one that adopted a more liberal vision and implemented widespread reforms to promote greater efficiency through the participation of the private sector.. In 2006, a new political process furthered changes to the economic model and set-up mechanisms to reclaim control of the economy for the public sector.

This Integrated Economic Analysis (IEA) aims to broaden understanding of the dynamics of the Bolivian economy and society, particularly in relevant areas that determine its capacity to generate pro-poor growth. In this context, the IEA emphasises the generation of employment, macroeconomic framework, and business environment related issues, thus identifying the main constraints to Bolivia's development.

The Development Dynamics

There are both internal and external factors that contribute to the dynamics of Bolivia's development and impact on the economy over time. This section briefly portrays those that appear more relevant to this analysis:

Global Context. In recent years, the tendency towards globalization of the world economy has had sustained growth in international trade, especially in Asia. At the same time, and over the past 25 years, extreme poverty has been reduced from 40% to 21%, while moderate poverty has fallen from 66% to 52%. This reduction in the incidence of poverty has been greater in Asia, marking the course of action for other developing countries, namely to produce manufactured goods for export and to take advantage of this opportunity to reduce poverty.

Demographic Structure and Dynamics. Bolivia has a wide-based population pyramid, with a growth rate likely to fall below 2% in the next 10 years. More than a century of material relative poverty in the rural areas of Bolivia has resulted in a predominantly urban (62%) society, with a continuous flow of internal migration from west to east and with increasingly higher levels of outward oriented migration.

Poverty and income disparities. In 2002, 39.3% of Bolivians lived in extreme poverty, with a higher incidence amongst the indigenous population. The total number of poor people has been on the rise and stands today at around 5.6 million inhabitants. In 2006, the Gini coefficient (income based) was 0.59 at the national level, showing a high concentration of income in the hands of a few Bolivians. The consumption-based coefficient exhibits a lower level of disparity (0.44), but it is still high.

Ethnic groups and inequality. In 2001, almost 50% of the Bolivian population was of indigenous ethnic origin, showing high poverty rates, high levels of illiteracy, low access to health services, and limited employment opportunities. These conditions require the design of public policies that favour inclusion and reduce discrimination.

Gender equality. The population distribution in Bolivia by sex is 50%, a parity that is not reflected in other areas of society. The gender gap is still wide in most social and economic indicators, particularly illiteracy rates, access to health services, and income generation. However, the past 15 years have seen an improvement in this situation, with the acknowledgement of the problem and the implementation of public policy to strengthen women's rights, but there is still much to be done.

Land ownership. The Agrarian Reform (1953) started a process of democratization of access to land, allowing for the redistribution of land to peasants and other rural dwellers, the abolition of the near-slavery conditions in which farm-workers were kept, and the implementation of widespread land colonization programmes. In time, a new process of land ownership concentration was generated in the lower plains in the eastern part of the country. In 1996, the INRA Act was approved to redirect public policy on land tenure and to legalise and protect individual and community ownership of land. A new law approved in 2006 aims to improve and speed up this process.

The political economy of the coca-leaf. The increase of coca-leaf cultivation started in the 70s and reached a peak in 1995. This situation required the implementation of strong eradication strategies, which since 1997 included the concept of Alternative Development that combined tough legislation with new economic opportunities provided to coca-leaf farmers. In spite of the successes and failures of these policies, it is clear that the relative importance of the coca-leaf economy has been significantly reduced since then. From 2006 on, a new strategy has been put in place by the government, one which recovers the cultural significance of the coca-leaf, whilst chastising drug trafficking.

Environment and climate change. Bolivia has been at the forefront of the creation of institutions to promote environmental protection and raise consciousness about the importance of sustainable development for pro-poor growth. An additional component of this already difficult situation is climate change, which in a very short span of time has already had negative effects on agriculture, through droughts and glacier evaporation, and could have important future implications for the exploitation of Bolivia's natural resources.

Dependence on natural resources. Traditionally, Bolivia has had a strong inclination to export non-renewable commodities, a situation that has resulted in a heavy dependence on income generation (taxes) from a few sectors, particularly that of hydrocarbons – which represent nearly 80% of the total tax revenue (2006). The volatility of commodity prices makes government income vulnerable, a situation that should be mitigated by the introduction of revenue protection mechanisms and spending controls.

Economic structure and growth dynamics. The national productive structure has experienced a small increase in industrial activities and basic infrastructure in the past few years. The extractive sectors and agriculture grew faster in stark contrast with all labour intensive sectors, namely mining, manufacturing, and services. This result weighed down efforts directed at generating inclusive economic growth. Average economic growth during the past two decades has been 3.6%, with the export oriented sector as the most dynamic segment.

Employment and productivity. Between 1990 and 2005, the average growth rate for the economically active population (EAP) was 3%, whereas the working age population grew by 3.2%. The economic sectors that are currently generating more employment are agriculture (39%), commerce (19%), and services (14%). They are relatively low productivity sectors.

Market performance. The past 15 years have exhibited a positive tendency in market performance, although there are still some important factors that hinder its development as well as pro-poor growth, most notably the economic and trade union power bases, the inadequate linkages between national markets, the low levels of integration with external markets, the lack of clarity and stability in the 'rules of the game', and distrust of the judiciary.

The legacy of the 90s and the position of the PND. The economic policies implemented from 1985 onwards favoured macroeconomic stability and the development of an entrepreneurial private sector within a framework of limited price distortions, openness to international trade, and the application of initiatives directed at lifting constraints in order to generate higher levels of economic growth. In spite of their many achievements, these policies were unable to generate either inclusive growth or a significant impact on poverty reduction, despite the important progress achieved in the human development index. Quite to the contrary, the perception was that during this period wealth concentration was on the increase. The National Development Plan (PND, for its acronym in Spanish) aims to redress this situation with the implementation of public policies directed at recapturing a major role for the state in running the economy, in a way reminiscent of State capitalism. This approach presents the obvious challenge of returning better results, in terms of pro-poor growth, than those obtained with similar policies during the 1960s and 1970s.

Employment Analysis

Quantitative Analysis. Bolivia's population was estimated in 2007 to be around 10 million inhabitants. The population is relatively young (nearly 57% are under 25 years of age), with a working age population close to 63% and an economically active population in excess of four million people by the year 2010. Capital intensive sectors, which are low employment generators, attracted most of the investment in the country. The scant attention paid to the manufacturing and industrial sectors has had a negative impact on the capacity of the economy to deliver pro-poor growth. In addition, the excessively protectionist nature of Bolivian labour laws does not favour the creation of new jobs in the formal sector, which affects competitiveness of national companies in the medium term. These constraints to the expansion of formal employment are the main cause for the growth of the informal sector of the economy, which currently demands the largest share of workers (60% of the economically active population), the majority of whom are women.

Worker's pay recorded a remarkable increase between 2003 and 2005 (the general index went from 181.1 to 192.2) benefiting more blue-collar workers than managers and administrators, who saw their incomes go down in relative terms. Also of note are the wage differences between workers that are employed by firms that produce and sell in the domestic market and workers that are employed by exporting firms, which on average have higher salaries. The same applies to workers employed in the eastern part of the country, who appear to have lower salaries than their western counterparts.

Skills, access and employment opportunities. The mismatch between the supply of academic training and the demand for qualified personnel is still acute, both in the public and private sectors. The largest excess supply of professionals exists amongst those with training in law and auditing, whereas there is still an unfulfilled demand for professionals trained in production and transformation (engineering). A similar situation is experienced with all technical training. The main access to employment is through sectors of low productivity (agriculture, construction and services – hotels and restaurants), whilst there are few opportunities available for access to high productivity sectors (mining, hydrocarbons, electricity, gas and water).

The Employment Agency created by the Ministry for Employment has only limited coverage, which is one the reasons why landing a job is still difficult and mainly done through personal contacts or political patronage. Women have more difficulties finding jobs and consequently remain unemployed for longer periods.

The legacy of the 90s and the position of the PND. The implementation of a market based and private sector led economic model resulted in a process of productive restructuring which favoured the extractive industries and commercial agriculture, without promoting higher levels of industrialization. During the 90s, new employment was concentrated around the construction, mining, hydrocarbons, commerce, and service sectors to the detriment of the manufacturing sector or other export-oriented sectors. At the same time, the informal sector has experienced considerable growth that had an effect in reducing unemployment, but with activities that have low productivity and generate low levels of income.

The current government has not explicitly outlined an employment generation strategy in the PND, despite suggesting the need to "achieve changes and effective solutions to the problem of unemployment through actions directed at diversifying the economy, multiplying actors and generating conditions for the significant expansion and improvement in employment opportunities". One of the main challenges facing the government in office is to achieve increased levels of employment with better opportunities for stability and inclusion, higher levels of productivity and pay, in addition to sustainability in time.

Macroeconomic Analysis

The external sector. Bolivia has increased its external trade considerably in the past 5 years (25% growth per year on average). Exports of raw materials increased their share of total exports from 46% in 2001 to almost 75% by 2006. Imports, which averaged 10% a year for the past five years, have also been on the increase, although at rates lower than exports,. Bolivia has a marked tendency to export basic non-renewable resources, but a positive trend has emerged in the export of light manufactures in the immediate past, due largely to the effective utilization of trade agreements signed with neighbouring countries and the trade concessions granted by the US to Bolivia through the ATPDEA. It is important to highlight the need for this growth spurt in manufactured exports to continue if unemployment is to be reduced and better opportunities for employment with higher wages for the poor are to be created in the country.

In recent months, the weakness of the American dollar has resulted in an important appreciation of the Boliviano. This situation can derive in a real appreciation of the national currency and in a loss of competitiveness which is likely to hit the most vulnerable groups in society through an increase in the cost of living. The liberalization of the balance of payments generated a noticeable increase in the openness of the economy. However, it also increased the volatility of capital movements.

Finally, foreign direct investment (FDI) was attracted into Bolivia at the end of the 1990s and mainly into the extractive sectors of the economy, particularly the hydrocarbons sector. The net flow of investment has diminished in the past few years due to the uncertainty spawned by the political events that took place in the country. This reduction in FDI has negatively affected opportunities for the generation of quality employment.

The national economy. In 2007, the rate of inflation reached its highest levels in a decade (11.7%) and also broke the one digit score that had characterised the previous ten years. This increase was positively correlated with the growth of the money supply, with its principal component – currency in circulation – growing at annual rates close to 50%. The forthcoming increase in aggregate demand without a commensurate expansion of aggregate supply led to inflationary pressures that have become difficult to contain and that could strengthen a tendency towards a real appreciation of the exchange rate.

The Bolivian economy has exhibited a positive growth trend in the long run, only behind Chile as the best performer in South America during the 20 years leading to 2006. The growth in GDP was marshalled by the export sector and all others with links to it.

The Bolivian financial system is relatively solid, even though it is still highly concentrated on the dollar and characterised by a timid financial penetration. Financial intermediation is carried out mainly in American dollars with a growing segment of transactions being accounted for in Bolivianos. The high liquidity available in the financial system has resulted in historically low rates of real interest on assets. In addition, the growth and prevalence of micro-finance have improved access to credit, increasing the countrywide number of borrowers to nearly 20% of the economically active population.

Fiscal accounts. All fiscal variables are central to the administration of development policy in the long term. Bolivia's public finances have shown a marked improvement as a result of the expansion of the hydrocarbons sector, its prices and taxes. They also show a higher dependence on this particular source of income. This creates a highly vulnerable situation for the country in a potential scenario of falling energy prices. Also, the high growth tendency of government spending could worsen this potentially negative scenario if it is not checked in the future.

The Treasury is also showing signs of stress, which may become a source of macroeconomic instability, generated primarily by the cost of income subsidies introduced by the current administration, namely the "Juancito Pinto" cash payment and the "Renta Dignidad". This issue needs to be viewed in the context of reduced grants and negative concesional financing flows to the Treasury, and the diminished institutional capacity of the Bolivian public sector to negotiate and implement projects financed by international cooperation agencies, prompted by a loss of skilled professionals in this area.

The capacity of the State to generate pro-poor growth. Pro-poor growth can be enhanced by the State's ability to promote public policies that make the provision of public services simpler and more effective, by having a strong social safety net and the institutional framework to trigger a more inclusive and equitable path to development. To motivate these results, the government has to have a proper development mentality as well as the ability to design and implement public policies for pro-poor growth.

The legacy of the 90s, the new position proposed by the PND, and the existing policies. Not all the economic reforms implemented since 1985 have been successful, but it would be unfair to ignore what these policies achieved during this period and the institutional framework that was established, which additionally can be the foundation for further construction: i) renegotiation of the external debt, ii) tax reform, iii) development of a national market for public debt, iv) decentralization of government income and public spending, v) growth of social spending and investment, vi) strengthening of the banking sector regulatory institutions, vii) independence of the central bank, and viii) creation of a sectoral regulatory framework.

The economic proposals of the PND reinforce the role of the State as the most important instrument for the allocation of resources. These policies have increased pro-poor spending in health and to a lesser extent in education, but have specifically been targeted to support the development of micro and small enterprises. However, these types of policies based on transfers from the public sector, which are directed to help lower income groups, are unlikely to be sustainable in the future.

Business Environment Analysis

The business environment defines the existence of advantages or difficulties for entrepreneurs to undertake activities in Bolivia.

The role of national and foreign direct investment. Poor countries, such as Bolivia, have large investment needs and require investment rates of 20% to 25% of GDP per year to achieve economic growth rates in excess of 5% a year. These numbers put in perspective the importance that investment and, particularly foreign investment, have for the Bolivian economy. For this reason, Bolivia should make every effort to lift itself from the bottom of the regional list of countries' attractiveness for investment, and to promote a more favourable business environment.

Factors that influence business climate and the perception of country risk. Factors perceived to be more relevant to the definition of the business environment in Bolivia are the lack of a clear-cut set of "rules of the game", the existence of political and social instability, tax regulation, and the country's economic outlook. Entrepreneurs are also keen to point out other factors, such as the existence and quality of services including basic services, telecommunications, finance, transport, human resources, and road infrastructure.

The "Doing Business" Index of 2007, which classifies 175 economies around the world on the ease of doing business in each country evaluated, ranks Bolivia as 131 with one of the lowest scores amongst all countries in the region. This is particularly so on the most important factor of evaluation which is the complexity of the procedures and the cost for starting-up a business. This conclusion is shared by the relevant offices of the Ministry of Planning and Development, which have outlined a series of proposals to intensify the work undertaken so far in the pursuit of a more conducive business environment and a better perception of Bolivia's country risk.

State support for market access. In the past, Bolivia has signed a number of trade agreements which reduce entry costs and allow exports to compete effectively in external markets. However, and given that Bolivian exports are still heavily reliant on raw materials (mineral ores and hydrocarbons), it appears that the benefits of these trade agreements have not been fully exploited, but for a handful of non-traditional products.

The 2007–2011 Strategic Plan for the Comprehensive Development of Small Producers (PEDIPP for its acronym in Spanish), which is also an important component of the PND, has defined four areas to work on: i) recognition and strengthening of its organisations, ii) education for development, iii) financing, and iv) market access. At present, the government has concentrated most of its action on the design of new mechanisms for financing small productive units, without much thought for the development of new markets.

The nature of enterprises. On December 2006, there were 23.082 registered private enterprises in Bolivia, and around 16.000 had renewed their registration. The vast majority of enterprises (95% of the total) are 'one-person companies' or limited liability companies that operate from the three main cities in Bolivia: La Paz, Cochabamba, and Santa Cruz. In the formal sector, the majority of businesses engage in commercial, real estate, and construction activities.

Advantages of an improved business climate. Given the type of companies that are being set-up in the country, it is paramount that Bolivia addresses the problem of lack of clarity in the "rules of the game" and the strengthening of the country's institutions. The end result of these efforts will attract new investment, generate new employment opportunities and, consequently, increase income levels. These efforts, in addition to lifting the existing restriction to the development of the private sector, are the challenges facing the government in the short run.

The Main Constraints for Development

Structural constraints. The main constraints of a structural nature are: low levels of investment in the economy to generate pro-poor growth; instability in the business climate, which limits opportunities for higher investment in labour intensive sectors with higher productivity; better access to external markets; and the potential to reward its workforce with improved wages. These industries are the most sensitive to the business climate and, hence, it will pay to direct conscious efforts to improve it; little capacity of the Bolivian public sector institutions to manage, develop, and implement public policies that favour economic growth with inclusion and without discrimination.

It is important to add: i) the fragility of the income base of the Treasury, ii) the risks of pro-cyclical policies for employment and productivity, iii) limited access to credit, iv) rigidity of labour laws, v) mismatch between supply and demand for qualified workers, vi) the inefficient functioning of the markets and low capacity for regulation.

Short and medium term constraints. The main constraints in the short to medium run are: inability to negotiate new trade agreements and poor use of existing ones for triggering pro-poor growth; indecision with regard to the generation of public policies to promote the private sector, the micro, small and medium enterprises; and a growing migration, which may determine a loss of qualified human resources.

The PND makes reference to a number of these constraints in its analysis of the Bolivian economic situation without determining operatively what action should be taken to eliminate these constraints. Challenges to the successful implementation of the PND continue to be the absence of specific policies and actions aimed at removing the limitations that hinder higher levels of pro-poor growth, with a stronger emphasis on the generation of productive employment.

Conclusions and Recommendations

Although it is possible for the IEA to help identify the main constraints to pro-poor growth, this analysis also requires a better understanding of the power structures that exist in Bolivia and the political and social arrangements currently in place to find realistic options for the lifting of these constraints and to move towards the desired objectives.

How to support pro-poor growth?

The promotion of pro-poor growth will be best served by supporting efforts that lead to the generation of new, sufficient, sustainable, and productive employment opportunities, which require the following:

- to permanently weigh the costs and benefits of establishing an improved business environment to attract productive investment,
- to focus attention on issues affecting competitiveness of Bolivian businesses through the use of all available instruments provided by international cooperation,
- to evaluate the role of public investment in developing productive infrastructure together with private investment,
- to prioritise technical education and training of human resources in skills required by firms working in the export sector,
- to support the design and development of pro-active strategies for enhanced market access and trade concessions with trade partners and trade blocks,
- to devise and promote public policies that generate incentives for private enterprises to develop productive linkages and specialization,
- to design strategies to strengthen non-traditional export sectors with the resources available from the exports of hydrocarbons and other products from extractive industries.

Which actors to support?

The Ministry of Planning and Development is the relevant public office at the national level with which Sida should start an open dialogue about the constraints to pro-poor growth and the contribution that Sida can provide to help lift them. Dialogue between the Bolivian government and Sida should include issues related to: i) business climate, ii) factors that affect the competitiveness of Bolivian companies, iii) capacity and ability of the public sector to design and implement public policies to support pro-poor growth, iv) strengthening of the public investment system to monitor and evaluate programmes and projects, v) technical education and training, vi) international market access for Bolivian products, and vii) public policies that promote linkages between companies and specialization.

Finally, all work undertaken in the above suggested areas should be accompanied by institutional strengthening projects for the main public institutions that are responsible for the design and implementation of public policies, and the management of the tax payer's money in this area. The aim is to encourage the emergence of a stronger perspective, at the state level, about development and pro-poor growth.

Introduction

Since the 1950s, Bolivia has experienced a series of changes in the direction of its economic policies and its model of accumulation. At the start of the 20th century, economic activity was centred on the extraction and commercialization of unrefined minerals in external markets, a situation that generated few opportunities for a balanced development between the regions of the country and contributed to the creation of a weak state – unable to organize and manage its own development. This state of affairs was not able to sustain itself beyond the 1950s, when political parties with a different viewpoint about the strategy for development were foiled in their quest to gain power via the ballot-box and a violent reaction from the population led to – what is known today as – the national revolution of 1952. The new government introduced drastic measures to reform the State, including the nationalization of the most important private mining companies (then an important source of income and employment in the economy), the political and economic inclusion of the indigenous population, and the construction of a capitalist economy, with a strong role for the State. This particular economic model survived into the 70s, when a military coup d'état, that had the support of left-wing political parties, came to power with the purpose of nationalizing the main foreign-owned oil company operating in Bolivia in a sector that had became important for the economy in the 60s. Successive administrations during this period exercised co-government with the most important urban and rural trade-union organisations, which were given ample powers to define public policy.

This process came to an abrupt end in 1971, when another military *coup d'état* endorsed a return to State capitalism (still heavily dependent on the mining and hydrocarbons sectors, but this time favoured by high international prices for these products), a model of accumulation that lasted up to the early 80s. The return to democracy in 1982 coincided with initiatives to once again involve blue-collar workers and peasants in the running of State affairs. Those sectors had benefited from an erratic public policy directed at improving their incomes, particularly those of the wage-earning workers and public servants. This new arrangement, however, took place against the backdrop of an international financial crisis (with falling international prices for Bolivia's export products and an increase in the share of the national budget used to service a large external debt), which made futile all efforts to increase incomes and led to the reduction of incentives to production, a dramatic fall in the supply of goods and services, food shortages, a spiralling inflation rate and, finally, the resignation of the government in 1985.

The reforms undertaken by the government that was sworn-in in August 1985 are still prevalent in the structure of the Bolivian economy to this day. The New Political Economy, which was introduced with the passing of Supreme Decree 21060, defined fiscal rigour and macroeconomic stability as the main objectives of public policy, and were sustained – in the short run – by initiatives aimed at freeing prices, opening the economy (to mitigate the production crisis) and leaving the allocation of resources to the market.. This formula was applied with varying degrees of efficiency up to 2006, when the new government of President Evo Morales was instated and proceeded to apply public policies in direct opposition to the prevailing economic model.

Changes introduced into the economic model and the new perspectives on development that have been put forward by the present government are still in their first phase of implementation, although there are clear signals that the State will have a greater role in economic decisions and resource allocation. It is not part of the analysis undertaken in this document to explore the political conditions that give rise to the different forms of social organization in Bolivia, but it is difficult not to foresee the importance that this will have in political and economic decisions to be made in the near future. Preliminary results of the deliberations that took place at the centre of the Constituent Assembly (CA) have shown that the new Constitution will incorporate a variety of topics related, amongst other things, to forms of ownership that will be permitted in Bolivia, the areas in which the private sector will be allowed to operate in and those that will be of exclusive access for the State. Land ownership and the operation of private enterprises in the mining and hydrocarbons sectors will be important indicators to estimate the potential future development of the Bolivian economy and the levels of investment that could be raised under those conditions.

It is in this context and with the expectation that the year 2008 will remove uncertainty and build the necessary level of consensus to resolve vital issues for the future of the country, that we present this Integrated Economic Analysis (IEA). The main objective of this document is to contribute to a better understanding of the determinants of pro-poor growth in Bolivia, focusing on three important factors – employment, macroeconomic stability, and the business environment – and the limitations that exist for the development of the country. The paper is organised as follows. Chapter I introduces briefly the evolution of the main variables that explain the performance of the Bolivian economy in time, but also as a snapshot of the current situation. Chapter II presents a detailed analysis of employment in Bolivia, pointing to the factors that determine its structural characteristics and the varying forms that Bolivian society has adopted to employ its skilled and non-skilled workers. Chapter III examines the performance of the key macroeconomic variables, namely the potential of the external sector, the national economy, the influence of fiscal imbalances on the options for development, and the design of macroeconomic policies and institutions for pro-poor growth. Chapter IV sets-out to review the existing conditions to do business in Bolivia and to investigate the preparedness of national firms to encourage investment. Chapter V reviews the main limitations to the future development of the country, underlining the constraints that are particular to the macroeconomic framework and the business climate. Finally, Chapter VI puts forward a number of recommendations for the future work of the Swedish cooperation in Bolivia with a view to helping the country undertake the task of lifting those constraints identified in this document.

1. The Development Dynamics

The following section provides a background reference for the performance of the Bolivian economy in recent years, as well as a depiction of poverty in the country, in an effort to identify the strengths and weaknesses of its development process. This section will also contribute to highlight the main opportunities and challenges facing Bolivia in its quest to achieve pro-poor growth.

1.1 The Global Context

An Integrated Economic Analysis has to be prepared in the context of a wider global picture, inasmuch as all issues raised in relation to Bolivia have a strong connection with the performance of the world economy and the model of insertion of Bolivia into the global economy. For this reason, the process of globalization, with its threats and opportunities, must provide the framework for this analysis.

Globalization of the world economy in the recent past has increased international trade at rates higher than the growth of global GDP. Asia has benefited disproportionately from this process, and the emerging economic powers of the region are increasingly becoming a threat to Latin America (LA) in international trade. In the past 25 years, LA's share of world trade went down from nearly 10% in the early 1980s to 4% in 2006.

On the other hand, world poverty has been falling during the same period. In the past 25 years, extreme poverty fell from 40% to 21% and moderate poverty from 66% to 52% of the world population[1]. It is interesting to note that the largest reduction in poverty rates has taken place in Asia (China, India, Taiwan, Singapore, Vietnam, etc.), where the growth of foreign trade in relation to GDP has also been high. This is a phenomenon which is likely to be explained by the growth of investments in the region, which in 1975 accounted for 45% of all the investments received by developing countries compared to 65% in 2006. The figures for LA are 50% in 1975 to less than a third in 2006.

An important factor that explains LA's loss of its competitive edge, as well as the falling share of international trade and its capacity to attract new investment, is the low levels of productivity of the factors of production in the region. In the 60s, the average productivity of a worker in LA was 2.4 times that of a worker in Asia. Today, the ratio has been inverted

1 World Bank (2005) – "Global Poverty down by Half since 1981"

and a LA worker's average productivity is only 0.75 times that of his Asian counterpart. This decline in average productivity has also been experienced against the US (0.34 against 0.25) and Europe (0.50 against 0.17)[2]. The use of aggregate data hides the fact that the countries that have contributed more to this decline in average productivity are Argentina, Bolivia, Peru and Venezuela[3].

Hence, on the basis of the analysis of the results it appears that openness to international trade, an ability to attract foreign investment, and an increase in labour productivity have been important variables to generate conditions for economic growth and poverty reduction in the recent past.

1.2 The Structure and Dynamics of Population in Bolivia

Demographic theory suggests that societies with a population pyramid that is widest at the centre (which encompasses the population of working age, between 15 and 64) are more likely to experience growing levels of average productivity per worker[4]. In Bolivia, as in the majority of developing countries, the population pyramid is widest at the bottom (population whose age is between 0 and 14), which suggests the existence of a large proportion of the population that is not economically active and is thus dependent. It also suggests a population more oriented to consumption rather than to production.

Population growth in Bolivia went up from 2.25% in 1990 to 2.4% during the period 1995–2000 and down again to 2.25% between 2001 and 2005. Estimates from the national Institute of Statistics (INE, for its acronym in Spanish) suggest that the rate of population growth will continue falling to 2.15% in 2007 and to less than 2% in the next decade. These results show a country in demographic transition likely to experience structural changes in its population composition in the future.

Another important issue in Bolivia's population dynamics is the transformation from an eminently rural society into a predominantly urban one. At the beginning of the 20th century, only 18% of the total population lived in cities. Today, that number is 62% and, if the trend is maintained, by 2010 nearly two-thirds of all Bolivians will live in urban areas. This result suggests a strong and growing pressure to generate urban employment. Urbanization has also brought about changes in the regional distribution of the population in the past 20 years. The western regions of Potosi, Chuquisaca, Oruro, and La Paz have been losing population to migration towards the eastern regions of the country, namely Santa Cruz, Tarija, Cochabamba, Beni, and Pando. Migration is a phenomenon that affects seven out of ten municipalities in Bolivia, a conclusion that should place it high on the national planning agenda[5].

Migration is not only internal, but external. Bolivia is losing human resources to Argentina, which is the preferred destination of young migrants from the rural Altiplano and the high valleys. Unofficial estimates put the migrant population in Argentina at around a million, the vast majority of whom live in and around Buenos Aires producing and selling fruit and vegetables. Another significant proportion works in manufacturing. Brazil and Chile are also countries that have received Bolivian migrants in the past. More recently, migration flows have been directed towards the US, where there are a number of large Bolivian

[2] The Role of the Structural Transformation in Aggregate Productivity". Duarte & Restuccia (2006). University of Toronto.

[3] Ibid.

[4] See "Informe del BID sobre Demografía en América Latina" (2005)

[5] Study about migration patterns in different municipalities of Bolivia, FAM (2007).

settlements (mainly migrants from the rural areas, employed in the construction industry), and Spain, where more than 300,000 Bolivians now live[6]. Most migrants to Spain now come from the urban areas of La Paz and Cochabamba, but increasingly also from Santa Cruz, and have left Bolivia in search of better employment and income opportunities[7].

1.3 Poverty

Extreme poverty (measured as income lower that US$1 a day) affected 39.3% of the population in 2002. According to INE, the highest incidence of poverty (42%) is amongst the population that describes itself as indigenous, whereas the corresponding figure for the non-indigenous population is 24.1%. The situation of extreme poverty, measured by incidence of poverty and prevalence of malnutrition, may have fallen between 2001 and 2004 according to INE estimates[8].

Moderate poverty indicators show a reduction in the incidence of poverty, intensity of poverty, and the poverty gap between 1999 and 2005 (see table 1). However, this contrasts with the absolute increase during this period in the number of poor people, which has grown by more that 500,000 to reach 5.6 million people.

Table 1: Moderate Poverty Indicators by Geographical Area

Indicators	Unit	National		Urban Area		Rural Area	
		1999	2005 (p) (1)	1999	2005 (p) (1)	1999	2005 (p) (1)
Incidence	Percent	63.47	59,63	51,36	48,18	84,00	80,05
Gap	Percent	35.99	33,30	22,19	20,25	59,37	56,58
Intensity	Percent	25.62	23,36	12,75	11,14	47,43	45,16
Poverty Line	Bs. pc/month	293,1	300,4	328,1	336,0	233,6	236,4
Total Population	Persons	8.000.798	9.366.312	5.035.535	5.606.907	2.965.263	3.123.069
Poor Population	Persons	5,078,106	5.584.772	2.593.091	3.392.653	2.418.926	2.483.029

Source: Instituto Nacional de Estadística (2006)
(p): Preliminary (1) All indicators are calculated by income

These same trends, in the reduction of moderate poverty, apply to the urban areas during the period under discussion, but cities are also where the absolute number of urban poor has grown the most. All poverty indicators, including intensity and the poverty gap, performed better in the rural areas over this period. Here, it is important to note that poverty indices measured in terms of income are higher that its equivalent measure of unsatisfied basic needs (NBI), and that since the mid 90s the general tendency is downward[9]. In recent years, Bolivia has been making steady progress towards the objectives of the Millennium Development Goals, although it appears unlikely that all of them will be fulfilled in time.

Another important characteristic of poverty in Bolivia is that poorer people are concentrated in the higher (altitude) regions of the country

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6 A study prepared by ACOBE (Asociación de Cooperación Bolivia España) in 2007 estimates that there are nearly 350.000 Bolivian migrants in Spain.

7 The study of ACOBE finds that 37% of all migrants come from Cochabamba, 23% from La Paz and 18% from Santa Cruz, the three main cities and employment markets in the country.

8 INE, www.ine.gov.bo

9 The Unsatisfied Basic Needs Index measures the proportion of people/homes that have one or more of its basic subsistence needs unmet. The index captures infrastructure conditions and is completed by indicators of economic dependency and schooling.

and that there is a growing poverty gap between the east (lower) and west (higher) regions of the country. A number of studies also show that there is a considerable environmental problem in Bolivia, the result of intensive land use, inappropriate watershed management, deforestation, and industrial pollution. This situation hinders the potential development opportunities for the poor people of the country.

1.4 Income and Wealth Inequality

The Gini coefficient (income based) measured at the national level in 2006 was 0.59, one of the highest in the region and showing a large concentration of income in a small number of Bolivians. The calculation may not be, according to INE (2006), totally reliable as it suffers from distortions and updating issues. In this context, table 2 shows that income inequality is even higher in the rural areas.

Table 2: Gini Coefficient

Geographical Area	1999	2000	2001	2002	2003–2004	2005 (P)	2006 (P)
Bolivia	0.58	0.62	0.59	0.60	n.a.	0.60	0.59
Urban	0.49	0.53	0.53	0.54	n.a.	0.54	0.53
Rural	0.64	0.69	0.64	0.63	n.a.	0.66	0.64

Source: Prepared with information from INE (National Employment Survey November 1997; Household Surveys - Living Conditions Measurement Program, November–December 1999, 2000, 2001, 2002; Household Surveys 2003–2004, 2005 and 2006).

On the other hand, it has been argued recently, based on information compiled in 2005, that the consumption based Gini coefficient is substantially lower than the income based index, at 0.44[10]. Although still high, this result suggests a lower level of inequality among the population in Bolivia and that public policy to reduce poverty should focus more on wealth creation and less on income redistribution.

1.5 Ethnic Groups and Inequality

There are 36 different ethnic groups in Bolivia all of them with different size populations. On the one hand are the Quechua or Aymara people (with more than 4 million inhabitants combined) and, on the other, the Pacahuara people (who are 11). According to the INE, the indigenous population[11] represented more than 50% of the total population of Bolivia in 2001[12]. Potosi has the largest share of indigenous population with 81%. In the lower regions of the country, with the exception of Tarija, the indigenous population is a minority, reaching 22% at it highest in Santa Cruz. The indigenous population is made up predominantly by Quechuas and Aymaras, with the ethnic groups from the low lands accounting for, on average, 15% of the total population of their region.

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[10] In "El País más Desigual". Roberto Laserna - Semanario Pulso No. 438, February 2008

[11] The UN defines as indigenous population those groups that have had historical continuity with pre-colonial societies in predefined territories and who consider themselves different from other groups in society that exist within all or in part of that territory.

[12] The 2001 census of population did not include a category for "mestizos or of mixed race", which resulted in a lot of people that did not consider themselves as of white origin to place themselves under the category of indigenous origin, when historically Bolivia has a rich story of cultural and social mixture.

Table 3: Total Population, Indigenous Population, and Area of Residence (2001)

Department	Total Population			Indigenous Population		
	Total	Urban Area	Rural Area	Total	Urban Area	Rural Area
Chuquisaca	531.522	218.126	313.396	65%	52,7%	73,4%
La Paz	2.350.466	1.552.146	798.320	60%	45,7%	86,8%
Cochabamba	1.455.711	856.409	599.302	69%	52,2%	92,3%
Oruro	391.870	236.110	155.760	61%	45,0%	85,1%
Potosí	709.013	239.083	469.930	81%	56,3%	93,2%
Tarija	391.226	247.736	143.490	18%	17,2%	19,0%
Santa Cruz	2.029.471	1.545.648	483.823	22%	17,9%	35,4%
Beni	362.521	249.152	113.369	14%	9,3%	24,2%
Pando	52.525	20.820	31.705	11%	13,9%	9,9%
Total	**8.274.325**	**5.165.230**	**3.109.095**	**50%**	**36,0%**	**73,2%**

Source: INE, VAI, UNFPA. La Paz, November 2003. Prepared by SAXgr

Poverty indicators by ethnic group show that poverty rates are higher for indigenous populations in relation to non-indigenous populations, both in urban and rural areas (80.4% against 62.2% in rural areas and 58.9% against 42.1% in urban areas). The slight reduction experienced in the incidence of extreme poverty amongst the indigenous population at the national level (50.6% in 1999 compared to 48.8% in 2006) is not reflected in the cities, where indigenous poverty rates were higher in 2006 (31.1%) than in 1991 (30.2%).

Table 4: Poverty Indicators and Inequality by Geographical Area and Ethnic Language Status 1999–2006

Geographic Area and Indicators	1999	2000	2001	2002	2003-04	2005 (P)	2006 (P)
National							
Poverty Incidence (%)	63,5	66,4	63,1	63,3	63,1	60,6	59,9
Indigenous	73,1	76,0	69,4	71,0	70,1	67,9	69,3
Non Indigenous	45,1	54,1	51,9	53,3	49,1	49,7	46,0
Extreme Poverty Incidence (%)	40,7	45,2	38,8	39,5	34,5	38,2	37,7
Indigenous	50,6	56,1	46,0	48,7	42,0	47,4	48,8
Non Indigenous	21,8	31,1	25,9	27,5	19,4	24,2	21,3
Urban Area							
Poverty Incidence (%)	51,4	54,5	54,3	53,9	54,4	51,1	50,3
Indigenous	60,8	62,2	59,1	60,5	61,7	56,2	58,9
Non Indigenous	40,7	48,2	48,2	48,1	43,7	46,0	42,1
Extreme Poverty Incidence (%)	23,5	27,9	26,2	25,7	22,9	24,3	23,4
Indigenous	30,2	34,1	29,3	31,6	29,0	29,4	31,1
Non Indigenous	15,9	22,9	22,2	20,5	14,1	19,4	16,0
Rural Area							
Poverty Incidence (%)	84,0	87,0	77,7	78,8	77,7	77,6	76,5
Indigenous	85,8	89,8	81,4	81,9	80,7	80,8	80,4
Non Indigenous	72,1	78,0	64,1	70,2	66,4	65,5	62,2

Geographic Area and Indicators	1999	2000	2001	2002	2003-04	2005 (P)	2006 (P)
Extreme Poverty Incidence (%)	69,9	75,0	59,7	62,3	53,7	62,9	62,2
Indigenous	71,8	78,3	65,7	66,7	58,3	67,6	67,6
Non Indigenous	57,5	64,3	38,1	50,1	36,4	45,2	42,8

(p) Preliminary. Source: UDAPE (2006)

Illiteracy rates amongst indigenous population (15 years and older) is 19.61%, a rate that is considerable higher than the 13.28% national average. Illiteracy is particularly severe amongst indigenous women, with one in six not being able to read and write (see Annex 1). The indigenous population also has fewer educational opportunities, both in terms of school coverage, continuity, and quality. In 2006, the indigenous population had 3,2 years less schooling (6,9 years) compared to the non-indigenous population (10,1 years). Additionally and in spite of the progress observed in the past decade, school dropout rates remain high, especially amongst indigenous boys and girls. In 2003, three out of ten indigenous children between the ages of 6 and 19 did not attend school.

Health indicators are not much better. Of all the indigenous pregnant women, nearly 49% do not have a health professional in attendance at the time of delivery, compared to 17% for non-indigenous pregnant women. A fraction of this difference may be explained by cultural and religious beliefs, but that type of health care is important for the health of the mother and the new born baby in cases of emergency. Infant mortality is also significantly higher amongst indigenous children. For every 1000 live births, 62 indigenous infants do not live to see their first birthday, compared to half that rate amongst the non-indigenous population. For children under five years of age, the rate goes up to 87 for every 1000 live births for the indigenous population, and to 45 for the non-indigenous population[13]. Public health coverage is low in Bolivia, but it is even lower for the indigenous population.

Finally, unemployment amongst the indigenous population at the national level has remained constant between 1999 and 2006 at a rate of 2.8%. However, data for the urban areas show an increase of 4.7% in 1999 to 5.4% in 2006. The same applies to the rural areas where unemployment amongst the indigenous population rose from 0.3% to 0.7% during the same period (see Annex 2).

1.6 Gender Inequality

The distribution of the population by gender shows 50% parity between men and women, both for current data and future projections (2010). In the urban areas, females account for 51.3% of the population, whereas in the rural areas the opposite appears to be true. In fact, there is a negative trend in the percentage of women that make up the population in the rural areas, falling from 48.49% in 2000 to 47.67% by the year 2010. This latter result may be explained by the higher levels of migration to the urban areas amongst women.

[13] Data from the "4to. Informe de Progreso de los Objetivos de Desarrollo del Milenio" y "Pueblos Indígenas Originarios y Objetivos de Desarrollo del Milenio", UDAPE, 2007.

Table 5: Urban and Rural Population Projections by Sex (2000–2010)

Classifica-tion	2000			2005			2010		
	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total
Men	2.536.031	1.658.164	4.194.195	2.946.725	1.751.568	4.698.293	3.368.385	1.833.589	5.201.974
%	48,69%	51,51%	49,77%	48,66%	51,95%	49,84%	48,66%	52,33%	49,89%
Women	2.672.571	1.561.024	4.233.595	3.108.668	1.620.258	4.728.926	3.553.722	1.670.458	5.224.180
%	51,31%	48,49%	50,23%	51,34%	48,05%	50,16%	51,34%	47,67%	50,11%
Bolivia	**5.208.602**	**3.219.188**	**8.427.790**	**6.055.393**	**3.371.826**	**9.427.219**	**6.922.107**	**3.504.047**	**10.426.154**

Source: UDAPE; Prepared by SAXgr

Parity in the distribution of the population between men and women is not reflected in other areas. For example, illiteracy rates are higher amongst women (19.35%) when compared to men (6.94%). School dropout rates are higher for girls, 43 out of every 100 leave school before completing primary education, than for boys, 38 for every 100[14]. In health care, according to the Health Report 2004, the incidence of exclusion for women is 77% at the national level and 94% in the rural areas. The reasons that may explain this level of discrimination and exclusion are: women's illiteracy rates, poverty, rural population dispersion, and cultural differences and mistrust[15].

Gender inequality is still prevalent in the workplace. Salary levels for men are higher than for women, even when adjusted to reflect the same work (see graph 2: Monthly Salary by Activity). Also women spend on average longer than men looking for employment. Unemployment is higher amongst women and getting worse. In 1996, the rate of female unemployment in the cities was 0.1% higher than that for male unemployment. By 2006, this gap had widened to 1.2%.

In spite of this negative outlook, the situation for women has been improving over time, particularly in the past two decades, due largely to the implementation of public policies directed at improving gender equality. However, political instability experienced in the recent past has had a negative impact on the efficiency of these policies and has, consequently, delayed their results.

In general, the most important results have been obtained in two areas: the open recognition of the differences and the strengthening of women's rights, but little yet with redistributive effect. In other words, there is still a lot to be done in terms of improving women's access to resources, production inputs, credit, and land, amongst many others. This will require a more aggressive set of public policies and more effective actions. Progress made so far is mainly the result of women coming together, organising themselves and pushing for more recognition, protecting their rights, and demanding attention to their own specific needs. It is also important to mention the support provided by international cooperation agencies to this endeavour and the apposite international context, which persuaded Bolivian governments to ratify in 1989 the United Nations International Convention on the Elimination of all forms of Discrimination against Women and to have an active participation in the IV International Conference on Women held in Beijing, China, in 1995[16]. Work undertaken in this area has been translated into a body of legislation and a set of public policies that allow women to uphold their rights and to push for more recognition in Bolivia.

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[14] INE, Censo de Población y Vivienda 2001

[15] "Bolivia: Perfil de Género"; Martha Lanza; 2006.

[16] "Análisis de Equidad de Género en Bolivia: 1992 – 2002"; Viceministerio de la Mujer; 2003.

Table 6: Positive Actions to Eliminate Gender Gaps

Action/Standard	Year	Description
Law 975	1988	Women cannot be dismissed from employment during pregnancy and up to a year after childbirth.
The National Council for Social Policy is created.	1991	Council that formulates the Ten Year Plan for Actions in Favour of Women and Children.
The National Office for Children, Women and the Family (ONAMFA) is created.	1992	Institution that puts forward the National Women's Programme that introduces a change in the concept of intervention from assistance to social investment, with a proposed set of public policies that recognise the important multiplier effect of improving living conditions of women.
The government creates a Secretary of State for Ethnic, Gender and Generational Affairs, with a Viceminister for Gender Issues.	1993	The Viceminister was part of the organisation of the Ministry for Human Development that for the first time introduced into the government's purview the capacity to define public policies to breach gender gaps and incorporate gender as an analytical and operative concept for improvements in human development.
Law 1551 Popular Participation	1994	Promotes the participation of women and children in the design, control, and follow-up of municipal decision-making.
Law 1565 Education Refor	1994	Introduces the concept of gender equity as a guiding principle in education and the design of curricular activities.
Law 1674 against Domestic Violence	1995	Defines and develops mechanisms to prevent and penalise intra-family violence.
Law INRA 1715	1996	Defines gender criteria for the distribution, administration, tenure and use of land in favour of women.
The government created a Viceministry for Gender, Generational and Family Affairs, with a Director for Gender Issues.	1997	Moved to the Ministry of Sustainable Development and Planning.
Law for the Abbreviation of Civil Processes and Family Assistance	1997	Introduced reforms to Family Law that simplified procedures for family assistance and, particularly, common law marriages.
Law 1984 Electoral Reform	1997	Introduced a mandatory quota of 30% of women in the list of candidates up for election to Congress.
Law 2028 of Municipalities	1999	Recognised mechanisms for the supervision of gender equity and the establishment of Integral Legal Services in all municipalities.
Law 3160 Protection of Victims of Crimes against Sexual Freedom	1999	Defined crimes against sexuality and hardens penal sanctions against other types of crime.
Code Law 2026 on Boy, Girl and Adolescent	1999	Established rules for care and protection.
Supreme Decree 26350.	2001	Approved the mandatory enforcement of the National Plan For Gender Equity, National Plan for the Prevention and Eradication of Violence against Women and the Programme for Poverty Reduction amongst Women, 2001–2003.

Action/Standard	Year	Description
The government created a Viceministry for Women	2002	Dependent from the Ministry of Sustainable Development, it is the first time that a government department is created for the exclusive treatment of gender issues, responsible for the design of public policy to allow women to exercise their rights fully, including the economic sphere.
Law to Regulate Paid Household Employment	2003	Regulated the rights and responsibilities of paid domestic workers employed in private house-holds.
Law 2771 Citizens and Indigenous Population Groups	2004	Established the principle of gender parity in the election of candidates in municipal and national elections.

Source: "Bolivia: Perfil de Género" by Martha Lanza, and "Informe de Sistematización sobre la aplicación de la plataforma de Acción de Beijing (1995) y los Resultados del XIII Periodo Extraordinario de Sesiones de la Asamblea General (2000)", CEPAL.
Prepared by SAXgr

1.7 Land Ownership

The Agrarian Reform. Bolivia's Agrarian Reform process was initiated on August 2, 1953 and was implemented as part of the manifesto of the National Revolution of 1952[17]. Its most important results were the redistribution of land to peasants and other rural dwellers, mostly in the Altiplano region and the upper valleys, away from big landowners; the elimination of the conditions of near slavery in which farm-hands were kept; the release of the work force in the rural areas; the legalization of land occupancy by peasants and rural workers; the promotion of colonization programmes towards the lower lands in the east of the country in order to expand the agricultural frontier and to make these regions part of the national economy. This process, which also involved the political intention of eliminating the power and influence of big landowners in the running of the country, was accompanied as well by other measures designed to generate conditions for the construction of a more democratic and egalitarian state, such as the introduction of universal suffrage and educational reform.

In spite of its positive results, the implementation of the Agrarian Reform has had a downside. First, the Altiplano region and the upper valleys have been subjected to a process of endless subdivision of land properties to the extent that most of the remaining holdings are today uneconomic. Second, it promoted the empowerment of agrarian trade unions as representatives of the rural communities to the detriment – and consequent weakening – of the traditional pre-colonial authorities and forms of representation (markas and ayllus). Third, and in spite of efforts made by successive governments during the 70s and 80s to improve agricultural productivity through the provision of cheap credit (the Agricultural Bank of Bolivia), technical assistance (the National Office for Community Development and the Bolivian Institute for Agricultural Technology), and other costly programmes of integrated development, the Agrarian Reform has done little to improve the living standards of rural peasants and dwellers. Finally, the strengthening and consolidation of a national system for the provision of basic foodstuffs at low prices has been achieved by high levels of cross-subsidisation from the rural indigenous-peasant communities to the cities.

[17] The Agrarian Reform was implemented initially with Law Decree 3464, but was later ratified and approved by law on 29 October 1956.

In the 1970s, the implementation of the Agrarian Reform was set aside and the military dictatorships that ruled the country for much of this decade gave way to an arbitrary and cost-free system of land distribution, especially in the eastern lowlands of the country, to encourage support and political loyalty. This system was all but equitable, with 96% of all beneficiaries receiving less than 100 hectares of land and a small proportion of people, around 0.6% of the total received between 2,500 and 50,000 hectares. This process of land distribution was organised without a proper system of registration, a situation that made the definition of property rights difficult and troublesome. Another negative side effect of this process has been the degradation of land and other natural resources.

It has been estimated that of the 110 million hectares that constitute the area of the country, 72 million are not suitable for agricultural production or farming, 32 million are in the hands of 40,000 firms (medium and large) and only 6 million are owned by 550,000 families of peasants and rural dwellers. In other words, 90% of all land owners are in possession of 11% of all arable land, while the remaining 10% owns 89% of all arable land in Bolivia[18].

During the first period of implementation of the Agrarian Reform, its application was the responsibility of two important government institutions: i) the National Office for Agrarian Reform (SNRA) and ii) the National Council for the Agrarian Reform (CNRA), later to be replaced by the National Institute for Colonization (INC,1965). The mandate of the first was to redistribute land and legalise its ownership, whereas the second had to promote colonization through the awarding of new land. This arrangement was not efficient and, in time, it became corrupt. So, in 1996, both these organisations were replaced when a new INRA law was passed by Congress.

The INRA law. The INRA law, passed in October 1996, created the National Institute for Agrarian Reform (INRA, for its acronym in Spanish) with a mandate to solve the following problems:

- lack of clarity in all legal aspects of land ownership registration,
- deficient provision of land to the indigenous people in the west of the country with the creation of a mechanism for communal ownership of land (TCO),
- land accumulation by individual owners, land speculation,
- non-productive land use (land ownership is required to fulfill an economic or social function),
- frailty of the existing institutional setup (with the introduction of a new institutional framework, the separation of regulatory controls – judicial and administrative – and the invitation to civil society to participate in the control of all institutions in an effort to establish minimum levels of transparency for all procedures).

The INRA law had a timeframe of 10 years, a period which was deemed sufficient to address all problems related to the legalisation of property rights to productive land in the rural areas[19]. After ten years the results are poor. Only 11% of all arable land has been registered and legalised,

[18] Sandoval G. Organizaciones de base y desarrollo local en Bolivia estudio en los municipios de Tiahuanaco, Mizque, Villa Serrano y Charagua. The World Bank Social Development Family Environmentally and Socially Sustainable Development Network. New York, 1998, p. 20.

[19] The INRA law recognises three forms of land ownership legalisation processes: simple (SAN-SIM), integrated to the legal registry of property (CAT-SAN) and communal (SAN-TCO).

18% is in the registry process, 15% is in the legalisation process and 57% is yet to be dealt with[20].

The application of the INRA Law has had some positive outcomes. First, it reduced the process of accumulation of massive extensions of land in individual hands, improved the administration of land as a factor of production, stopped the arbitrary process of land grants, established a public tendering system to obtain land concessions, and defined clear procedures for the expropriation of land. These are important achievements for a country that, until not long ago, was awarding huge tracks of land to individuals. In this vein, perhaps, its most important achievement, has been the legalisation of the ownership of communal lands for some indigenous populations, in line with de 169th United Nations Convention.

The cost of this process in relation to its results has been one of the most important drawbacks of the application of the INRA law, inasmuch as it has left the issue of the equitable distribution of land still unresolved. This situation has allowed for the existence of large tracts of unproductive or unused land still in the hands of a few landowners, who refuse expropriation and the redistribution of land. It is a well known fact that only a fraction of the land in the ownership of medium and large businesses is assigned to the use designated by law. A second problem – which is a critique from a more liberal perspective – is that the INRA law has reduced the scope for the creation of a land market, by establishing communal property of land and defining that all small rural holdings cannot be sequestered. This situation, in their view, is hindering the development of traditional agriculture, providing incentives for an inefficient use of resources, promoting the expansion of the agricultural frontier without due regard to environmental consideration, especially with regard to the degradation of forests. Also, the registration of land property in favour of small producers will not be of major economic significance as they will not be able to sell, rent or mortgage their property and, hence, put it to its most beneficial use. Such a view, obviously, puts individual rights over communal rights, which has been a long-held demand by the indigenous population. The limited impact generated by the INRA law has been one of the causes for the growing conflict in the agrarian sector since the year 2000, a situation that was aggravated in 2006, when the social demands for solutions to the problem of land accumulation became overwhelming.

A new beginning for the Agrarian Reform. As part of the strategy to implement the PND, on October 28, 2006, the government of President Morales approved a law that renovates the Agrarian Reform process, but this time from a more indigenous and communitarian perspective. The new law aims to correct mistakes and to speed-up the process of legalisation and registration of land that was started with the INRA law, introducing – to this effect – special new mechanisms to complement the existing ones, namely "legalisation without bureaucracy" and "legalisation by traditional mechanisms of conflict resolution" [21]. Other important changes are:

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[20] Rojas, Juan Carlos. Estado del Proceso de Saneamiento a 10 Años de vigencia de la Ley 1715. 18/10/1996–18/10/2006. Dirección Nacional del INRA. La Paz, 17 October 2006.

[21] The mechanism of "legalisation without bureaucracy" applies to properties that have already been legalised, are in the process of being legalised, or belong to the territory of indigenous or peasant communities. These properties can be registered with immediate effect as long as this does not affect the legitimate rights of a third party. On the other hand, the mechanism of "legalisation by traditional mechanisms of conflict resolution" purports to provide a way towards registration of land by allowing all involved parties to agree on the boundaries of the specific holding using their traditional forms of conflict resolution. This agreement would be binding for the authorities in charge of legalising and registering the property.

- the introduction of new actors to the National Agrarian Commission (NAC) and the relevant Regional Agrarian Commission (CAD) in order to promote better understanding and to look for consensus in the design of public policies for the redistribution of land,
- the reduction of the time allowed for legalisation and registration to take place and for the presentation of a legal challenge to the decisions undertaken by the relevant authorities in this process,
- the expropriation of land if it does not fulfill an economic or social function, and its redistribution to indigenous communities,
- the requirement to evaluate the economic and social function condition every two years.

The contents of this law pit two strong viewpoints about land and land ownership in the country against each other. On the one hand, there are those who think that the current legal framework for land ownership holds back agricultural development and other productive ventures. On the other, there are those who believe in the importance of favouring communal ownership of land to promote more equitable development and to limit the opportunities for land accumulation.

1.8 Coca-leaf and National Public Policies

Historical data shows a sustained increase in the harvest area and the production of coca during the 1970s and the beginning of the 1980s, doubling-up every five years, until 1995 when it reached 50,000 hectares (2.69% of arable land) and 105.156 metric tonnes (1.34% of all agricultural production). From 1995 on, the data shows a clear reduction in the harvest area with a trough in 2000 at 14.000 hectares. Since then and up to 2004, there has been a steady rise, both in harvest area and production, which is explained by the slow-down in eradication activities in the Chapare region and the fall in the international price for coffee[22]. Additionally, the infighting and instability that has dominated the political arena since 2003 made it very difficult to apply continuous and structured public policies in relation to coca-leaf production.

[22] Agricultural Analysis Documents (1990 – 2004). UDAPE.

Table 7: Area, Production, Agricultural, and Coca Yields (1965–2006)

Year	Agricultural Sector			Coca			
	Area	Yield	Production	Area	Yield	Production	Price
	Has	Mt/has	Mt	Has	Mt/has	Mt	Bs X 100 Pounds Load
1965	n.a.	n.a.	n.a.	3.277	1,52	4.976	n.a.
1970	n.a.	n.a.	n.a.	4.450	1,91	8.480	n.a.
1975	n.a.	n.a.	n.a.	11.285	2,39	26.961	n.a.
1980	1.175.145	5,07	5.960.455	22.780	2,13	48.579	n.a.
1985	1.471.962	4,43	6.517.577	44.286	2,41	106.772	n.a.
1990	1.386.337	4,79	6.639.114	47.645	2,45	116.605	n.a.
1995	1.833.217	4,29	7.870.737	49.274	2,13	105.156	310
2000	2.154.025	4,61	9.923.703	14.600	n.a.	n.a.	1.595
2003	2.153.046	5,52	11.877.348	23.600	1,65	39.000	1.863
2004	2.493.974	4,72	11.760.443	27.700	1,77	49.000	1.857
2005	2.646.173	4,67	12.354.808	25.400	1,69	43.000	1.507
2006	2.747.235	4,43	12.167.320	27.500	1,73	47.700	1.566

Source: Agricultural Sector: UDAPE; Coca: Data for 1965–1995: "La Economía de la Coca"; Fernando Rojas Farfán; Data for 2000–2006: "Bolivia: Monitoreo de Cultivos de Coca " 2004, 2005 and 2006 editions, United Nations Office for Drugs and Crime; Price: INE.
Prepared by SAXgr

In the early 80s, the weight that coca-leaf production had on the economy became apparent. Available estimates suggest that in 1985 coca-leaf production was equivalent to 12.5% of agricultural GDP and 2.42% of total GDP. The growing trend starts to decline from 1990 onwards, when coca-leaf production accounted for 8.23% of agricultural GDP, and slows by 2006, when it registers a contribution of 3.74% to agricultural GDP and only 0.41% to total GDP.

Table 8: Gross Domestic Product and Coca 1980–2006 (Thousands of Bolivianos)

Sector/ year	1980	1985	1990	1995	2000	2003	2004(P)	2005 (P)	2006 (P)
Total Gdp	111.259	2.366.158	15.443.136	32.235.073	51.928.492	61.904.449	69.626.113	76.153.767	89.428.309
A. Gdp Industries	86.031	1.992.511	12.610.760	24.784.540	38.774.429	5.907.011	62.278.471	64.509.413	72.658.262
1. Gdp Agriculture & Forestry	18.857	449.940	2.371.077	4.789.906	6.732.951	8.312.057	9.275.858	8.872.240	9.776.874
– Coca	1.774	57.150	195.108	297.286	411.745	408.236	436.916	357.850	365.571
Coca% Gdp Agriculture	9,41%	12,70%	8,23%	6,21%	6,12%	4,91%	4,71%	4,03%	3,74%
Coca % Total Gdp	1,59%	2,42%	1,26%	0,92%	0,79%	0,66%	0,63%	0,47%	0,41%

(p) Preliminary
Source: UDAPE; Prepared by SAXgr

The slow-down in coca-leaf production can be explained by the implementation of the 1008 law in 1988, which distinguishes between traditional coca-growing regions from areas of excess production, where coca plantations should gradually be eliminated. The application of the law was not without difficulties and generated a number of stop-go type interventions, which explain why from 1990 to 1995 there was not a significant reduction in coca-leaf production and, instead, statistics show it to be a period with the highest peaks for harvested area of coca.

The evolution of public policies. In the 1970s and early 1980s the military dictatorships, some of them with evident links to drug-trafficking, did little to prevent the increase in coca production. The first few experiences of 'alternative development' started in 1984 in the subtropical regions of La Paz and Cochabamba, with projects that failed to contain the growing trend in coca-leaf production[23]. The implementation of a new economic model in 1985, with the passing of SD 21060, and the collapse of the international prices for tin, in 1986, left 23,000 miners out of work. These people, with few alternative income or employment opportunities, started to migrate to the coca-growing regions and to try their hands at coca-leaf production.

The noticeable increase in coca harvests and coca-leaf production forced the government of the time to initiate a strict programme to control coca production and fight drug-trafficking, with the specific objective of "eliminating the country's economic dependence on coca production by the end of the 1980s". From 1987, there was a change of direction in public policy with the introduction of Alternative Development, a policy concept aimed at building consensus for coca eradication through the use of incentives to coca farmers to switch to the production of other crops. Together with the introduction of Alternative Development, the Bolivian government designed a strategy to improve international perception about the coca-leaf highlighting its cultural and traditional uses[24]. A three-pronged plan was also drawn to fight illicit drug-trafficking, based on: i) prevention and rehabilitation from drug abuse, ii) prohibition of drug trafficking, and iii) alternative development for the regions with excess coca production[25]. A multi-actor council, called the National Commission for Alternative Development (CONADAL), was created for the purpose of assisting in the process of coca substitution and charged with the responsibility of implementing the policy of Alternative Development[26]. In 1988, through the approval of the 1008 law – Coca Regime and Controlled Substances – the production, distribution and commercialization of the coca-leaf were regulated. It established sanctions and judicial procedures for illicit-drug related offences and classified Bolivia's territory in three categories according to coca-leaf production: regions of traditional production, ii) regions of transitory excess production, and iii) regions with illegal production.

In 1989, the government of President Paz Zamora initiated an offensive against the coca-leaf's negative international perception by declaring that "coca is not cocaine". This offensive, later known as "coca diplo-

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23 Ybarnegaray 1993, in "La Economía de la Coca"; Rojas Farfán, Fernando; February 2002.

24 In the 1961 United Nation's Single Convention on Narcotic Drugs (modified in 1972), the coca-leaf is classified as a drug and is included in the list of controlled substances.

25 "La Economía de la Coca"; Rojas Farfán, Fernando; February 2002.

26 In 1973, the Bolivian government put in operation its first institution in charge of fighting illegal drug-trafficking, known as National Office for Dangerous Controlled Substances, which in 1981 became the National Council for the fight against Illegal Drug Trafficking. In 1987, a new Council for the inappropriate use of drugs and Drug trafficking is created, together with a specialised unit within the Bolivian police force, known as the Special Force for the Fight against Drug Trafficking (FELCN, for its acronym in Spanish).

macy", was part of the new National Strategy against Drug Trafficking that was implemented in 1990, structured around two basic concepts: i) individual monetary compensation to coca-farmers for hectare of coca eradicated and ii) alternative development, but this time with an emphasis on markets access for the alternative crops[27]. This strategy was short-lived and was replaced in 1994 by the National Strategy for Alternative Development, submitted to the consultative group meeting and quickly baptised as the "zero coca option". This new strategy recommends different actions and interventions for the following three areas, conceptually identified as: i) regions with coca production, ii) poor regions that eject population, and iii) regions with potential for new development. In 1998, with the change in government, a new strategy was put in place, this time built around the concept of the need for Bolivia to recover its self-esteem and dignity in the fight against illicit drug-trafficking. The "Dignity Plan" modified the mechanism of monetary compensation for hectare eradicated – applied until 1997 – from individual compensation to communal compensation and assigned the responsibility for the implementation of the strategy to the National Office for Agricultural Substitution (DIRECO, for its acronym in Spanish). This decision generated an immediate reaction in the coca-growing regions, particularly Chapare, where conflict and violence ensued. The increased level of confrontation had a negative effect on the economy, already battered by the international crisis that hit Bolivia in 1999.

In 2003, a new government – under pressure from all sectors of society, but particularly from coca-farmers – abandoned the policy for total eradication of coca-leaf production in the regions of excess production and allowed producers to keep a plot of land with coca plants the size of a "cato" [28]. This decision was accompanied by the introduction of the National Plan for Alternative Development, which defined the need to work in four different but complementary tasks: i) economic development, ii) social development, iii) natural resource management and iv) institutional development. The execution of the plan was severely limited by the political instability that surrounded the period after 2003.

In 2006, the government of President Morales approved the National Strategy for the Fight against Illicit Drug-Trafficking and the Revalorization of the Coca-Leaf, which according to its own definition aims to be effective, sustainable, and based on social participation and respect for human rights. The implementation of this strategy has been haphazard, inasmuch as it has not been possible yet to eliminate the penal sanction hanging over coca-leaf production in the Vienna Convention of 1988.

1.9 The Environment and Climate Change

A number of factors related to the use and conservation of natural resources have the potential to affect environmental quality in Bolivia, and thus, the conditions for sustainable development and pro-poor growth. The rapid destruction of natural resources (deforestation, land erosion and water pollution), combined with the lack of adequate investment in resource management and shrinking institutional capacity, is giving way to a significant loss of physical assets that is certain to affect the country's development opportunities.

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[27] The Cartagena Declaration, signed in February 1990, points-out the need to open new markets for all products as an alternative to the coca-leaf.

[28] The "cato" is a quarter of an hectare. The "cato" for each coca-farmer had been a strong demand from the Chapare region since the 90s, when the concept of the coca zero option had been introduced.

Since the 1990s, Bolivia has undertaken important actions to create institutional capacity and develop the legal framework to effectively manage natural resources and care for a sustainable environment. These actions have also been adequately funded and, consequently, the environment has been high on the public policy agenda for much of the past two decades.

It is not intended, in this section, to expand on this situation or to summarise the main challenges facing the country in this area, given that a parallel study has been commissioned to elaborate on the limitations that the environmental question poses for Bolivia's development[29]. Hence, this document only aims to describe some of the more relevant issues that are required for the analysis of other subjects in the following chapters, particularly those related to climate change and its present and future impact on the environment and the state of Bolivia's natural resources.

Climate change, understood as a phenomenon that stems from global warming, is a problem that currently affects both developed and developing countries and that in the past few years has been particularly hard on Bolivia[30]. According to Nicholas Stern[31], the majority of countries in Latin America, including Bolivia, will suffer from changes in climate that will affect agriculture through droughts, the product of the melting of most glaciers in the region and the consequent considerable reduction in the water supply[32]. It has been estimated too, that Bolivia will also be the victim of increased levels of rain and storms and that this will carry with it a higher incidence of disease and epidemics. All the prevailing ecosystems will have enormous difficulties in dealing with these climate changes [33].

A study prepared by the National Programme on Climate Change in Bolivia suggests that this phenomenon will have the following consequences for the country:

[29] Bolivia Environmental Policy Brief: Environmental Sustainability, Poverty and the National Development Plan, Daniel Slunge y Rossmary Jaldin, Environmental Economics Unit (EEU), Department of Economics, Göteborg University. Junio 2007

[30] The international scientific community agrees that the main cause of climate change in the world is the emission of greenhouse gases that are the product of human activity.

[31] Author of the study: "The Economics of Climate Change", commissioned by the government of the UK in 1996.

[32] The Human Development Report 2007-2008, published by UNPD, points to the fact that in 1975 Bolivia had glaciers in an area of 562 Km2 that had been reduced to 396 Km2 by 2006. This report is in agreement with the study commissioned by the Office of the Community of Andean Nations (CAN) which shows that in 1940 the Chacaltaya glacier in Bolivia covered 223 Km2 and in 2001only 48 Km2, which is a loss of 78% of its previous area. In 2005, it had snow only in three areas and is expected that it will have disappeared by 2010.

[33] Interview with Stern, published in La Prensa, 21 October 2007.

Table 9: Estimated Climate Change Impacts by Region

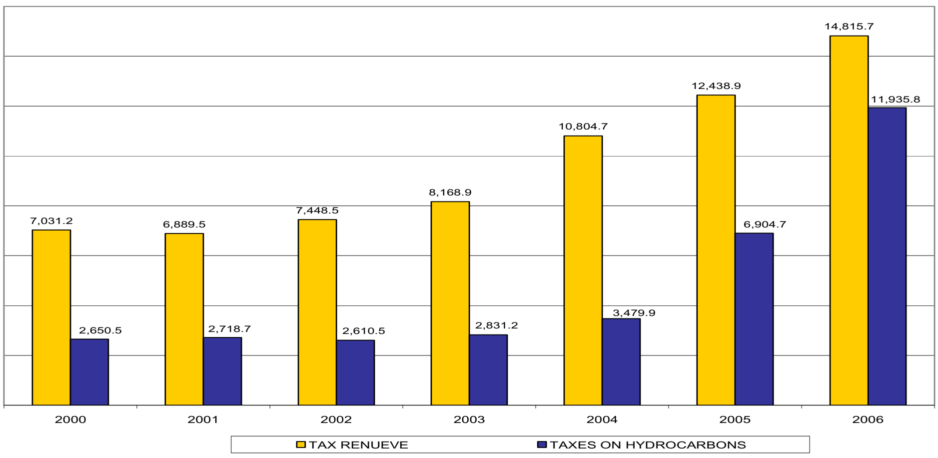
Region	Impact expect
Altiplano (Highlands)	• Increased concentration of rains • Increased frequency of storms with a lower number of days with rain. • Increased frequency of hail. Reductions in the rivers flows.
Interandean Valleys	• Increased concentration of rains. • Increased frequency of storms with a lower number of days with rain. • Increased frequency of hail
Chaco	• Reduction of the number of days with rain. • Increased periods without rain during the harvest seasons. • Recurrent and intense droughts. • Reduced flows in rivers.
(Flat) Plains and Amazon	• Increase in the amount of rainfall received by event. • Increased rate of clouds. • High humidity in the summer and heavy droughts in winter

Source: Arana, Iván and others; "El Cambio Climático en Bolivia (Análisis, síntesis de impactos y adaptación)"; National Program for Climate Change; La Paz; 2007

1.10 Bolivia's Dependence on Natural Resources

Since colonial times, Bolivia has had a strong inclination to export non-renewable commodities. In 2006, exports from the extractive industries accounted for US$ 3.100 million of the US$ 4.234 million of total exports (nearly 75%). Additionally, and given the abundance of natural resources, investment (foreign and national) has had a tendency to concentrate in these high return sectors, but with little interaction with the rest of the economy (economic enclaves). One consequence of this situation is the permanent squabble for the appropriation of the income that these sectors generate, particularly amongst the national government, the regions, the municipalities and the private sector. Historically, tension and conflict increase when international prices for these raw materials are high, which have resulted in the past in government intervention in these sectors (such as nationalization) in order to secure, in the short run, the redistribution of profits generated. In the past few years, the high dependence of the Bolivian economy on natural resources can be seen in the analysis of the revenues generated by the hydrocarbons sector, which represents a growing proportion of national income (close to 80% in 2006). This proportion is even higher if the revenue from mining activities is also taken into consideration (see graph 1).

Graphic 1: Revenue Comparison: Total Taxes – Hydrocarbons Taxes
Millions of Bolivianos



The economic dependence that Bolivia has on the exploitation of natural resources is not healthy, given the high volatility of international prices for raw materials, and shows the potential vulnerability of governmental income to this condition. Also, these sectors have become an important source of foreign exchange and their future performance in export markets will have considerable implications for the Bolivian economy as a whole.

Finally, the extractive industries generate only 1.5% of all employment in Bolivia (7,500 in the hydrocarbons sector and 56,000 in mining), a fact that shows that the importance of these sectors to the Bolivian economy is to be found in revenue generation rather than in employment generation.

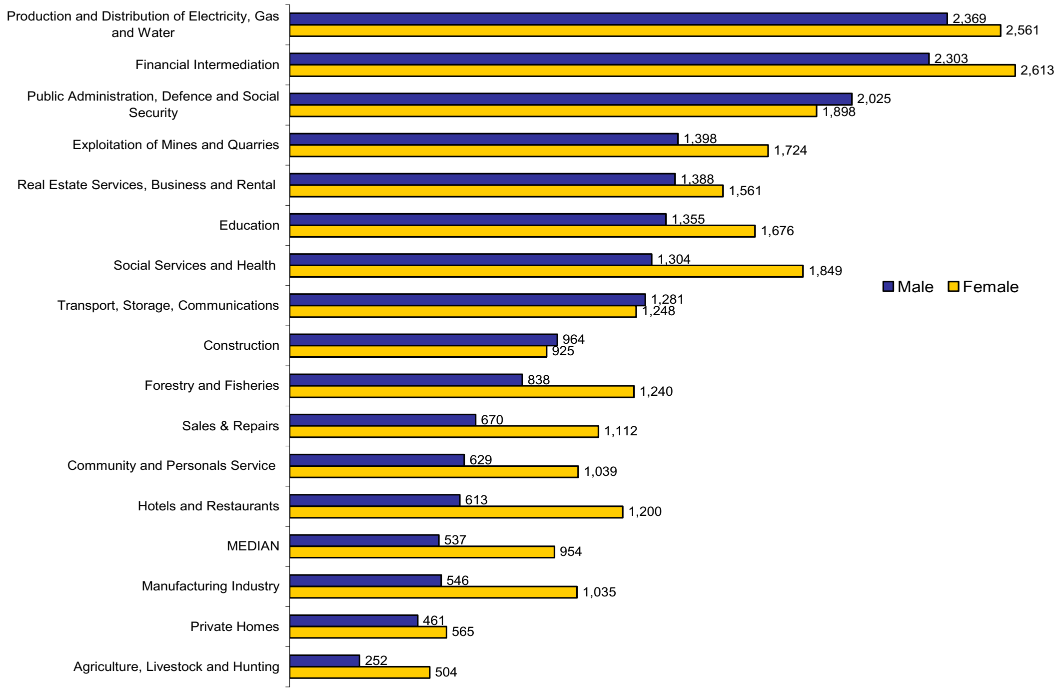
1.11 Bolivia's Economic Structure

Bolivia's national productive structure has shown a small increase in the industrial sector and basic infrastructure in the past few years. The largest gain in the share of total production has been experienced by the extractive sector and industrial agriculture. This means that the structure of production in the country has moved in favour of capital intensive sectors to the detriment of labour intensive activities.

Low private investment and the absence of economic linkages within the productive sectors have contributed to reduce the growth of employment in activities of higher productivity and with a larger capacity for employment generation. In this context, the agricultural sector (agriculture, forestry, hunting, and fishing) has a fluctuating performance with a participation in total production of 15.5% in 1986 to 16.5% in 2006. Modern agriculture (industrial agriculture sectors) is one of the more dynamic sectors (it grows at a rate of more than 8% a year), whereas traditional agriculture grows only in line with the growth in population. The labour intensive low wage service sector (housing construction, public administration, and commerce) exhibits below average growth, which explains why employment levels in these activities have stayed almost constant between 1999 and 2003. In contrast, modern service sectors (transport, communications and financial services) have performed better and show much higher rates of growth. Employment in mining and manufacturing fell from 1.45% to 0.56% and from 11.4% to 10.8%, respectively, whereas employment in construction grew from 5.8% to 7.3%. The most dynamic sectors of the economy (communications, hydrocarbons, financial services, industrial agriculture and services to businesses) employ relatively few workers, but because of their higher level of productivity they pay better than the more traditional sectors.

The observation that the median pay rate (Bs 823) is lower than the mean pay rate (Bs 904) confirms that the distribution of income from employment is skewed, particularly considering that the highest earnings are accounted for by workers in the electricity sector, water and natural gas, financial intermediation, and public administration which in total represent less than 1% of total employment.

Graphic 2: Bolivia 2004 – Monthly Income by Economic Activity (In Bolivianos)



Gender differentials in earnings in low productivity sectors (agriculture, manufacturing, hotels and restaurants) do not necessarily reflect differences in productivity between men and women, which may suggest the existence of gender discrimination. This is not the case in the public sector, where women's earnings are higher than men's.

Another interesting observation is that micro-businesses generate more that 83% of total employment but contribute only with 26% to GDP. Big companies (with 50 or more workers) employ less than 9% of the total workforce but their contribution to GDP is more than 65%. This situation suggests that there is an important differential in productivity between the two groups, given that micro-businesses appear to generate Bs 4.000 for each unit of employment a year and big companies Bs 101.000, or 25 times more. The productivity of small and medium enterprises is calculated at Bs 10.000 per unit of employment a year, higher than that of the micro-business, but substantially lower than that of big companies. Thus, public policies directed at promoting investment and the use of more advanced technology in small and medium enterprises appears to be a necessary condition to increase average labour productivity in Bolivia.

Finally, it is important to remember that a sizeable portion of the economy is informal. Employment in the informal sector has varied between 64% and 59% in the period 2000 to 2005 (UDAPE estimates). The informal sector also accounts for around 76% of women's employment and 59% of men's (data for 2003).

1.12 The Dynamics of Economic Growth

Bolivia's average economic growth rate for the past twenty years is 3.6%. The modern export-led sectors have been growing at a faster rate, whereas the non-tradable sectors have been lagging behind. Amongst these sectors one can include manufacturing, traditional agriculture, construction, and commerce.

Economic growth in the past few years is strongly linked to the performance of the export sector, which represented 63% of GDP in 2006. In the past five years, the export sector has been growing at an average rate of 25% a year, whereas imports only managed a growth of 10%. However, a growth rate of imports higher than the rate of growth of GDP signals a potential weakness in the economy in the medium term, particularly considering that a significant proportion of imports are made-up of consumption goods.

In 2006, traditional exports (hydrocarbons and minerals) grew to be 75% of total exports, with natural gas and zinc representing 50% of that total, making them the largest foreign exchange generating activities, but also making the economy more vulnerable to potential international price or production shocks. Industrial agriculture has also been an important engine for economic growth (with growth in excess of 8% a year in the past 20 years), particularly because of the linkages that were created with other actors in the production chain (seeds, industrial inputs, machinery, transport, financial services, and outsourcing). This particular effort has been a considerable contributing factor to the growth of the general economy and employment in the western region of the country. The growth of exports has also been important in apparel, silver and gold jewellery, wood products, and leather manufactures, which are key to the construction of high productivity employment generation capabilities in the economy. The latter export sectors are however vulnerable and dependant on the extension of concessionary trade mechanisms, such as ATPDEA and the Generalised Preference System (GPS).

The increased and, by now significant, flow of semi-skilled Bolivian migrants to other countries in the region and the rest of the world has had a positive effect on the Bolivian economy in terms of the level of remittances that this phenomenon has generated. Remittances by Bolivian migrants rank now with mining exports as a significant source of income (according to the methodology prepared by the IDB).

Table 10: Remittances Received (In millions of US dollars)

Year	Multilateral Investment Fund – IADB	Bolivia Central Bank – BCB (1)
2001	103	107,2
2002	104	83,0
2003	340	137,5
2004	422	178,3
2005	860	303,5
2006	1.030	569,5

Prepared by SAXgr (1) Official data BCB.

This foreign exchange windfall could become an important source of economic growth in the years to come, once the initial phase of turning remittances into household consumption goods is over and these resources are put to other uses capable of generating multiplier effects within the economy.

In 1998, the rate of total investment to GDP reached its peak at 24%. This rate has been falling steadily since then to 13.7% in 2005 and 14.5% in 2006. Public investment was relatively constant at 5.4% as a percentage of GDP for much of the same period, but has suffered a noticeable hike recently to around 9% of GDP. Private investment, however, has fallen drastically from 18.6% in 1998 to 7.9% in 2006. The fall in the rate of investment is linked to the reduction experienced in foreign direct investment, which was recorded at US$ 65 million in 2004 compared to US$ 1.026 million in 1998, at its historical peak, and has averaged US$ 650 million in the past decade. The fall in private investment in the near past is a reflection of the worsening business climate due to increased political and social instability, increased conflict with trade unions, and a negative perception by investors about the credibility of the "rules of the game".

1.13 Employment and Labour Productivity

The growth rate of the economically active population (EAP) was 3% for the period between 1990 and 2005. The growth of the EAP in urban areas was on average 4.6% per year during the same period and was considerably higher than the EAP in rural areas, which did not quite reach 1%. This result is explained, in part, by the rural-urban migration patterns experienced during the past 15 years. Similarly, the working age population (WAP) grew by 3.2% between 1990 and 1999, a rate that is higher than the EAP and may be showing a reduction in labour market participation rate amongst young people who appear to be staying in school longer. On the other hand, the median age of the population could become an economic strength in the future, inasmuch as it could provide the basis for productive reconstruction if adequately trained.

Sectoral participation in employment generation shows that the agricultural sector experienced a falling trend since 1996, when it represented 44% of total employment. In 2005 the equivalent figure was only 39%.

Table 11: Employed Population by Economic Activity

Economic Activity	1996	2000	2001	2002	2003	2005(p)
Total	100	100	100	100	100	100
Livestock	44,5	38,9	41	42,4	40	38,6
Extractive	1,5	1,4	1,1	1	1,2	1,7
Industry	11	10,1	10,3	11,2	10,6	10,9
Electricity, gas and water	0,3	0,5	0,4	0,2	0,4	0,3
Construction	4,7	6,6	4,8	5,4	6,6	6,5
Trade	19	19,8	20,3	18,8	20,3	18,8
Transportation	4	4,3	4,7	4,6	4,5	6
Financial	1,9	3,2	2,6	2,5	2,2	2,8
Services	13,2	15	14,7	14	14,2	14,4

Source: INE; (p) Preliminary

The sectors that improved their participation in total employment are: i) construction, ii) financial services, iii) transport, and iv) other services. The industrial and commercial sectors maintained a constant level of participation throughout the period 1999–2005.

For employment to grow at a rate of 6% a year, a rate that is higher than the growth of labour supply in urban areas, investment has to reach levels of at least 20% of GDP. Additionally, this investment needs to be concentrated in manufacturing which is a sector capable of incorporating large numbers of workers and also to improve productivity per unit of labour. Large firms are likely to have an advantage in this process at the moment, but there could be a role for small and medium enterprises if investment is forthcoming and they are capable of increasing their productivity levels. The role of small and medium enterprises in employment generation can also be strengthened by the creation of backward linkages with big firms.

In the past few years, these backward linkages have started to become apparent in important manufacturing sectors (cotton apparel, wood products, and jewellery amongst others that are export-oriented) showing the way to new forms of integration between all the different sizes and types of enterprises, the consolidation of new strategic alliances and the sharing of common interests. In time, and in the pursuit of their own interests, the larger companies will initiate a process of technological transfer and training towards smaller firms that will enable them to improve their levels of productivity, increase their business opportunities, and open a path for the micro-enterprises to participate and, thus contribute to pro-poor economic development.

In this analysis it must be borne in mind that average productivity in the Bolivian economy had at best remained constant during the period 1999–2003. This means that the level of employment per productive unit has been on the increase and that even the modern sector of the economy has been vulnerable to this trend. This could be pointing to the fact that the fall in private investment in the recent past has had a negative effect on labour productivity across the economy. The sectors with the highest productivity per unit of employment are mining and the hydrocarbons sector, followed closely by electricity generation, water and natural gas, financial and outsourcing services. At the other end of the spectrum, the sector with the lowest level of productivity is public administration, recording even lower rates than those of the traditional agricultural sector. The task of improving this situation is paramount if the country aims to recover a productive structure capable of delivering higher growth, where small and medium size firms have an important role.

1.14 Market Performance

Markets are good mechanisms for resource allocation when there are no distortions to affect their performance. These distortions can take the form of imperfect information amongst participants, monopoly power, entry barriers and obstacles to resource mobility, and ambiguous property rights amongst many others. In these particular cases, selective State intervention and clear public policies could mitigate the negative effect of these distortions.

In the recent past, Bolivia has exhibited a trend towards improved market functioning, in spite of the existence of economic structures and trade unions that have slowed progress in terms of increased market competitiveness and transparency. The State has been gradually introducing new initiatives to curb these distortions, but these have not been fully implemented and to do so requires more work, clarity of objectives, and political will. The markets for some products have been traditionally inefficient and prices do not reflect social costs or the relative scarcity of resource (liquid gas, diesel, electricity generation in isolated systems, etc.). Moreover, prices in these markets have distorted the prices for other products in other sectors, incidentally, at a higher fiscal cost. In the past decade, the internal market for hydrocarbons, heavily subsidised by the government, had introduced important distortions in the Bolivian economy, namely an incentive for the use of diesel, other factors such as smuggling of natural gas to neighbouring countries, delays of necessary changes in the energy matrix (away from oil and into natural gas), and the construction of pipelines for the transport of natural gas to the east of the country, which suffers from shortages.

On the other hand, problems in the allocation of resources also affect those sectors that produce positive externalities, such as education and health, where the basic quality of public services has engendered a private market that is short on efficiency, of variable quality and is badly regulated by the State. Another important factor that has a bearing on the performance of most markets in the Bolivian economy and that limits its potential for integration are the uneven terms of trade between urban and rural areas, which are heavily set against rural dwellers. The population sectors that are better informed (traders and intermediaries) profit from this situation and have an interest in maintaining the status quo.

The relative absence of market linkages – due to a lack of trust between the different actors in the production chain – is another central factor limiting the correct market functioning. Lack of trust arises from the failure of all actors to achieve minimum common standards of quality in production or their inability to fully comply with the demands of contracts. Vertical integration has been the answer to deal with this particular problem, but could lead to others – like absence of specialization – which breed inefficiency and contribute to the concentration of wealth. However, the markets in the west of the country appear to be better integrated than in the east of Bolivia, a condition that seems to have contributed to economic development that is more uniform across the regional economy. Sub-regional trade integration agreements have not responded either to the expectations of improved conditions in the economy, inasmuch as they failed to substantially improve access to neighbouring markets and to generate linkages with foreign industries. Bilateral trade agreements have seldom been fully exploited, in many cases because of the lack of a clear strategy for their better utilization. It appears that these agreements have been negotiated for political rather than economic reasons and thus are more difficult to implement.

Finally, instability in the "rules of the game", the future of property rights, and the lack of trust in the judicial system have also affected compliance with contracts signed between the private sector and the State, generating further uncertainty, an increase in the "country-costs" and demands for a much higher return on investments, which raises the bar for the viability of many projects. In addition, the uncertainty introduced by the position of the government in relation to land ownership has had negative consequences for potential investment and has contributed to a non-sustainable use of natural resources, where depredation is common and utilization is focused on short tern considerations.

1.15 The Legacy of the 90s and the Position of the PND

Public policy implemented between 1985 and 1990 in Bolivia was directed at generating the necessary conditions for the emergence of an entrepreneurial private sector in a context of limited price distortions and the gradual opening of the economy to international trade. In this perspective, the role of the State was confined to the design and management of public policy that favoured productive endeavours through the introduction of incentives and the construction of public infrastructure, aimed at smoothing-out transaction costs in the economy. Similarly, public investment was required to develop human resources and improve the living conditions for all of the population. For a variety of reasons, that run from the implementation of public policies that favoured the development of the extractive sectors of the economy or the growth of industrial agriculture in the east of the country to the absence of social policies directed at improving the situation of the poorer segments of the populations, this approach – labelled neoliberal – failed to satisfy the expectations of the majority of Bolivians. This situation has resulted in the generalised demand for the reversal of the economic model applied until 2005 and the implementation of a new model with a stronger role for the State in running the national economy, which is the objective of the National Development Plan submitted in 2006.

The Plan outlined by the administration of President Morales is more "dirigist" and advocates the return to State capitalism so as to reunite the political and economic powers with the decisions of the government, while chastising all the progress achieved in the past in relation to administrative and political decentralisation. The Plan is also based on a particular sociological perception of the Andean culture, without due regard for the existence of other cultural sensitivities within the Bolivian society, a fact that restricts its wider appeal and presents the government with difficulties when it comes to establish consensus for the implementation of public policy that encompasses the whole of the country. For a detailed analysis of the issues relevant to the present study that are included in the PND see the following chapters.

1.16 Bolivia's Development Challenges

The background described above suggests that the options for a more equitable development in Bolivia, one that promotes pro-poor growth with social stability, requires the design of clear-cut policies and incentives to increase productive employment, in addition to establishing the conditions for new investment opportunities that may be exploited by the poorest segments of the population. These policies should make these latter actors central to all initiatives aimed at generating economic growth and not simply passive onlookers waiting for the fruits of development to reach them.

In this section, the paper outlines the most important challenges facing the country in the future with a view to examine them in greater detail in the following chapters. These are:

- the growth in the workforce (mainly in urban areas) at rates higher than those experienced in the past, due to demographic changes observed during the 90s,
- the capacity of the economy to generate productive employment at levels proportionate to the transition from a predominantly agricultural economy (40% of all employment) to a more industrial/manufacturing based economy,
- the need to generate incentives for positive discrimination in public policy so as to increase employment and income opportunities for the poor,
- the harnessing of the strength of the financial system and the vast experience with micro-credit in the country to generate incentives for productive investment and technological upgrades in micro and small firms,
- the better use of remittances, that are likely to continue coming into the country in the foreseeable future, away from consumption and into productive investment,
- the expertise to design and manage selective migration policies (temporary organised migration programmes) to take advantage of the opportunities offered by the regions of higher economic and productive potential in the country,

- the need to tie improvements in labour productivity to an improvement in income so as to distribute the gains from increased productivity and income more equitably, without generating disincentives for entrepreneurial effort,
- the administration of justice, respect for property rights and contract compliance are critical factors for the attraction of private investment and, consequently, improvements in labour productivity.

However, the biggest challenge for those responsible for the design and implementation of public policy in the future will be to properly prioritise in the agenda all actions necessary to promote rapid economic growth, which is – at the same time – more inclusive and has the added task of disrupting the inequality gaps that are prevalent in Bolivia today. The necessary actions to achieve this objective are all important, which makes it even more crucial to define a strategy that sets clearly how to approach them gradually and in the right order to make them more effective. Also, it is necessary to adjust expectations about the timeframe in which results are likely to be visible and have an impact on the livelihoods of the population in order to maintain the credibility and viability of this agenda.

2. Employment Analysis

2.1 Quantitative Analysis of Employment

Employment, unemployment, under-employment, and poverty indicators are the product of the interaction of a set of economic and social variables that have been characteristic of the country in recent years. These indicators are, however, likely to be modified by new factors, such as migration, the growth in exports and remittances, which will have an effect on their future performance.

a) Population dynamics

The process of urbanization experienced in Bolivia in the past transferred poverty from rural areas into the cities. Rural migrants settled mostly in and around the city of El Alto (close to La Paz) and in the periphery of Santa Cruz. Population growth in the municipality of El Alto between 1992 and 2001 (the last two censuses) was 5.10% a year, the highest rate in the country and twice that registered for the whole of the La Paz region. Equivalent figures for the city and the region of Santa Cruz were 5.08% and 4.29%, respectively[34].

Bolivia's total population in 2007 is estimated to be around 10 million inhabitants, 50.1% of whom are women. Also, relevant data show that the cities house 54% of the population classified as poor, while the remaining 46% live in rural areas[35]. Urban growth is, therefore, surpassing the capacity of the modern sector of the economy to create jobs, transferring workforce to the tertiary and the informal sectors, as well as activities with a low technology base (i.e. construction). The information supplied so far illustrates clearly a process that can be best described as the 'urbanization of poverty', a situation that will gradually become a problem for the cities. It is important to note here that extreme poverty continues to be a phenomenon that mainly afflicts rural areas. Projected estimates calculated by INE suggest that cities, and not rural areas, will be responsible for population growth in the foreseeable future, a fact that points to the need for the design of public policy aimed at promoting urban employment.

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[34] INE, Population Statistics.

[35] See Annex 3

b) Population structure

Bolivia is a relatively young country in terms of population distribution, with nearly 57% of its total made-up of people under 25 years of age. The age group between 25 and 50 represents 30% of the total population and those older than 51 years of age account for the remaining 13%.

Table 12: Population Structure by Range of Age, 2007

Age Ranges	Percent
Under 25 years	56,86
Over 25 and Under 50 years	30,18
Over 51 years	12,96

Source: Based on INE's information, Yearbook 2005.

The population of working age is 62.82% of the total population, where the age group between 29 and 59 represents the largest proportion for both men and women. However, a younger age group is present in employment statistics for sectors such as agriculture, retail trade and household services, in some cases with workers as young as 10 years old, as is the case of cane sugar harvest, cotton picking, and Brazil nuts stock-piling.

According to a number of published studies, young workers are employed in sectors which require low levels of qualification, the service sector, retail trade, and agriculture[36]. Older workers (54 years and older) are over-represented in low-skill sectors, mainly associated with unstable, meagre and informal employment, and in which they are engaged for life in the absence of pensions and social security[37].

c) Labour supply

Economic growth experienced recently has been low in relation to population growth and, in particular, growth in the working age population. This situation has resulted in a shift of workers from the formal to the informal sector, mainly composed of productive micro-businesses, small retail ventures, and services which have been created as household survival strategies. It has been estimated that for every 10 new jobs generated by the Bolivian economy, close to 6 are informal, a fact that explains – in part – the decline in labour conditions and the high rates of urban under-employment[38].

INE's population projections suggest that the working age population will exceed 4 million people by 2010, of whom 55% will be urban males and the remaining 45% will be made-up of urban females and rural inhabitants (both men and women). The growing labour supply is explained by the increased number of youngsters that enter the labour market at a young age and the late exit of older workers. An increase in female participation rates is also a factor, prompted by the fall in household earnings, the reduction of discriminatory barriers and higher levels of education amongst women.

Based on this evidence, it is clear that by 2010 the economy will have to offer employment opportunities to more than 4 million Bolivians. This number could turn-out to be slightly lower if access to the labour market by young people is successfully delayed by an increasing number of

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36 FUNDAPRO, "Estudio de mercado laboral en Bolivia", Edited by Fundapro, La Paz, 2004. Ministerio de Trabajo, Micro y Pequeña Empresa Urbana y Periurbana de Bolivia, Edited by Ministerio de Trabajo, La Paz, 2004. UDAPE, Desempeño Económico al Tercer Trimestre 2006. Informe Especial Sobre Empleo, Edited by UDAPE, La Paz, 2006.

37 Fundapro. Estudio de Mercado Laboral en Bolivia, P 38. mimeo, La Paz.

38 See Annex 4

education and training alternatives or because family incomes grow adequately over the next few years. Given the limited capacity that exists in the modern sector of the economy for the creation of employment [39] and the new dynamics that the government aims to generate for micro and small companies, through the implementation of favourable public policy, including cheap financing from the newly created Productive Development Bank (BDP, for its acronym in Spanish) [40], it is likely that most new jobs will be created in micro and small size productive units dotted around the country. The government's PND gives priority to these enterprises by introducing incentives in the form of more equitable access to credit financing for artisans, micro, small and medium businesses, peasants and indigenous producers and their economic organisations.

d) Changes in employment

The growth in the informal sector of the economy at a rate of 8.6% a year from the 90s has contributed to a situation of substantial reduction in the quality of employment[41]. Around 60% of the working age population is currently characterised by low-income self-employed activities that generally offer little in the way of better prospects for the future of these workers. To be self-employed and informal means that the worker will be subject to variable length working days, to be paid by product and not hours, and to be uninsured (health and pension plans).

On the other hand, the formal economy, especially those firms that are part of the export sector, demands a skilled workforce that is also capable of multitasking. The reduction in unit costs is no longer the only factor to improve productivity and competitiveness in modern enterprises. Nowadays, technology allows companies to produce a variety of goods almost simultaneously, a situation that necessitates a workforce with different skills and abilities than what is required for simple mass production.

More flexible schemes for hiring workers have also been introduced with the outsourcing of production processes, which today are vital to entrepreneurial activity. This particular way to undertake production of goods and services creates opportunities for small and medium companies to link themselves to exporting firms that have the potential for pulling them into higher levels of development. Having said that, it is important to note that within the export sector there are marked differences in productivity levels between companies, which are due to the use of different technology, the organisation of the production process, and the ability to generate added value. These differences in productivity will be reflected in the firm's capacity to generate new employment opportunities.

The informal sector has been shrinking in the past few years, as can be determined from the data in Annex 4. This result could be signalling that the informal sector has reached a limit in its capacity to accept new workers displaced from the formal sector of the economy or – also a

[39] Related in part to the greater opportunities that exist in the extractive sectors of the economy, which are not labour intensive, and in part associated with the negative perception of the business climate, which disproportionally affects the modern industrial, export-oriented sectors, as is shown in Chapter IV.

[40] According to Supreme Decree 28999, the BDP is the product of an institutional reorganisation of the second-floor bank NAFIBO, which was responsible for the administration of resources intended for the provision of finance to financial institutions recognised by the State for the concession of micro-credit loans. The aforementioned legislation established that the BDP could provide credit for productive endeavours in amounts from US$ 3000 (or equivalent in national currency) at an interest rate of 6% a year to individuals of organised groups of producers.

[41] Oficina Internacional del Trabajo, Oficina Regional para las Américas, Equipo Técnico Multidisciplinario para el Área Andina. Bolivia: Políticas de Empleo y Protección Social, Mimeo 2001 P. iv.

possibility – that the unemployment rate is fed not only by salaried workers that lose their jobs, but also by people who are unable to consolidate their activities in the informal sector.

e) Participation rate

The modest rate of growth experienced by the economy in the past few years has affected a number of important employment indicators. The global participation rate, which measures the ratio between economically active population and working age population, increased from 43.5% in 2002 to 44.8% in 2003[42]. This change may suggest a reversal of the inbuilt disincentives for labour market participation. The increase of family members in the global participation rate can also be explained – on the one hand – by the growth in female participation in the workforce, which grew from 30% to 39% between 1990 and 2003, and – on the other – by a fall in the incomes generated by heads of household (according to a study by the organisation Pro Mujer, which suggests that average family income could be as low as $US 150 per month or US$1 per day per family member).

Income in rural areas, according to a study prepared by CIPCA (a Bolivian NGO) after collecting information from five peasant communities, could be as low a Bs. 1652 per family per year. Similarly, a study undertaken by the UniverSidad del Valle, concluded that income in the rural areas is Bs. 918 per family per year, but with a standard deviation of Bs. 663, which shows that these results are skewed towards low salaries and highly dispersed ones at that[43]. Low income levels generated by individual family members necessitate that more members are brought into the labour market. In other words, there is an inverse relationship between head of household income and the participation of other members of the family in the labour market, a relationship that strengthens the vicious circle of poverty reproduction.

f) External limits to the expansion of employment

High economic growth rates are not a sufficient condition to generate employment in the numbers and quality that are required if poverty trends are to be reversed. For the latter to take place, it is important to mould the type of economic development that is necessary. Recent history shows that the highest levels of private investment have been directed at sectors which are intensive in capital, with its consequent limited impact on employment generation and poverty alleviation. The sectors that could generate more employment are manufacturing or industrial agriculture, but these are sensitive to social and political conditions or the opportunities that internationally integrated markets offer for exports. In this context, to motivate growth in these sectors it seems imperative to eliminate uncertainty in the "rules of the game" and expand the markets for goods and services both internally and externally.

Another factor that holds back the expansion of employment in the modern sector of the economy is the weight of regulation and costs associated with hiring and firing workers. Labour legislation in Bolivia was introduced in 1939 and the prevailing labour law dates back to 1942. This legislation was motivated by the idea that workers were at a disad-

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[42] UDAPE, Desempeño Económico al Tercer Trimestre 2006.

[43] Carmen Velasco, Power Point presentation, La experiencia de Pro Mujer en Bolivia. Tom Peines of the Centro de Investigación y Promoción del Campesinado –CIPCA-, Composición del Ingreso Familiar y la diversificación agrícola – Una aproximación a seis zonas campesinas de Cochabamba y Norte de Potosí- Published by CIPCA in 2006. See, Gonzalo Bautista Camacho, Ema Hazou Claros, Estudio Socio Económico y de Salud, UniverSidad UNIVALLE, 2007.

vantage from employers and, thus, needed the protection of the State to level the playing field. Modern concepts of labour legislation have not been fully implemented yet in most of Latin America, where the protection element is still prevalent, although there have been efforts to extend the concept beyond labour stability to encompass also labour mobility. Legislation in Bolivia maintains only the original concept and is now terribly complex, inasmuch as there are 2500 legal procedures associated with it and in some cases in open contradiction with each other. This dispersion in the law creates uncertainty and insecurity amongst workers and employers alike.

Changes in the rules and regulations of employment, approved by the Ministry for Employment in May 2007, were introduced with a view to improving the conditions and the quality of work in Bolivia, but have only managed to harden the conditions for the firing of workers, introduce a disincentive for the hiring of new personnel, limit labour flexibility, and reduce the competitiveness of businesses. With the introduction of these new regulations the employer is now the owner of his/her employees.

g) Informal sector

In the 1970s, Bolivia experienced rapid growth in the number of self-employed workers (informal sector). The informal sector has become the largest source of petty employment, accounting for nearly 60% of the economically active population[44]. In 1990, 75.9% of all informal employment was in the hands of women. After 5 years, women's participation in the informal sector grew to 77.5%, falling slightly in 2003 to 75.8%. During this period, women's employment in the informal sector was heavily concentrated in activities related to domestic/household services and the retail trade[45].

It is no longer possible to refer to the informal sector as illegal in the same way as it was done 10 years ago. The development of micro-credit loans, basic municipal regulations, and registration mechanisms to gain access to training and technical assistance, amongst others, have somehow legalised the activities of the informal sector, in ways that do not necessarily correspond to those defined by law and the formal operation of private enterprises. For this reason, it is incorrect to define the informal sector only in terms of its absence of legality, but it is necessary to expand the concept to include: i) low skilled work, ii) low level of technological innovation, iii) use of traditional or out of date technology, iv) participation in sectors of easy and low cost access, v) lack of permits to open or operate workshops, vi) unpaid work, vii) tax evasion, viii) absence of health and safety regulations and risk management, ix) no provisions for health insurance, pensions, and social security.

In recent times, it is possible to observe the development of incipient links between the modern sector of the economy and the informal sector, but these are not yet the norm in most production chains. Additionally, it is suggested that where they exist, these linkages are ad-hoc and hardly the result of conscious policy effort. Nevertheless, it has been encouraging to observe that in the recent past some modern export-oriented firms have begun to outsource some of their production to small and medium size enterprises, trade union associations, and independent artisans. This has been the experience, for example, of COPROCA SA – a company

[44] UDAPE. Desempeño económico al 3er. trimestre 2006. Informe especial sobre empleo

[45] INE. Boletín especial sobre salarios (2007)

that manufactures clothing from alpaca and llama wool – which developed a strategic alliance with a small organisation of women knitters known as "Asociación Señor de Mayo". The former supplies the knitters with wool and the latter knit jumpers, gloves, hats and other clothing for export. A similar experience is underway with AMETEX SA, a leading cotton apparel exporter to the US market and "Manos Maravillosas", a group of women who put the finishing touches on all items that require embellishment before they are exported.

A more recent experience has been the organisation of the project "community of producers", a private sector initiative that brings together 500 small and medium size producers in the region of La Paz with a number of successful entrepreneurs, who advise, help and technically support emerging companies with their individual business plans. The region of Santa Cruz has also been exploring ways in which producers can collectively improve the functioning of different productive chains and strengthen the links between smaller and larger producers. One such example is the agreement signed in 2007 between FEGASACRUZ, the umbrella organisation for large farmers in the east of the country, and smaller producers in the region, which establishes mechanisms for the strengthening of the latter's more effective participation in agricultural fairs and the productive chains for milk, fruits, and handicrafts, all with due regard for the sustainable development of natural resources.

These initial results, which are the product of private initiative, should be studied by the government in order to provide a basis for the design and implementation of public policy directed at formalising these new and incipient linkages, in addition to promoting the generation of new opportunities for synergy between the formal and informal sectors of the economy. Furthermore, these initiatives should also be used to help small and medium size companies to formalise their operations and to achieve better quality standards in production.

h) Recent trends in earnings, employment, and poverty

Earnings indicators showed an interesting trend between 2003 and 2005[46]. The general index rose from 181.1 to 192.2 during this period, but earnings by blue-collar workers rose faster, moving from 169.55 to 199.45. In contrast, earnings by white-collar workers (administrators and managers) went down from 229.2 in 2003 to 221.5 in 2005. One possible explanation for this observation is that the higher growth in blue-collar worker's earnings owes much to the capacity of trade unions in Bolivia to exert political pressure – through marches and road blockades – to demand higher wages, an ability that is not shared by white-collar workers (be these in the private or public sector).

Another important feature of earnings indicators is the differential that exists between the wages and salaries paid to workers in businesses that produce and sell in the local market compared to those that are more export-oriented. The average monthly earnings for a worker employed by an export-oriented business[47] is Bs. 2,400, which compares favourably with Bs. 1,461 that is the average monthly earnings for a worker employed by a company that produces and sells in the local market[48]. For example, manufacturing export industries pay an average wage of Bs 2,083 per worker, a figure that is substantially higher than the

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46 See Annex 5

47 INE, IBCE, UDAPE, Empleo y percepciones socio-económicas en las empresas exportadoras bolivianas, P. 30,31 La Paz, 2006. (See Annex 6).

48 Labor, www.labor.org.bo Observatorio Laboral, see Annex 7

Bs. 993 that workers earn in a factory that produces pasta and other flour-derived products for the local market. The latter average earnings are, however, higher than those that service sector workers can command, which are on average Bs. 754. These earnings differentials are explained by differences in productivity levels between the sectors, as well as higher capital to labour ratios and better qualifications of human resources. In this context, public policies to promote export industries are not only beneficial for the exporter, but also for the workers, peasants, technicians, engineers, and other professional personnel.

There are also regional differentials in earnings. Export companies located in the region of Santa Cruz pay nominal salaries of Bs. 3,300 a month per worker, whereas in Tarija the corresponding figure is only Bs. 2,262. Both of these regions are, however, important recipients of investment from the hydrocarbons sector. In contrast, average salaries by worker in exporting companies located in La Paz and Cochabamba are Bs. 2,254 and Bs. 1,710, respectively. These higher earnings are received by workers engaged by industrial sector firms.

The highest differentials in earnings exist between the modern sector of the economy and the informal sector. Labour legislation defines maximum and minimum standards for labour market functioning and, as such, determines that the length of the working day is 8 hours and the length of the working week is 48 hours. The minimum wage/salary is determined by the Ministry for Employment. Empirical studies confirm that both these standards, which are subject to government control, are complied with in the formal sector of the economy. The minimum wage/salary is set so that:

- employers cannot pay a lower rate than what is established,
- employers can calculate all obligatory bonus payments on that basis,
- it acts as a reference point for other non-salaried workers.

The informal sector complies, in general, with the standards set in law for the length of the working day and week, but earnings are half those of the formal sector and, quite often, are below the minimum rate. In the semi-formal industrial sector[49] the working day and week are longer than that set by law, and earnings are similar to those in the informal sector. Finally, in the household sector, working hours are lower, but earnings represent a quarter of those received in the formal sector[50].

Extreme and moderate poverty are a characteristic of both the formal and informal sectors of the economy, but it is the informal sector where poverty is higher. A recent study shows that this feature has not been modified in more than a decade and 5 workers out of 10 that are engaged in the informal sector are poor and 2 are classified as extremely poor[51]. Also, data by income level for 2006 suggests that 8 out of 10 people that belong to the poorest household quintile work in the informal sector. On the other side of the spectrum, only 4 out of 10 people that belong to the 20% richest households were engaged in informal sector activities. The information outlined above shows a positive relationship between poverty and informality, a statement that challenges the notion that poor people can beat poverty by becoming small "entrepreneurs" in the informal sector, let alone public policy initiatives that have been promoting micro-credit and other incentives to support this sector as a strategy for poverty alleviation.

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[49] Firms that engage in industrial activities, where there are less than 5 workers.

[50] See Annex 8.

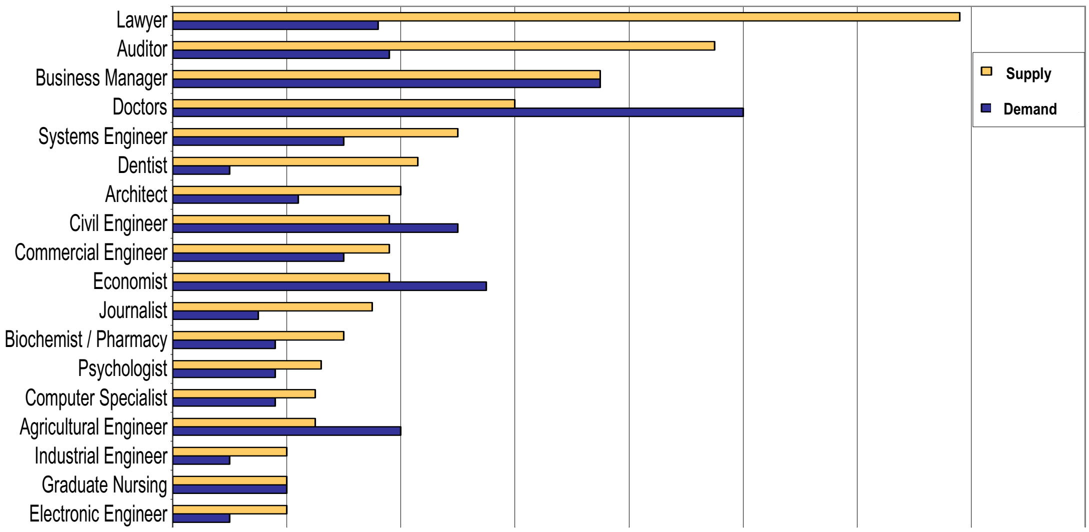
[51] "La Informalidad en el Mercado Laboral Urbano 1996–2006". UDAPE 2007.

2.2 Capacity for Employment

a) Employability

Employability is a characteristic that workers can achieve through education, training and experience that improve their chances of being employed or be kept in employment [52]. Given that only 2% of all school leavers in Bolivia have technical qualifications that prepare them for immediate labour market access, the remaining 98% are in a condition of labour market vulnerability and have fewer opportunities to gain paid employment. Also, a number of studies about the Bolivian labour market highlight the mismatch between the supply of academic training and the demand for qualified workers, in both the private and public sectors[53]. The largest excess supply of professionals exists amongst those with training in law and auditing, whereas there is still an unfulfilled demand for professionals trained in production and transformation (engineering).

Graphic 3: Supply and Demand of Professionals



Source: Labor Study in Bolivia. FUNDAPRO.2006

The training mismatch in the labour market is higher amongst technical subjects, which means that technical education – both in institutes and universities alike – does not respond to the demands of the present needs of businesses in Bolivia.

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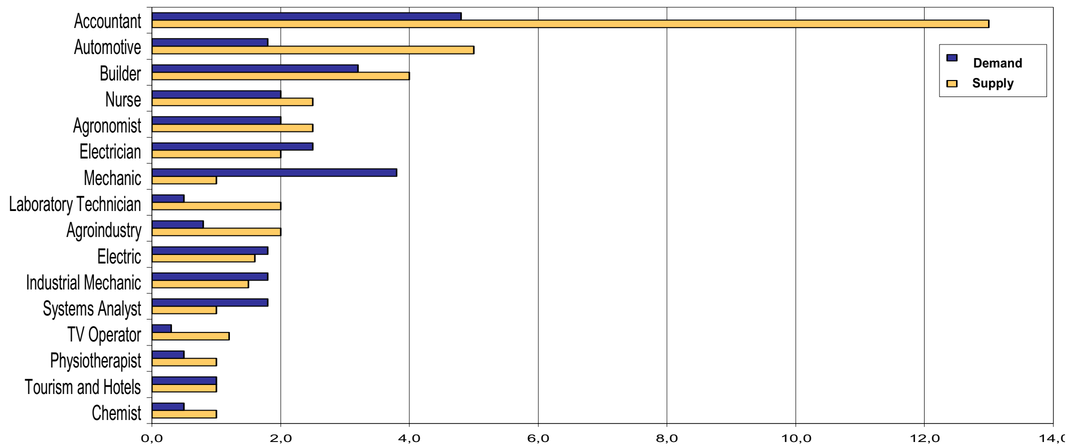
[52] Employability relates the qualifications, knowledge, and skills of workers, which increase their opportunities to find employment or be kept in employment, to improve their work, to adapt to change, to choose a different job or integrate themselves with ease into the labour market (ITO, Resolution on the Rights for the Development of Human Resources, General Conference, 88 Meeting, Geneva, June 2000).

[53] FUNDAPRO 2005, Estudio Laboral en Bolivia. Mimeo.

Graphic 4: Supply and Demand of Technicians



Source: Labor Study in Bolivia. FUNDAPRO.2006

Analysis of the information depicted above shows that, in general, the Bolivian education system is failing to prepare and train young professionals and technicians, whose new acquired skills are in demand in the labour market. This trend, if maintained in the future, will generate important constraints and seriously compromise the productive development of the country.

One significant development in the study of the Bolivian labour market is the finding that at a lower level of qualification it is easier to find employment. This paradox can be explained by the productive model adopted in the country, which has been sustained by the growth of the services and retail trade sectors, a low technology industrial sector and a business strategy designed to divide productive activities into their most basic components[54]. Evidence to sustain this contradiction can be found in employment data, which shows that in 2005 a person that had only completed primary education (6 years of schooling or less) needed 11.3 months to find employment, whereas a person with secondary level education (12 years of schooling or more) or with technical education required 14 months before gaining access to paid employment[55].

b) Productivity

Data analysis shows that the lowest levels of productivity in the Bolivian economy are experienced in the agricultural, construction, and service (hotels and restaurants) sectors. In contrast, the sectors with the highest levels of productivity are mining and the hydrocarbons industry, followed closely by electricity generation, natural gas, and water supply. Productivity in manufacturing remains stable over the study period, however, at low levels (see Annex 12). The data on productivity also reflects the structure of employment (both, in the formal and informal sectors) and the contribution of firms to GDP. The import of large firms to the economy is given by their high relative productivity levels and their contribution to GDP, whereas smaller size firms – with production directed to the local markets and relative low levels of production – are important because of the large number of employment opportunities they generate. The low productivity levels and the incidence of low-skilled workers are not an exclusive feature of urban enterprises, as these

[54] The work undertaken in a factory is divided-up completely, with the specific purpose of simplifying all procedures as much as possible. This is not a feature characteristic to Bolivian production processes; it was developed by Henry Ford.

[55] See Annex 11.

characteristics are reproduced exactly in rural area companies. This situation explains the relatively low contribution that sectors such as agriculture, forestry, hunting, and fishing have on the growth of GDP.

Table 13: Contribution to Employment and to GDP by Type of Enterprise and Productivity

Company Size	Contribution to Employment	Contribution to GDP%	Productivity in 000 Bs
Micro	83.1	25.5	4
Small	4.7	2.7	8
Medium	3.4	3.3	13
Large	8.7	65.3	101
Adjustment		3,2	

Source: CONAPE[56].

There are around 500 small and medium sized enterprises engaged in manufacturing and commercial activities to supply the local market. Micro sized firms account for the largest number of them, at around 100,000, with activities centred on light manufacturing, retail trade, and the production of handicrafts. Finally, the rural area is home to around 500,000 peasant productive units.

Agricultural production is the largest employment generating sector and accounts for close to 40% of the working age population. Agricultural production may be divided into three regions: i) low plains, ii) high valleys, and iii) the Altiplano. The low plains to the north and east of the country is the region with the greatest number of harvested area (71.5%), but employs only 24.2% of the population working in the agricultural sector[57]. This is also the region with the highest levels of mechanisation in agriculture in the whole country. The high valleys account for 18.9% of all harvested area with 50.6% of all employment engaged in agriculture. The Altiplano region (a high plateau) has the lowest percentage of harvested area (9.6%), but has more than a quarter (25.2%) of the employment opportunities generated in the sector.

An important feature of Bolivian agriculture is the co-existence of a dynamic industrial agricultural sector, which provides foodstuffs for consumption in the national market and, also, for export, with small-scale traditional agriculture in the west of the country. Most city migrants originate from the higher western region of Bolivia, which implies that employment is falling in these rural areas. In turn, the low plains act as a magnet for migration, but where most agricultural activities are mechanised. In any event, the rural areas continue to eject population that moves to the cities in search for work and better prospects. For this reason, the focus of public policy should be the rural/urban border, without relinquishing public investment in rural areas which is capable of sustaining viable productive endeavours.

[56] Ernesto Pérez de Rada. Visión Productiva de Bolivia: Análisis de propuestas, FUNDAPRO, MPD. p.10

[57] Oficina Internacional del Trabajo, Oficina Regional para las Américas, Equipo Técnico Multidisciplinario. Bolivia: Políticas y programas de empleo y protección social, mimeo, 2001.

2.3 Labour Market Access

Labour market intermediation is still underdeveloped in Bolivia, despite efforts undertaken by the Ministry for Employment to modernise it and increase its scope. At present, the Employment Agency initiative operates only in La Paz and, by extension, in El Alto, and consequently is not yet a point of reference for either workers or employers. In this context, the mechanisms mostly used to link workers with potential employers are personal contacts and political patronage. These mechanisms are used in all firms, irrespective of size.

Selection criteria for hiring workers vary with the firm and the employer, but some entrepreneurs have suggested that their preference is for older workers (45 years of older) with experience in any sector of the economy, except for retail trade in the informal sector[58]. Another selection criterion is youth, but especially younger people that originate from the rural areas. The municipality of La Paz, in coordination with the Ministry for Employment, has started a programme known as "My first job", which aims to motivate firms to hire young professionals from across the country. The existing jobs are advertised by the Ministry for Employment in the "young worker's fair" under the label "ready for work".

In the informal sector, workers are particularly attracted by the small-scale retail trade ("gremialistas") and the apparel manufacturing in cotton fabric and leather. However, these are sectors with high entry barriers, mostly in the form of membership in a particular group or organised trade union. Hence, access to the informal sector is costly.

2.4 Labour Market Opportunities

Women seem to be at a disadvantage when it comes to looking for a job (see the following chart). In 1996, the unemployment rate was low, given that this year was part of the period of economic expansion. By the end of the 1990s, at the heart of a world slump, the unemployment rate had climbed to around 8.5%. Reduced dynamism of the Bolivian economy resulted in an increase in the jobless population, which could only mean one thing: both, the formal and informal sector, were shedding workers[59].

Table 14: Unemployment Rate, in Urban Areas (Percentage)

Rate in percents	1996	2000	2001	2002	2003	2005
Unemployment rate	3,12	7,46	8,5	8,69	8,71	8,15
Male	3,0	6,2	7,5	7,3	6,8	6,8
Female	3,2	9,0	9,7	10,3	11,0	9,9

Source: UDAPE

Here, it is important to point out that women spend the longest time in unemployment. According to the chart above, in 1996 men took 10 months on average to find employment, whereas the equivalent figure for women was 31 months. By 2005, the length of unemployment fell for both, men and women. In the recent past, population groups for whom it was easier to find employment were under 25 years of age or over 45 years of age, a fact that suggests that employers may prefer employees with lower family commitments (see Annex 11).

58 Fernando Caballero, Human Resources Manager of United Furniture Industries Bolivia S.A.

59 In 2005, the occupation rate in the informal sector fell from 63.2% a 59.1%.

The results highlighted above seem to suggest that women have lower employability levels than men and, hence, that public policy should be designed and implemented to improve employability in general, but particularly for women. When workers (men and women) stay for long periods in conditions of unemployment, knowledge and networks are lost, making it even more difficult to regain employment and bringing about an increase in social exclusion.

A major problem in the Bolivian labour market is that of gender discrimination, but discrimination by ethnic origin is also prevalent. The latter problem has not been studied systematically and no data exists for the rural areas. The following conclusions are drawn from information collected by the ILO/PRODEL study for the cities of La Paz and El Alto with regards to preferences in the hiring of workers and the ensuing mistrust that employers have about their workers[60].

Table 15: Discrimination Aspects

Hiring preference			Worker mistrust		
Language	**La Paz**	**El Alto**	**Worker**	**La Paz**	**El Alto**
Aymará	67	46	Aymará	35	38
Quechua	50	34	Quechua	39	45
Spanish	87	70	Spanish	n.a.	n.a.

Source: Survey of labor rights knowledge in Bolivia, OIT and PRODEL

The chart above shows that in the cities of La Paz and El Alto employers prefer to hire workers who speak Spanish rather than workers whose mother tongue is not Spanish (i.e. Aymara and Quechua). Discrimination by ethnic origin is intensified when the variable mistrust is incorporated into the analysis. Nearly 40% of all employers included in the study, both in La Paz and El Alto, mistrust workers that cannot express themselves properly in Spanish, with the native Aymara-speakers generating a slightly lower level of mistrust than the native Quechua-speakers. The above data show that 65% of all inhabitants in La Paz and 62% in the city of El Alto trust native Aymara-speakers. The corresponding figures for native Quechua-speakers are 60% and 56%, respectively[61]. Another important conclusion of the study is that as the level of education increases in both cities, employers are increasingly more trustful of their employers, irrespective of the language in which they express themselves.

Under-employment is another major challenge facing the labour market, be this visible or invisible[62]. Visible under-employment increased from 10.4% in 1996 to 15.1% in 2005, whilst invisible under-employment grew less over the period, from 9.8% in 1996 to 12.3% in 2005.

60 OIT/PRODEL, Encuesta sobre conocimiento de los derechos laborales en Bolivia. PRODEL, 2001.

61 Ibid.

62 According to UDAPE, visible under-employment is the proportion of employed workers who are not paid to work 8 hours a day and, consequently, are in search of a second job to complete the working day. Invisible under-employment, on the other hand, is the proportion of the population that is paid less than the minimum wage set by law or that perceive that they are being paid less than their contribution to productivity.

Table 16: Employed Population in Visible/Invisible Underemployment (%)

	1996	2000	2001	2002	2003	2005
Total	20,2	27,3	25,2	27,3	27,9	27,4
Visible Underemployment Rate	10,4	9,3	12,4	11,9	12,0	15,1
Invisible Underemployment Rate	9,8	18,0	12,8	15,4	15,9	12,3

Source: UDAPE

The relatively high rates of under-employment explain, in part, the low levels of income/earnings and the differences in education and training of the workforce, which have not adjusted sufficiently to the demand for labour expressed by firms.

2.5 The Legacy of the 90s and the Position of the PND in Relation to Employment

The replacement of state capitalism by a market-based and private sector-led economic model which was the key characteristics of the economic model prevalent in Bolivia for the past two decades resulted in a process of productive restructuring that favoured the emergence of extractive industries and commercial agriculture in the country. But this happened in the absence of an accompanying large scale process of industrialization, which in turn resulted in a net transfer of assets and activities towards the tertiary sectors of the economy. Thus, a large proportion of the Bolivian economy is at present dependent on retail trade and other services of low relative productivity and, consequently, with little capacity to generate and multiply quality employment.

In the 1990s, the generation of employment in the economy relied on a small number of sectors, namely construction, mining, hydrocarbons, retail trade, and services, while modern sectors, such as manufacturing and other export-oriented sectors, were experiencing a relative reduction in employment. In other words, the restructuring of GDP across the economy shows a trend towards concentration in high technology capital intensive activities (hydrocarbons, financial services, and telecommunications) at the same time that production is being dispersed amongst a growing number of low productivity tertiary sectors and, more surprisingly, light manufacturing and other industrial sectors. The combined process explains the net gains in productivity across the whole economy[63].

In 1988, the Paz Estenssoro government introduced a ten-year strategy for employment generation that was never fully implemented, because it appeared at the very end of the government's term in office. The same was true for the Employment Plan launched during the government of Paz Zamora in 1993. Hence to this day, Bolivia does not have an active policy for employment generation. The PND of President Morales advocates, on this subject, the need to "introduce changes and effective solutions for unemployment through actions directed at diversifying the economy, multiplying economic actors, and generating conditions for a significant expansion of higher quality employment opportunities, as the optimum platform to transform the productive matrix inherited from the market economy" [64].

[63] See Annex 10.

[64] SD 29272, 12 September 2007, Ministerio de Planificación del Desarrollo, PND. "Bolivia digna, soberana, productiva y democrática para vivir bien". Gaceta Oficial, Edición Especial No. 0103.

The PND, in a preliminary version, considered the possibility of including a commitment to create 90,000 additional employment opportunities a year and the reduction of the rate of unemployment from 8.7% in 2004 to 4% by the end of the period of government (2011). However, these figures fall well short of what is required in order to achieve a significant impact on the labour market, particularly if the 120,000 new entrants a year, are taken into consideration. Thus, the final version of the PND does away with numbers and promises only "that men and women of working age will find quality and sustainable employment", without suggesting how this lofty objective will be achieved.

2.6 The Challenges for Public Policy on Employment

The analysis undertaken in the preceding sections has identified the main characteristics of employment in Bolivia, as well as all factors that need to be taken into account in the design of public policy to promote stable, productive, and higher paid employment and reap the benefits that these results have in the long term. In this context, policies should be able to:

- face the growing levels of informality in the labour market through the introduction of creative incentives for the generation of long-term, higher paid jobs that will contribute to employment formalization,
- face the reduction in labour productivity across the economy through the promotion of incentives that favour the adoption of new technology,
- design and implement the necessary reforms to solve the mismatch in the supply of education and training and the demand of firms for new skills and abilities,
- improve the employability of the Bolivian workforce, particularly young people and women, to reduce exclusion levels and promote a better labour market integration,
- face-up to discrimination in all its shapes and sizes (gender, ethnic origin, language, religions, etc.) through regulatory actions, but also with adequate education and training,
- introduce transparency into the labour market by expanding public services such as employment agencies, education and training and the management of the demand for labour,
- make use of the short term competitive advantage that relatively low labour costs (in relation to the rest of the region) provide Bolivia to strengthen production in sectors that are labour intensive, which will in time result in better opportunities for income generation.

3. Macroeconomic Analysis

Over the past 20 years, income per capita in Bolivia (GDP based) grew at an average rate of 1.3% a year. This rate, which is higher than that experienced during the period 1970 to 1986 (-0.7%), is still lower than that required to significantly reduce poverty in the country. The analysis put forward in this chapter aims to identify weaknesses, as well as strengths, in the macroeconomic context so as to help understand the limitations and opportunities to achieve higher levels of economic growth, especially in those sectors and activities that are likely to benefit poor people. To do so, this chapter considers the evolution of the external sector of the economy, the performance of the domestic economy, the potential to generate pro-poor growth with adequate economic policies, as well as the conditions under which these policies are likely to produce the expected results and, thus make a lasting contribution to income-poverty alleviation in the country.

3.1 The External Sector

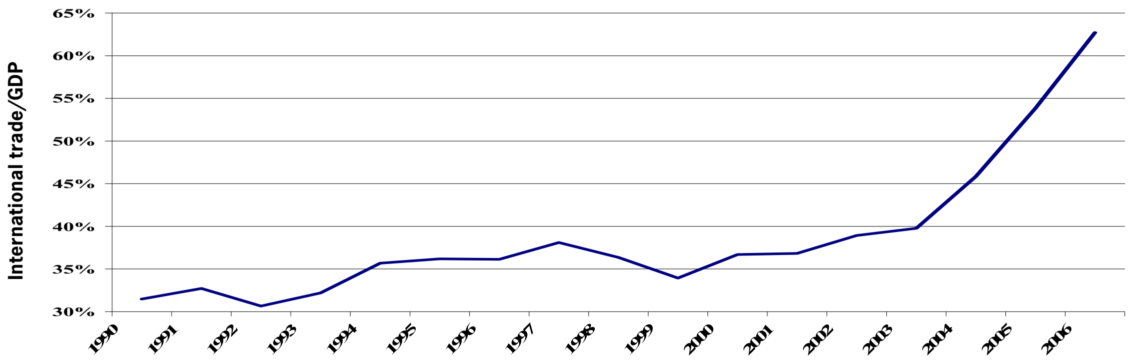
Bolivia has considerably improved its external trade in the past 5 years. Three factors account for this result: i) the completion and implementation of the natural gas export to Brazil project, ii) the demand for natural gas from Argentina, and iii) the increase in international prices for the country's export products. In this context, the share of exports from extractive industries (mining and hydrocarbons) grew from 46% of total exports in 2001 to nearly 75% in 2006, when two products (natural gas and zinc) represented more than 50% of total exports. Recent export dynamics in the mining sector, together with the completion of two large mining projects[65], also augur well for mineral exports in the near future.

The growth of exports has resulted in a positive trade balance for the first time in more than a decade, which has had the effect of pushing imports up, too. The average annual rate of growth of imports is slightly higher than 10%, well below exports, which experienced an average growth rate of 25% a year. The new found dynamism of the external sector has been an important contributing factor to the increased openness of Bolivia's economy, particularly since 2003. International trade accounted for 63% of GDP in 2006, a figure that compares positively with the early 1990s, when international trade represented less than 30% of GDP. The price effect on exports of raw materials is the main factor

[65] San Cristobal and San Bartolomé, both projects are located in the region of Potosi and will extract lead, silver and zinc.

that explains growth in exports, a result that shows the vulnerability of the national economy to external price shocks. Furthermore, considering the close relationship between national income and exports, the low tendency to save in the economy, and the reliance on hydrocarbon taxes for government income, a sharp fall of international prices and, consequently, of the value of exports could spell disaster for the poor, as their consumption will be compromised by the reduction in income levels and the presence of inflation.

Graphic 5: Bolivia: Degree of Openness of the Economy



Source: BCB. Prepared by SAXgr

3.1.1 Competitive advantages, restrictions, and vulnerability

Bolivia has a propensity to develop exports of non-renewable raw materials because of the abundance of natural resources that exist in the country. However, the limited labour absorption capacity in these sectors combined with the low value-added incorporated into these products has engendered a dilemma that is difficult to solve and which has been the source of great conflict in the past. When international prices of raw materials are high, certain forces within the economy purport that only State intervention will allow a more equitable distribution of the income generated by the effective exploitation of the country's natural resources. The opposite view suggests that it is important to create the necessary conditions to attract foreign direct investment to help exploit the wealth of existing resources in Bolivia. The current political situation is tainted by this argument, where high international prices and, consequently, higher profits have moved Bolivian society to press for more State intervention in the exploitation and commercialization of natural resources.

In recent years, however, exports of light manufacturing products (apparel, jewellery and goods made of wood and leather) have also been on the rise. This emerging sector is the most vulnerable to economic fluctuations, inasmuch as what justifies its competitiveness is a very delicate balance. Amongst other things, manufacturing and export of these products depend on socio-political stability and clarity in the "rules of the game" so that firms can comply with exports contracts in time and with the required quality specification. The growth experienced by these sectors owes much to the implementation of trade agreements with neighbouring countries and the Andean Trade Preferences and Drug Eradication Act (ATPDEA) passed by the US Congress to help Bolivia, Colombia, Ecuador, and Peru export non-traditional products to the US.

Bolivia's competitive advantages in trade derive from the abundance of natural resources and the relatively low labour costs. The poor investment record in sectors other than mining and hydrocarbons has hindered their development and limited their potential as a source of employment and pro-poor growth. Also, it has affected their backward and forward linkages with the rest of the economy and thus its capacity to create room for specialization and the development of new competitive advantages which arise from higher levels of specialization and technical capacity. Finally, limited economic diversification and poor levels of integration (within and between sectors) complete the list of factors that contribute to the persistence of a vicious circle that prevents these sectors from developing.

3.1.2 The structure and evolution of the economy: strengths and weaknesses

The economy, which is highly dependent on the primary sectors and is strongly linked to the tertiary sector, has a weak industrial structure vulnerable to external and internal shocks. This weakness is reflected in the low rates of investment, particularly from the private sector, and in the absence of linkages within and between productive sectors, which has resulted – in turn – in the slow growth of the productive capacity of the country and of the basic infrastructure that should act as an enabling condition. Inroads into this situation were made in the past two decades, when low international prices for raw materials forced the Bolivian economy into developing an industrial sector with some export capacity, albeit one that is small and vulnerable. Having said that, macroeconomic risks have been significantly reduced in the recent past, but institutional weaknesses are still a threat that needs to be addressed and recognised as an important limitation for development.

The incipient growth in industrial capacity has not been confined to the region of La Paz. Other regions of the country have been able to make headway in the process of productive diversification. This development has been accompanied by a process of political and economic decentralization, which has – in some measure – shielded these regions from national and political shocks.

3.1.3 Appreciation of the exchange rate and its effect on the poor

As of late, the weakness of the American dollar in international markets has resulted in a substantial appreciation of national currencies in most countries around the world. Bolivia is not an exception and it has also experienced a nominal appreciation of the Boliviano against the American dollar, but accompanied by a depreciation of the real effective exchange rate and higher levels of domestic inflation. It is not inconceivable, however, to project that in the short to medium term Bolivia will also experience a real appreciation of the Boliviano against the dollar and other currencies in the region, given the extraordinarily favourable international price conditions and the significant increase in the volumes of export products, particularly natural gas. A real appreciation of the national currency will reduce competitiveness, a development that will hit the manufacturing sector and all other employment generating sectors the hardest. For this reason, and in order to mitigate this contingency, it seems necessary to reduce government spending, so as to release inflationary pressures in the economy and to prevent a deepening of the current economic cycle. Pro-cyclical economic policies accentuate the peaks and troughs in the trend, reducing average economic growth in the long run. On the other hand, a higher volatility in the growth of GDP generates more uncertainty and sets limits to the creation of new employment in the productive sector.

In this context, if fiscal and monetary policies are not sufficiently fine-tuned so that management of the exchange rate is a good complement for prudent fiscal policy, the prevailing favourable external conditions may not be fully taken advantage of. At first glance, an expansion of government spending would not appear to be a bad idea to increase income per capita (measured in US dollars), even if this results in the appreciation of the exchange rate, because in a context of high international prices exports of raw materials are unlikely to be affected. However, an expansionary fiscal policy would be felt by the export-oriented industrial/manufacturing sector, which as a result of the exchange rate appreciation is certain to lose competitiveness. Lower international orders would – in turn – result in fewer employment opportunities or even job cuts in the sector being created[66].

In principle, this need not be a problem either, if the State becomes the main source of employment in the economy and "income from the government-seeking" policies still provide a safety net for the poor. However, this scenario is clearly not sustainable in the medium and long term. An economy that is unable to generate productive employment will eventually impact negatively on the salaried classes and those that are dependent on the productive sector.

3.1.4 Liberalisation of the balance of payments and its impact on the poor

An important feature of the economic model introduced in Bolivia the late 80s was the gradual opening of the economy to international trade. As with many other countries, its initial effect was an increase in the volatility of capital movements and the production of export-oriented goods. However, given the incipient development of capital markets and the strength of the financial system, the effects of trade liberalisation were mainly felt in the balance of payments and its prices. Nevertheless, in the case of Bolivia these effects have generated an increase in the volume and diversity of imported goods available to the population along with a significant reduction in prices.

The limited capacity of the economy to create productive employment has caused a significant increase in migration flows towards other countries in the world in the past few years. Migration has resulted in remittances, which according to the Bolivian Central Bank reached US$ 700 million in 2007[67]. This level of remittances has had a large positive effect on aggregate demand, a large proportion of which is believed to be used in the consumption of goods, in particular of imported products. The chain of events may work as follows: an initial number of remittances are spent by the recipients to supplement the cost of basic foodstuffs and, later, clothing. In a second moment, remittances finance the consumption of imported goods, such as kitchen appliances. In a third moment, remittances are slowly introduced to finance investment, especially on housing. In this context, the area of remittances is of strategic importance to the economy, which with careful design of public policy may be effectively directed to increase savings, leverage other financial resources and, as much as possible, to finance private investment in housing, but also in productive infrastructure.

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66 Sectors, such as agriculture and industry, which together generate 50% of total employment

67 Other sources, such as IDB and the financial sector estimate remittances to be around US$ 1,000 millions in 2007.

3.1.5 Foreign capital flows: effects on the generation of quality employment

The vast majority of foreign direct investment attracted to Bolivia during the 1990s was used to develop extractive industries, particularly the hydrocarbons sector. Only a small percentage of these investments is accounted for by the manufacturing and service sectors. Also, the economy has been hit by disinvestment, a consequence of the important level of uncertainty that has been introduced by the political and social events experienced in Bolivia during the past few years.

Table 17: FDI Flows by Economic Sector, 1996–2004 (Millions of US$)

Descripción	1996	1997	1998	1999	2000	2001	2002	2003	2004 (p)	2005 (p)	2006
Gross FDI Received	427,2	854,0	1.026,1	1.010,5	832,5	877,1	999,0	566,9	385,0	404,4	435,1
Hydrocarbons	53,4	298,6	544,2	448,9	411,9	531,0	709,5	335,8	124,3	105,0	104,5
Mining	19,7	29,9	38,1	23,1	28,5	34,5	11,6	20,5	8,9	183,0	251,3
Industrial	32,7	24,7	16,4	152,1	93,4	87,3	91,1	62,2	99,2	58,3	47,8
Electricity	38,7	100,8	74,7	71,7	36,2	39,0	39,6	34,8	45,1	45,0	16,0
Trade And Services	282,8	400,0	352,5	314,6	262,5	185,2	147,2	113,7	128,6	13,1	15,5
Uninvestment	0,0	0,0	0,0	0,0	-96,1	-171,3	-322,4	-369,5	-319,6	-681,0	-195
Fdi Received	427,2	854,0	1.026,1	1.010,5	736,4	705,8	676,6	197,4	65,4	-276,6	240,1

Source: BCB, based on information from FDI Surveys, CPE and own data. (p) Preliminary

A central task of the current Bolivian government is to stop the downward trend in foreign direct investment. A number of reasons can be put forward in support of this statement; however the most pressing one refers to the need of increasing investment to raise production levels in order to create new, high productivity and better quality employment opportunities[68]. There are a number of studies in Bolivia that show that foreign direct investment can generate higher quality and better paid employment than domestic investment, which is reflected in time in improved levels of welfare of the population. To significantly increase the rate of growth in per capita income it is necessary to raise investment levels above 20% of GDP. Historically, domestic investment in Bolivia, public and private, has not been higher than 15% at its peak, which implies that the ensuing gap needs to be breached with foreign direct investment.

3.2 The Domestic Economy

3.2.1 Inflation and stability: policies and consequences

Inflation in Bolivia remained low at rates under one digit for more than ten years, but with a slight upward trend since the recession experienced in 2001-2002. The international crisis that affected Argentina and Brazil between 1999 and 2001 triggered a downturn in the Bolivian economy that was made significantly worse by the implementation of contractionary fiscal and monetary policies. The ensuing depression was one of the longest and deepest economic crises experienced in over 20 years. A negative by-product of the recession was the reversal in the trend of growth of GDP per capita, with its implications for the mitigation of poverty and income distribution.

[68] See "Lineamientos Estratégicos del Plan Nacional de Desarrollo".República de Bolivia (2005).

Year to year inflation reached 11.7% in 2007, its highest level in thirteen years. This increase in prices is highly correlated with the growth of the monetary base (currency in circulation), it grew at annual rates of 50% and over. Hence, currency in circulation has trebled in the past three years[69]. An important explanation for the growth of the monetary base is the change of trend and monetisation of the economy, away from the American dollar and into the Boliviano. Between 2003 and 2007, as a result of this newly expressed preference for the national currency, the percentage of American dollar denominated bank deposits fell from 91% to 63%[70].

The increased dynamism of the external sector has also played a part in the expansion of the money supply by increasing the balance of payments' current account at rates similar to those experienced by currency in circulation. Also, this expansion has had a multiplier effect, similar to an increase in government spending, which runs through the economy by boosting the income of households and firms and, consequently, consumer spending. An important effect of the new economic dynamism of the external sector is the growth experienced in industrial production in 2006, which was the highest in the past three decades. Retail trade has also experienced noticeable levels of growth.

Table 18: Gross Domestic Product by Activity (Average Growth 1987–2006)

1987–2006		**1987–2006**	
1.3 Coca	-6,98%	7.1 Transport And Storage	3,97%
8.3 Housing	1,88%	9. Communal Services, Social, Personal And Domestic	4,19%
3.5 Petroleum Refined Products	1,98%	7. Imports. Vat, Transaction And Other Indirect Taxes	4,24%
3.7 Other Manufacturing	2,45%	3.2 Beverages And Tobacco	4,39%
1.1 Non Industrial Agricultural Products	2,47%	3.1 Food	4,68%
10. Restaurants And Hotels	2,53%	4. Gas, Electricity And Water	5,00%
Public Administration Services	2,70%	3.6 Non-metallic Mineral Products	5,22%
5. Construction	2,77%	8.2 Business Services	5,84%
3.3 Textiles, Clothing And Leather Products	2,81%	8.1 Financial Services	6,02%
1.4 Livestock Products	2,96%	2.1 Crude Oil And Natural Gas	6,33%
6. Trade	3,18%	7.2 Communications	8,40%
3.4 Timber And Wood Products	3,22%	1.2 Agricultural And Industrial Products	8,43%
1.5 Forestry, Hunting And Fishing	3,24%	**Total: Market Prices**	**3,62%**
2.2 Metallic And Non-metallic Minerals	3,59%		

Source: INE

[69] According the Bolivian Central Bank, money in circulation grew from Bs. 3,865 million in December 2004 to Bs. 13,050 million in April 2007.

[70] See www.bcb.gov.bo - Estadísticas Monetarias Semanales.

In spite of a lack of private investment, the economy may be able to generate new employment opportunities – albeit not sustainable in the long term – given the current dynamic situation of the construction industry. Lack of investment in basic infrastructure and services sectors such as electricity and cement, will represent a bottleneck in the growth of the economy. However, growth in aggregate demand without a corresponding increase in aggregate supply may lead to inflationary pressures that may be difficult to contain in the short term. A possible outcome of this imbalance may be a real appreciation of the economy, which will give rise to the effect known as the "Dutch disease" [71]. If this upward trend is not too strong, exporters are likely to offset it with gains in productivity. However, this is not sustainable in the long term and it highlights a point of potential vulnerability of the national economy.

The long term preoccupation with the role that natural resources play in the development of countries which have them in abundance, has in the past elicited important academic research that suggests that – on the whole – their impact is negative for economic growth. Natural resources are traded in world markets that constantly push relative prices down, a factor that is reflected in the domestic economy as lower levels of income and the onset of the "Dutch disease". New research points in a different direction. Abundant natural resources may be positive for the economy as they contribute to growth and to the well-being of the population. Empirical research suggests that it is not natural resources that affect growth negatively, but the concentration of exports in a few products. Hence, diversification seems to be key to improve economic conditions and the well-being of the poor.

3.2.2 Sectoral composition of growth dynamics

The Bolivian economy has shown a long term positive trend in growth, although still modest in relation to its immediate needs. It ranks behind Chile as the economy with the highest rate of growth in South America in the past 20 years[72]. Income per capita, on the other hand, depicts an evolution that mirrors more closely the regional average, given the high levels of population growth prevalent in the country in the recent past. The 3.6% annual average growth rate for the period 1987–2007 was led by the expansion of the export-oriented sectors of the economy or those closely integrated to them. In spite of this important result, the four sectors that experienced growth rates higher than 6% a year in the past 20 years, account for less than 15% of GDP and an even lower proportion of the total employment generated by the economy.

This experience contrasts positively with that observed between 1952 and 1986, when the economic cycles were more clearly defined and procyclical fiscal policy had a tendency to accentuate these fluctuations, which are themselves highly correlated with oscillations in international prices of raw materials, and social and political instability at home. Structural reforms introduced in the period since have had an important effect in taming these fluctuations, improving average economic performance, and reducing the vulnerability of the whole economy to external shocks. The latter was also instrumental in the reduction of

[71] The economic expansion generated by the primary sector and other income from external sources increases domestic costs and reduces the competitiveness of labour intensive, export-oriented manufacturing sectors.

[72] IMF: 2006 World Economic Outlook

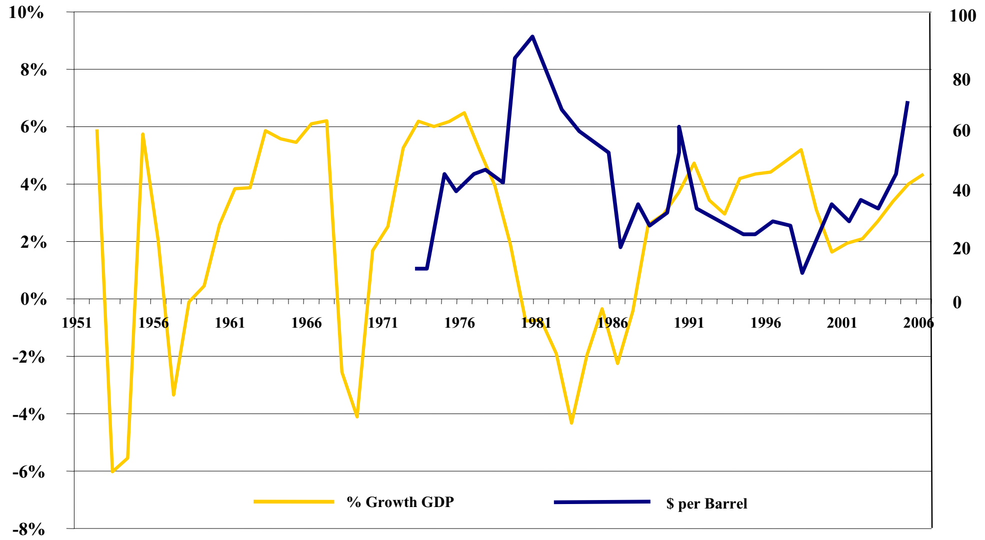
poverty in Bolivia and the substantial improvements experienced in the indicators of human development[73].

Table 19: GDP Growth adjusted by PPP and Real Oil Prices (1951–2006)

Period	Growth
1951–1969	2,0%
1970–1986	1,8%
1987–2006	3,60%
1951–2006	2,50%

Source: Based on BCB information. Prepared by SAXgr

Graphic 6: GDP Growth adjusted for PPP and Real Oil Prices (1951–2006)



Source: Penn World Tables and The Economist, September 2005.

3.2.3 Rates of interest, differentials, and access to credit

The Bolivian financial system is characterised by its high levels of "dollarisation" and the poor degree of financial penetration, incidentally, as a result of the experience of hyperinflation in the early 1980s. After long years of relatively high rates of interest, and following the depreciation of the Boliviano in 2003, real interest rates are falling and, in some cases, becoming negative. This outcome is a strong disincentive to save and points to further vulnerabilities in the economy. In the recent past, there has been a clear incentive for the financial system not to intermediate and, as a result, bank deposits have been at their lowest in close to a decade. The growth in bank deposits has recovered slightly in the past years, but only through the growth in UFVs denominated accounts[74].

The largest percentage of bank deposits and loans are still held in American dollars, despite a strong tendency towards the "Bolivianisation" of the economy and bank transactions. In 2001, 98% of all loans in the financial system were dollar denominated, whereas by 2007 the proportion had fallen to 82%. Also from 2003 on, rates of interest on bank deposits have been higher for accounts held in Bolivianos than for accounts held in US dollars, reversing a trend that had been predominant in the financial system since time immemorial. Liquidity in the

[73] According to Collys (2004), Bolivia shows the highest rate of growth in human development indicators during the 1990s in relation to other countries in the region.

[74] UFV is a national currency referential index which maintains the value of deposits against inflation.

financial system has also allowed for a reduction of interest rates on loans, to levels that are historically low. This level of reduction is only possible because of the low rates of interest that are paid on deposits and, to a lesser degree, to the reductions in the differential between active and passive rates of interest, especially for loans and deposits in Bolivianos. These lower rates should act as an incentive to finance new private projects and initiatives. However, net private investment has been close to zero in the past two years and is unlikely to change in the near future. Bank loans have been turned more assiduously into mortgages, but at levels still below the peak experienced in 1998.

3.2.4 Evolution of micro-credit

An important aspect to highlight is the evolution of micro-credit and its change in composition. The chaotic growth of the banking sector at the end of the 90s was the result, on the one hand, of a disproportionate increase in lending and, on the other hand and more importantly, of an increase in the number of loans designed to finance consumption (advertised as such). By 1999, the proportion of the economically active population with access to credit was 20%, which is high by previous standards. Before the credit boom, access to the financial system was difficult, so this process contributed to the "democratization" of credit and to improve access to borrowing for those working in the informal sector, with innovative solutions to the prevailing regulatory restrictions. One such innovation was the introduction of micro-credit, which had been timidly presented a few years before.

From that moment onwards, it was the micro-financing institutions that were responsible for the sustained growth in lending to levels only experienced previously during the credit boom years (20% of the economically active population), but this time with better results. Micro-credit lending was more sustainable than consumption loans, the default rates were low and the financial system was able to reach sectors of the population that had seldom had access to credit. Thus, micro-credit was also important as a mechanism for poverty alleviation. The growth in micro-credit lending accelerated in the past ten years with the emergence of new institutions[75] (some regulated by the State and others self-regulated) and today micro-credit lending represents nearly 30% of all lending in Bolivia and 70% of the total number of loans in the financial system.

Among the many changes observed during this period is the reduction in the average size of loans, which was halved. The financial NGOs, which are self-regulated and associated to Finrural[76], have multiplied by four their participation in the micro-lending market in recent times, accounting for 3% of total lending in the economy and 27% of all loans. Regulated micro-lending institutions have doubled their participation in the market in ten years to reach 25% of total lending and 41% of all loans.

A point to highlight in the micro-credit market is the system of communal banking, which specialises in lending money to women from the lower income levels. A large chunk of the growth experienced in the number of loans from non-regulated micro-credit institutions owes much to this type of initiative (technology), which in addition presents the lowest rates of default for the whole system. It is clear that increased

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[75] Banco Sol, Banco los Andes, FFPs, Mutual Associations, and Cooperatives

[76] An association of non-regulated micro-credit institutions, the majority of which are financial NGOs.

competition amongst micro-credit institutions has been instrumental in the development of innovative solutions to provide access to credit, reduce its overall costs, provide a better service and improve the well-being of the population.

3.2.5. Financial system and capital market projections

An important proportion of the micro-credit loan portfolio has been showing of late an increase in the average size of loans and not in the number of loans. If credit loans became recurrent (renewed constantly and consistently to the same client) and the growth in their value were similar to that of the rate of interest accrued, then they may be hiding latent default risks for as long as the increase in loans maintains its natural dynamic. This is another potential economic vulnerability that needs to be carefully monitored.

On the other hand, if the increase in the average size of micro-credit loans is helping to finance the growing economic activities of the population to which these are directed, then micro-sized enterprises and other similar entrepreneurial initiatives are being properly looked after and provide an important source of dynamism for the economy as a whole. To unravel these questions and evaluate the impact of micro-credit on economic expansion and the emergence of a social entrepreneurial capacity, it is necessary to perform a more extensive analysis.

In any case, it is beyond doubt that the process of democratisation of credit directed at the development of economic activities with higher levels of productivity is a highly desirable objective to aim for in the fight against poverty and sustainable pro-poor growth. In this perspective, it appears important to strive to bring together all financial mechanisms available with productive investment or investment that improves the well-being of the population, such as social housing. These types of initiatives offer the added advantage of generating large scale employment opportunities and help to maximise the multiplier effect of credit flows into the economy.

Capital markets in Bolivia have shown incipient growth since the early 90s when the financial system achieved stabilization and the process of pension reform was initiated. However, further development has not materialised, given the fall in productive investment and the diminution of the levels of independence that regulatory bodies are supposed to enjoy. For this reason, capital markets (and other mechanisms of long term finance) in Bolivia are unlikely to develop greatly in the foreseeable future. It is also clear, that this situation is in itself a strong limitation to economic development, particularly in relation to the contribution of the private sector. Although the BDP has been established to partially bridge this need for long term finance, it is at present difficult to anticipate a rapid growth of its loan portfolio, especially if prudence and solvency are to be maintained.

3.3 The Fiscal Balance

The responsible management of fiscal variables is paramount for the implementation of development policies that can be sustained in time. In the period 1952–1985, fiscal policy was used politically to expand government spending without due consideration to corresponding sustainable increases in income. This type of fiscal management has more often than not resulted in economic crises that have plunged the country into recession and high levels of inflation. For this reason, it seems reasonable to study the current economic situation, one that in the government's view has overcome most of the restrictions of the past and is likely to deliver favourable economic results in the medium term. The big question is whether this is so and that the fiscal situation is not stretched to a breaking point if there is a fall in the international prices of raw materials that sustain government spending at present.

3.3.1 Government income: vulnerability and sustainability

A review of the information available for the non-financial public sector confirms a growing dependence on tax revenues from the hydrocarbons sector. In the past four years, tax revenues from the hydrocarbons sector have quadrupled and account at present for 80% of total tax revenue, despite the fact that other tax income has also been growing at two digit rates in the recent past. A sensitivity analysis of tax revenues to a 25% fall in the international prices for oil and natural gas suggests that the former may experience a reduction as high as 28% approximately[77]. The previous scenario of falling hydrocarbons prices from the levels prevailing in 2007 would cut government income by around Bs. 3,200 million. If to this exercise one adds the growing trend in government spending, which has been sufficiently large in 2007 to merit a projection of 4.1% of GDP for the fiscal deficit in the budget of 2008, the potential vulnerability to the economy of the fiscal balance is evident.

It is also important to note that there has been a significant reduction in the levels of low-cost external financing, which implies that the State (and especially the Treasury) has been relying on more expensive internal financing to close the fiscal gap. If a fall in government income increases the fiscal deficits and forces authorities to "print money", the consequent inflation (a regressive tax on cash) will fall disproportionally on the poor whose earnings are fixed. The existence of highly organised pressure groups with political power suggest that the benefits received from the government during the boom years in fiscal revenue, are unlikely to disappear in the event of a fall, putting pressure on the poorer segments of society to carry the burden of the resulting fiscal imbalance[78].

3.3.2 Internal debt: vulnerabilities and threats

The Treasury is at present a source of important vulnerabilities that risk destabilising the whole economy, if there is a significant reduction in government income or if the public loses faith in the capacity of the State to honour its internal debt. Tax revenue, which has been growing, has improved the fiscal balance in the Treasury and currently constitutes its main source of income. However, the income of the Treasury generated from the hydrocarbons sector has been falling, due to the substantial reduction in the revenues generated by the special tax on hydrocarbons and their by-products (IEHD, for its acronym in Spanish) whose rate has been reduced to almost zero to maintain domestic prices of petrol and gas fixed. Moreover, the important growth in the revenue derived from the application of direct taxes on hydrocarbon production (IDH, for its acronym in Spanish) has not benefited the Treasury, because of the decision to distribute most of this revenue amongst the regions, municipalities, universities, and other beneficiaries. Although this means that the Treasury income is more stable, it also clear that the income redistri-

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[77] Based on the unedited exercises of Mauricio Medinacelli about different scenarios for fiscal income with variations in international prices and volumes for hydrocarbon production.

[78] Natural disasters, due to climate change, may also become a significant source of macroeconomic shocks and, hence, a major factor of macroeconomic vulnerability in Bolivia.

bution initiatives of the present government (Juancito Pinto bonus, Renta Dignidad, etc.) will eventually be the responsibility of the Treasury itself.

The gradual fall in external disbursements to the Treasury is also worth mentioning. It has resulted in a higher level of dependence from internal finance, in spite of showing a slight surplus in 2006. Internal financing is done through the issuing of Treasury Bonds and it is projected that 2007 will show the highest net issue of bonds in the past six years.

3.3.3 Limitations to the use of low-cost external finance

The number of grants received by the Treasury (capital income) has been falling steadily in the recent past to around Bs. 12 million in the first quarter of 2007. The figure for the whole non-financial public sector for the same period was Bs. 150 million, which was disbursed in the first few months of the year. It is possible to argue that the reduction in grants and other low-cost external financing is due to the improvement in the fiscal and economic situation of Bolivia, but it is also evident that there are problems in the execution of projects financed by international cooperation agencies. According to data from the Viceministry for Public Investment and External Finance (VIPFE for its acronym in Spanish) and the World Bank, in May 2006 there was Bs. 3,800 million in external finance available in projects in execution or in the pipeline and close to Bs. 1,000 million in negotiation. Disbursed concesional resources (grants and external credits) up to May 2006 for the whole non-financial public sector were lower than Bs. 2500 million.

In view of the above information, it seems necessary for the government to optimise the use of resources available to Bolivia in the international cooperation organisations. Moreover, resources to finance programs and sectoral policies are relatively easy to access with funding mechanisms such as "basket funding" or SWAps. Thus not to use them to expand programs and projects appears wasteful and inefficient, particularly now that there is more flexibility to choose initiatives to finance and improve levels of execution.

3.3.4 Quality in public administration and spending policy

The previous paragraphs point to a deficient institutional capacity in the Bolivian public sector to define, negotiate, and execute projects financed by the international cooperation. In order to restore this capacity it is necessary to engage personnel with experience and technical qualifications, a necessity that has been made more difficult by salary cuts imposed by the government to boost its credibility with the population. Furthermore, the reduction in public sector pay has contributed to the loss of professionals with knowledge and experience and the resulting reduction in institutional capacity.

On the positive side, it is possible to highlight progress made in terms of inclusion. However, there is still much to be done. Institutional strengthening programmes should be aimed at improving the capacity of technical personnel, particularly those associated with the economic sector and the management of public funds. Bolivia, with the help of international cooperation, has utilized a considerable amount of resources to educate and train public sector employees, an effort that should be preserved. Also, it is just as important to note that, on the whole, technical personnel has served under different administrations and has been trained in different methodologies to improve the management of the public sector. To improve the current situation and avoid a drastic and irreversible decline in the capacity to manage public policy and the economy of the state, it is paramount that the government assigns a higher priority to retain technical personnel in preference to political appointees.

3.4 The Capacity of the State to Generate Pro-poor Growth

Pro-poor growth can only be achieved in a country where the State provides an adequate policy framework. The evidence collected from East Asia, where pro-poor growth has been attained, suggests that the State has an important role in facilitating growth through the provision of public goods, social safety nets, and the creation of institutional conditions necessary to harness sufficient capacity to embark on a development path that is more inclusive and equitable. All these can only be achieved with the effective implementation of public policy, which – in turn – implies the existence of institutional structures and conditions of governance capable of designing, executing, and evaluating these policies. Successful experiences also show that institutions are important, and that efforts undertaken to reform and build solid pro-poor government structures require that these be previously identified and strengthened accordingly.

For this reason, a State needs to be development oriented if it is to achieve a pattern and tempo of economic growth that favour inclusion of the poorer segments in society. The following chart summarises the results of an analysis undertaken to establish whether the Bolivian state is development oriented, and points to the policy areas that should be strengthened to promote pro-poor growth.

Table 20: Characteristics of Development Oriented States and the Situation of Bolivia[79]

Concept	General Characteristic	Perception of the current Situation in Bolivia
State Control and Legitimacy	The authorities and State systems are strong and legitimate, imposing political stability.	The strength and legitimacy that the government of President Morales had in 2006, when it was supported by 54% of the vote[80], has been considerably weakened in the past months, giving rise again to a situation of political instability.
	Progressive taxes are collected, employment is regulated and there is a safety net for the poor.	A progressive system for tax collection s in place, but it is a system that has yet to introduce income tax. A mechanism of employment and labour law regulation that protects workers is also in place. There is no system for social protection, but one is being designed based on current experiences.
	A sense of nation exists.	This is still the most important challenge facing Bolivia, given the exacerbation of regional sentiment.
	Investment is attracted and the objectives of national development are promoted.	Public policy on private investment (domestic and foreign) is not clear.

[79] Inspired on Cammack, D. (2007) The Logic of African Neopatrionalism: What Role for Donors? Development Policy Review, 25.quoted in “The Politic Economy of Pro Poor Growth. The Challenges of making Growth Pro Poor” by Kate Bird. Overseas Development Institute, Briefing Paper. January 2008

[80] Since democracy was reinstated in Bolivia, elections never gave conclusive results and political parties needed to make alliances to form governments. In 2005, MAS made history by winning the election outright and with a difference of 25 percentage points over the opposition (53.7% to 28.6%).

Concept	General Characteristic	Perception of the current Situation in Bolivia
Public Sector Management	A competent, autonomous and powerful bureaucratic system exists. Its loyalty is unquestioned and it has the freedom to create, direct and manage economic and social development. There are other public institutions and networks that promote and implement efficient economic policies.	In spite of the efforts undertaken since the early 1990s and until recently to form groups of specialist public sector workers that enjoy stability, institutionalisation is reversing. Public sector appointments today reward political loyalty and quality has been affected by the low levels of remuneration being received. Economic policies are the responsibility of the Ministry for Planning and Development, with little coordination with the Ministry of Finance and the Bolivian Central Bank. Institutions that were in the past part of the process of decision- making and evaluation are not longer fulfilling that role.
Government Legitimacy	The government is legitimate and has support, without having to redistribute public goods or change or block public policy to maintain support and political power.	In spite of its legitimacy, the government has started to redistribute public goods and also private goods to keep the levels of support that it has (populism). The policy of distribution of public goods is still applied by the current government in a similar fashion to that of previous governments.
State and Non-State Actors	The State is relatively independent from individual or group interests and is open to the participation of civil society in the design of public policy.	The State designs and manages public policy in favour of the poor (positive discrimination). However, indigenous groups and the so called “social movements” have a special relationship with the government, which favours their corporative outlook, fulfilling their demands and their short term objectives before those of the country. Civil society actors have an input in the design of policy, but only those that think alike. Critical viewpoints are not accepted.
Political Priority	Economic development is consistently prioritised by government policy, in an effort to promote productive initiatives.	Economic development is not the government’s priority and most policy options are political in origin. Policies for the promotion of the productive sector have been announced, but have not been delivered in practice.
National Behaviour and Attitude	Social and technical innovations are generated in or outside the country, but are later adapted and utilised to solve problems and create functional institutions and systems. Tolerance, meritocracy, social mobility and education are valued and promoted.	Social and technical innovations have been put forward by the government, but these are not sufficiently discussed with all actors, a situation that puts limits to their critical construction and reality tests. Tolerance, meritocracy, social mobility and education are not values that have been privileged by the State at present. Political activism and loyalty to the party are determinant to be appointed to public office. Education is perceived positively, but in some cases is viewed as negative (education = neoliberal).
Elite	Leaders promote development (which is also beneficial to them) and corruption is under control.	Political leaders in power do not promote development as a main objective. Corruption levels in government have fallen noticeably since President Morales took office.

It is possible to convince the better-off population of a country to support pro-poor growth policies if they perceive that these changes will also benefit them in the long term. To achieve consensus on this particular viewpoint is the task of the State, as is the implementation of policies to advance in the direction of achieving some of the characteristics of a development oriented State that favours pro-poor growth described above.

3.5 The Legacy of the 90s and the Changing Position of the PND

The economic process undertaken between 1985 and 2005, with its positive and negative aspects, has made important contributions in terms of public policy and the construction of institutional capacity that should not be ignored. The changing position of the PND in Bolivia has the opportunity to build on top of these foundations to achieve its overriding objective, which is to eradicate poverty and improve the living conditions of the poor. The most important policy initiatives of the past 20 years that can contribute to the construction of a new approach to development are:

The renegotiation of external debt. This is a process that was initiated in 1986 and that lasted for over 20 years, but allowed Bolivia to change its condition as a "highly indebted country". This process was also instrumental for achieving fiscal stability and improving public policies for external finance. The key elements of this process can be seen in the 90s with the negotiations to make Bolivia part of the HIPC initiative and the design and implementation of its strategy for external debt repayment. This strategy allowed Bolivia to be at the forefront of all initiatives aimed at reducing external debt, including multilateral initiatives that have been recently implemented. The fiscal benefits of this policy to the country are clear and have contributed also with additional resources for public investment in municipalities.

The consolidation of tax reform. The passing of Law 843 on, the independence of tax collection offices, such as the Internal Revenue Service and Customs, as well as the implementation of the new Tax Code allowed Bolivia to eliminate the fragility and instability of government income, to increase its tax base and to build greater fiscal sustainability. This process also favoured the capacity to transfer a significant proportion of resources to local and regional governments. However, it is necessary to introduce a higher degree of progressiveness to the tax system with the introduction of income tax, a policy option that the PND should seriously consider.

The development of an internal market for public debt. Although there is much argument about the size and growth of the internal debt, the development of an internal market for long term public debt has contributed to the incipient development of capital markets in Bolivia, as well as allowing fiscal policy some necessary flexibility and generating an important level of liquidity in the economy as a whole. The internal market for public debt has also been important for the development of a more effective monetary policy, one that relies less on direct instruments of control.

The decentralisation of public income and spending. This decision allowed municipalities and Prefecturas (regional level governments) to have access to economic resources and to develop effective regional and local policies of investment, improving in the process their quality and efficiency. Decentralisation of fiscal resources also aided local and regional decision-making. However, decentralised institutional capacity has not improved in time, reducing the impact of the process and making inefficient use of the increased level of resources. The resources available in Central Bank accounts, the atomisation of investment, and the quality of investment confirm this result.

The expansion of social spending and investment. The liberation of resources from the productive sectors of the economy allowed a shift in the patterns of spending and investment towards the social sectors, which resulted in the highest concentration of social spending ever experienced in Bolivian history. The visible outcome of the implementation of this policy was the improvement in the indicators for human development to levels that more closely resemble the progress made in the region as a whole.

The consolidation of financial regulatory bodies. The creation of the Superintendence of Banks and Financial Institutions (SBEF, for its acronym in Spanish) with independence, technical capacity, and the backing of a solid legal framework allowed Bolivia to develop an adequate regulatory structure that consolidated the national financial system through a number of strong economic crisis, including the period 1999–2003, and to build up a regulated micro-credit sector that is at the forefront of all countries in Latin America.

The independence of the Central Bank. The Bolivian Central Bank was strengthened during the 1990s in a fashion similar to that of the SBEF with the passing of law 1660 in October 1995. This law allowed the country to anchor the newly recovered macroeconomic stability and to cement its strength, generating in the process higher levels of trust in the financial institutions amongst the population and the growth of private investment experienced in Bolivia in the second half of the 90s. This process is also responsible for the reduction in the levels of inflation to below 5% in the same period.

The creation of a sectoral regulatory system. The implementation of a new regulatory system generated a legal framework for the participation of the private sector in a market that had previously been dominated by state monopolies with little capacity for investment, efficient allocation of resources, and growth. This regulatory system, which is seriously questioned by the current government, was not allowed to fully develop and gain political independence. However, even under such conditions it provided a sufficient legal and institutional framework to facilitate private investment and the development of vital sectors of the economy, namely energy and communications.

The economics of the PND. The majority of economic proposals embodied in the PND are not new and include an optimistic view of the role of the State in the economy. The transition from a liberal economy to an excessively centralised economy, where the State has control of most economic decisions, may lead the country down the path to stagnation and instability, as was the case in 1985. In fact, the experience with State capitalism between the early 50s and the 80s has shown its incapacity for generating sustainable economic growth in the country. The subordination of economic concepts to political ideas generates important inconsistencies that can affect the performance of basic macroeconomic variables. Also, the optimistic reading of the capacity of the State to develop productive efficiency is misleading and has resulted in an overestimation of most indicators of economic development. One example is the projection for public and private investment, which shows values that are significantly above those that have been experienced in the past two years. Similarly, fiscal projections show high deficits for all the years covered by the PND, which has not been the case recently and, to some extent, show the limited capacity that the current public sector has for policy design and implementation. These initial reality-checks should lead to reconsideration of some of the assumptions that sustain the PND, particularly in relation to the capacity of the State to take full control of the economy in the foreseeable future and to allow for more participation of the private sector in economic decisions under conditions of enhanced corporate social responsibility.

3.6 Pro-poor Macroeconomic Policies and Current Policy

The implementation of the law of Popular Participation was an important boost to pro-poor spending; inasmuch as it provided municipalities with significant resources for investment, to gradually improve the conditions of the social infrastructure, and to co-finance, with locally generated income, additional spending plans to increase the number of teachers and health care personnel in their jurisdictions. Also, with the savings generated from the HIPC debt relief initiative poorer municipalities received additional resources, which increased the average social spending in municipalities to record levels. Pro-poor interventions in the 1990s were organised around the Bolivian Poverty Reduction Strategy, which did not offer major innovations in terms of public policy and ran aground in its implementation at the turn of the century[81].

Pro-poor policy maintains most of the same ideas behind previous efforts and initiatives, although with a very significant increase in the levels of social spending in health and, to a lesser extent, education. Emphasis is also being placed on mechanisms to support and develop further micro-sized enterprises, but without yet establishing a trend towards productive capacity expansion capable of employment generation. Current policy initiatives are centred on the short term provision of increased levels of earnings to a specific number of sectors, which helps the poor but not in a sustainable manner. So, little effort is being aimed at changing the conditions of poverty themselves with changes in training opportunities that enable the work force to improve its productivity. Safety net policies and policies designed for more vulnerable groups are still under construction.

The prevailing macroeconomic policy increased the national budget by more than 50% in the past 2 years and an even higher level of public spending is being projected for 2008. These numbers are beginning to motivate questions about the sustainability and the consequences an eventual cave in of macroeconomic equilibriums might have on the poor. The growth in inflation to double digit levels has already created much uncertainty, which is affecting investment decisions negatively and, in turn, increasing the rigidity of aggregate supply in a scenario of increased aggregate demand through fiscal expansion. The short term increase in income for different demographic and political sectors (with mechanisms such as the Juancito Pinto bonus and Renta Dignidad) are positive for poverty reduction amongst target groups, but cannot be guaranteed in the long term or further than the current boom in international prices for Bolivia's export products.

The following matrix compares the main macroeconomic policies being applied today to those applied in the past and the possible consequent effects on the poor.

[81] See "La Estrategia Boliviana de Reducción de Pobreza: Una Nueva Brillante Idea?" Kristin Komives et al., Instituto de Estudios Sociales, La Haya - Holanda, 2003.

Table 21: Macro Policies 1990s–2006: A Comparative Matrix

Policy Area	Macroeconomic Policy before 2006	Macroeconomic Policy After 2006	Effect on Pro-Poor Growth
Government	Fiscal austerity, elimination of most subsidies and reduction in external net transfers. Chronic fiscal deficits financed with grants from international cooperation.	Rapid expansion of government income and spending. Tendency towards "income-seeking" policy options, with selective subsidies – financed now with fiscal surpluses.	In the short term it my have a strong effect on income poverty reduction, however in the medium term the sustainability of these policies ist question-able at best.
Monetary	Indirect policy instru-ments, such as open market operations. Independence of the Central Bank. Flexible exchange rate policy. Growth of internal debt from 2000.	Increased use of direct policy instruments, such as lending restrictions and loan conditioning. Independence of Central Bank is diluted. Growth in internal debt continues.	It may impact on access to credit and generate further difficulties because of a reduction in liquidity. Internal debt may affect fiscal stability without an appropriate restructuring strategy.
Regulatory	Independence of regulatory institutions with respect to political decisions. Varied levels of institutional develop-ment with increased technical expertise.	Regulatory bodies dependent from sectoral ministries and political decisions. Technical capacity has not yet been fully affected, despite threats.	Risk of limiting benefits to consumers and affect private invest-ment in public services through contradictory signals.
Government Income	Tax reform consolidation and strengthening of revenue mechanisms. Slow growth of hydrocar-bon revenue. More independence for the Tax Administrations.	Important growth in income because of changes in the hydrocar-bons sector tax system and higher prices for exports. Strong depen-dence on natural gas income. Decrease of institutional capacity to collect taxes in a context of high revenues because of price effect.	Resources to finance "income-seeking" social policies with potential to reduce income poverty in the short term. Increase in fiscal vulnerability in the medium term.
Government Spending	Control of recurrent government spending. Higher percentage of spending directed towards investment in social sectors, in a context of increased decentralization. Low levels of efficiency and spending limited by return on investment.	High growth in recurrent government spending following demands for increased wages and salaries. Growth in spending directed to salaries and subsidies for different sectors. Expansion of spending in state controlled firms.	May contribute to poverty reduction in the short-term, although it will depend on the quality of spending.

Policy Area	Macroeconomic Policy before 2006	Macroeconomic Policy After 2006	Effect on Pro-Poor Growth
Public Investment	Larger proportion of public investment directed towards basic infrastructure and social sectors (education, health care, basic sanitation). Problems with the quality of investment, limited impact. Reduced capacity in decentralised institutions to take on the role of central actors in public investment. Lack of continuity in efforts undertaken to improve that capacity.	Investment is still directed at social sectors and basic infrastructure, but there is also emphasis in investment in productive sectors (hydrocarbons, mining, others), service sector and infrastructure. The difficult political relationships with decentralised institutions reduce efficiency of investment. There are no plans to improve project execution and the quality of decentralised investment. It is the intention of the government to open the possibility for rural communities to be agents for the execution of public sector resources, thus avoiding the municipalities.	As long as there is no work undertaken on the question of improving the quality and efficiency of investment, its impact will be limited in the fight against poverty. There are also important limitations in the absorption capacity for more resources in the institutions mandated to promote the productive sector. There is uncertainty over the capacity of rural communities to become actors in the process of public investment, in relation to municipalities.

In addition to being prudent in the management of the macroeconomic variables described in the chart above, pro-poor public policy should be directed towards increasing the level of employment in the economy, together with incentives to positively impact on the average productivity of the workforce, and sustainable income opportunities. For this reason, it is paramount to promote efficient initiatives of higher productivity and better use of technology. In principle, it is the private sector that should have the capacity to undertake these initiatives, given its flexibility and political independence. Also, it is important to make sure that micro and small sized firms are capable of creating productive linkages with medium and large sized firms with higher levels of productivity, in order to improve their own levels of productivity and improve their prospects for growth.

For this reason, it does no appear sufficient to simply promote growth in employment through the exclusive support of small or public sector initiatives, in open confrontation with large enterprises. It also seems inadequate to limit the opportunities of firms for expansion to external markets, closing opportunities to negotiate favourable trade agreements that have the potential to improve employment and income generation and may – in turn – provide incentives for productive linkages to develop across the economy or in particular export productive chains, benefiting particularly micro and small-sized firms.

4. An Analysis of the Business Climate

This chapter analyses the current business climate in Bolivia and the possible effects the National Development Plan (PND) and other political decisions may have on the levels of investment and employment generation in the economy. The business climate is largely linked to the advantages or disadvantages that informal or formal business owners may face while developing their activities. There is a great need to work on creating a proactive climate where investment and sustainable sources of employment clearly contribute to the goal of reducing poverty generated by lack of income. We believe that investment is a basic element for pro-poor growth and that it is not possible to generate stable employment if no investment is made in sustainable businesses.

Uncertainty as to whether to set up businesses and invest in productive development has been high in the last six years for various reasons, including political and social instability in Bolivia. The policies unveiled by the different governments in power since 2002 (many of which were never implemented), as well as frequent institutional changes, have affected the levels of investment and as a result they have also affected the possibilities of the national and foreign sectors to create employment. However, other countries in the region have welcomed investment and Bolivia has let the opportunity to be competitive go by once again. [82]

The new government, which took power at the beginning of 2006, announcing new institutional and political changes, including the rewriting of the Constitution, has not helped quell the growing sense of uncertainty felt in the country's business sector since the beginning of this century. The PND introduced that same year did little to ease this uncertainty as it does not assign clear roles to the private sector nor provide tools to be used by the State. Those policies that should favour developing the business sector, promote exports, and step up production are yet to be fully defined by the government, which has only launched its policy of financing the micro and medium-sized business sector through the Productive Development Bank. For now the government

[82] According to a recent IFC report, Latin America has worked on simplifying the paperwork needed to comply with laws and regulations. However, some regions are making faster progress than others. Bolivia ranked third on the list in 2005 and fifth in 2006 ahead of East Asia and South Asia, but behind Eastern European countries, the OECD, the Middle East and Sub-Saharan Africa. This report states that Bolivia and Venezuela were the countries in the region whose regulations make it more difficult to start up formal businesses. Bolivia, which already has some of the most rigid labour laws in the world, has clamped down even more by demanding that employers secure the agreement of employees before firing them.

does not seem to be interested in setting up partnerships with the private productive sector; on the contrary it seems that it is heading towards confrontation by accusing the private sector of having a hand in the current food shortages and price hikes, which are now having an adverse effect on inflation. These confrontations could put the stability of the productive sector at risk and lead to worsening the business environment in the country.

It is possible to come to a reasonable understanding of the factors that, in the case of Bolivia, come together to produce a decent business environment that would attract more investment, by analyzing:

- The role of national and foreign investment
- The factors that impact the business environment, and how risk is perceived
- The role of the State in supporting the opening of markets
- The characteristics of businesses and their contribution to investment.

This analysis is backed up by consulting with the business sector, government institutions and the international cooperation departments working in the field of business, and by doing a library search.

4.1 The role of National and Foreign Investment

There is no sustainable economic growth without either State and/or private investment. If there is no investment then businesses cannot generate stable employment except in exceptional cases where a business uses additional resources that lead to growth over relatively short periods of time. Therefore, if we need stable employment to generate income to beat poverty, it is necessary to invest and grow. This is the only way that the poor can benefit from sustainable job opportunities and not just relief measures, which is the difference between fighting poverty structurally and not just looking at short-term relief.

Countries such as Bolivia, which need investment to grow above 5% annually in a sustainable way, and also need to generate stable sources of employment, require investments of around 20% to 25% of their Gross Domestic Product (GDP), around US$ 2,000 to US$ 2,500 million per year. Ideally these resources should come from internal, public and private savings but the country does not generate this amount internally and will not be able to at least in the medium-term. If the public sector could double the average investment seen until now, it would reach an investment level of US$ 1,200 million, which means that private investment would have to cover the difference (between US$ 1,000 to US$ 1,300 million per year). Historically, private domestic investment has never been able to cover such large amounts, covering only an average US$ 100 to US$ 150 million in the last few years. Appropriate and stable policies to promote national investment and a more favourable business environment could raise this level and maybe even manage to double it in time. Nevertheless, even if this happens national investment (private and public) would not be enough to cover the level of investment needed to meet the targets for growth proposed with a view to reducing income poverty. This brings into perspective the role that external savings, particularly foreign investment, should play along with the need to design attractive and stable policies to attract and maintain foreign direct investment in the Bolivian economy.

Foreign direct investment in 1990 totalled only US$ 65 million (1.4% of the GDP), and reached US$ 1,026 million, close to 12% of the GDP in 1998. In 2006, this investment had dropped to US$ 240 million, 2.3% of the GDP. This shows that even if the sector increased its investment capacity to 12% of the GDP as estimated in the PND[83] and the private sector[84] maintained a rate close to 3% of the GDP, between 5% and 10% of the GDP would still need to be covered by foreign investment to meet the investment and growth targets. This is the reason why the country needs to generate conditions for an additional US$ 500 to US$ 1,000 million to be invested in the country by foreign businesses per year. To facilitate this, Bolivia should take measures to restore the confidence of national and foreign investors in the country, pulling out all the stops to relinquish its place at the bottom of the list of countries in the region in which to invest.[85]

We should remember that the countries that receive large injections of foreign capital have understood and taken on the need to generate environments that welcome national and foreign investment, their political and ideological leanings notwithstanding. China has a clear, practical understanding of the importance of long-term legal guarantees and regulations for investments; it combines capitalism with socialism and is one of the largest receivers of international businesses. Likewise, although with more openness of its economy, Chile has developed public policies that put the strategic interest of the country before secondary political interests, all under socialist governments in the last few years.

The economic model is constantly under discussion in Bolivia and the thrust of the discussion changes depending on whether the government of the time is liberal or socialist. This makes it a complicated country for private investment, which has its effects on the economy and the capacity to create stable, well-paid jobs. There is a need for private, national and foreign investment and so the government must come up with strategies through which the public and private sectors complement each other and are not competing with each other, where they can form partnerships that work towards developing new businesses and sources of employment.

4.2 Factors Influencing the Business Climate and Perception of Country Risk

Once the country has recognized that private investment does play a role in the country and if we want to meet growth and employment targets, we should look at how various studies have analysed the conditions necessary to attract investment. We should make it clear that the absence of appropriate conditions is not a recent phenomenon and that these problems have plagued the country to a greater or lesser degree for many years now.

If we take as our reference point the work done by the Central Bank of Bolivia and the Federation of Private Businessmen with technical support from CEMLA and DFI[86], economic, institutional, legal, political, and social factors are considered to be the most relevant to how the business environment is perceived. When these factors are examined, more specific ones come to light such as "legal guarantees", the "political and social environment", and the "perception of the economic future" of the country. The entrepreneurs highlight factors such as the availability and quality of services, including basic services, telecommunications, financial, transport, along with human resources and road infrastructure.

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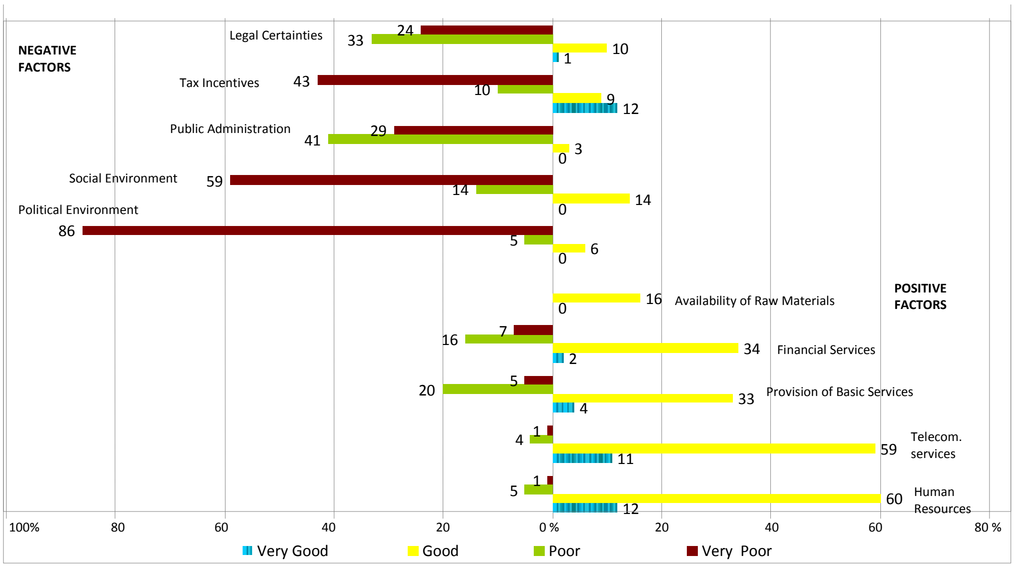
[83] This analysis does not cover the issue of effective public investment but this is definitely something that should be covered by other analyses given how it contributes to the growth of the national economy and the effort it takes.

[84] National and foreign.

[85] Where Bolivia was ranked by "Doing Business 2007", IFC September 2006.

[86] "Bolivia: Flujos de Capital Extranjero Privado y Percepción del Clima de Inversión". CEMLA-DFI, 2005.

Graphic 7: Perception of the Investment Climate in 2005. The Principal Factors (Positive and Negative) (Percentages)



Source: "Bolivia: Flujos de Capital Extranjero Privado y Percepción del Clima de Inversión" Report by CEMLA- DFI (2005)

One of the main factors taken into consideration by companies when investing is "legal stability", which 70% of the businesses interviewed considered to be important or very important whether or not they were exporters or had foreign capital, or where they were located geographically. "Economic stability" was ranked as equally important when deciding whether to invest. Almost 70% of the businesses interviewed also saw "socio-political stability" as being important or very important.

In the extractive sector (mining and hydrocarbons) 80% of the businesses interviewed rated "tax benefits" as being an important or very important factor in their decision to invest. This sector gave the same importance to legal stability. Close to 60% of the businesses (with no difference as to location, source of capital and end market) considered "inflation" and the "exchange rate" as relevant variables when investing, with over 70% of the extractive businesses highlighting how important low inflation was for their decision. With regards to accessing markets, 69% of the businesses interviewed (77% of those who do not export) considered "access to the domestic market" as important or very important while 88% of the export businesses saw "access to foreign markets" important or very important, although only 50% of these stressed the importance of this factor. These businesses considered access to markets as a highly relevant factor when deciding whether to invest.

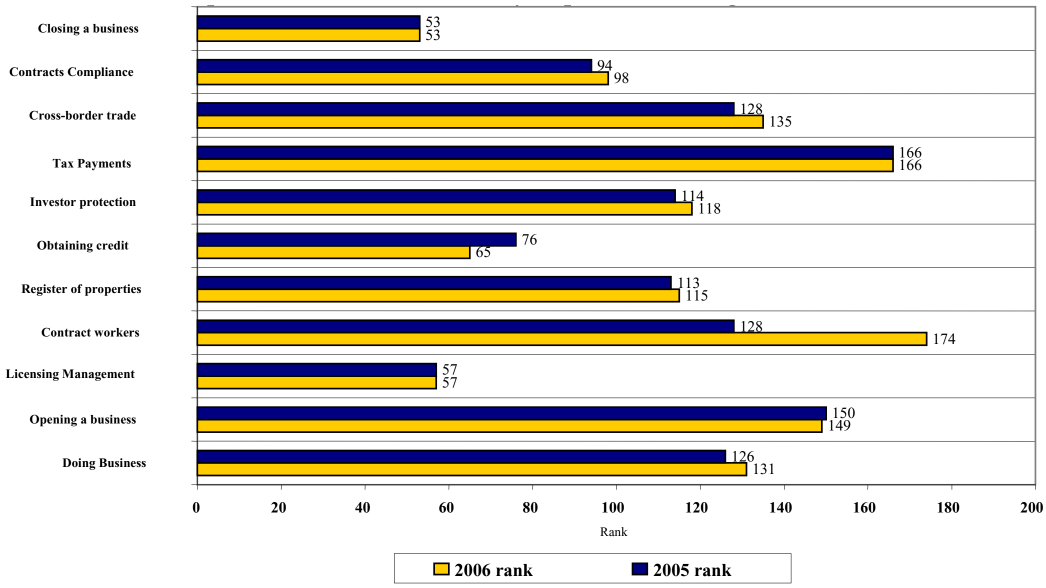
The *"Bolivian Cost Index"*[87] showed that the main factor affecting the country situation is "institutionality" because it is a vital element for the country's development as it guarantees the provision of public services and reduces levels of corruption. It also shows that efforts to reduce the number of different licenses should continue, particularly those requested by the National Customs. It also recommended that the Constitutional State should be strengthened, with the Legal Branch mentioned in reference to the number of steps taken to become part of the system. It is

[87] An Index developed by the Chamber of Industry and Commerce of Santa Cruz (CAINCO) to measure how important the factors are for the country's investment environment. The aim of this index is to facilitate, monitor and prioritise an agenda of actions to support the investment environment.

curious that cost is not mentioned when other studies have shown that this is a factor that lowers business competitiveness. No comments were made about interest rates, although the poorly developed mechanisms for accessing capital markets and high transaction costs were. According to the same study, high infrastructure costs, taxes, and benefits would be of less concern.

The IFC's "Doing Business 2007"[88] classifies 175 economies around the world on ease of doing business in each country evaluated. The top ranking countries in the region are: Chile (28), Mexico (43) and Uruguay (64). Venezuela (164) and Bolivia (131) are the lowest in the region. Bolivia went from ranking 126 in 2005 to 140 in 2007, placing itself in the penultimate quintile of the sample. The five economies ranked as the best are: Singapore, New Zealand, the United States, Canada and Hong Kong (China).

Graphic 8: Bolivia's Situation by Topic in the Doing Business



Source: Doing Business 2007. World Bank publication and IFC

One of the areas where Bolivia lags behind most of the countries analysed in this document is that of starting up businesses where it is necessary to register with at least six offices, almost all of which belong to the public sector.

Table 22: Institutions Involved in the Process of Opening a Business

Entity	Proceeds from Processing
Fundempresa	Registration in the Commerce Registry
National Tax Service	Tax Identification Number
Municipal Government	Municipal Taxpayers Registration
	Municipal Operating License
Ministry of Labour	Employer Registration
Health Insurance Fund	Employer Registration
AFPs (Pensions)	Employer Registration

Source: Doing Business 2007 Report. World Bank and IFC.

[88] International Finance Corporation: "Doing Business 2007".

There are other individual processes to be carried out to register staff with the Social Security in the short and long-term and in some cases with different related Associations, depending on the type of business being set up.

According to reports of the Productivity and Competitiveness Unit (UPC)[89], which was dependent on the Ministry of Planning for Development (up to 2006), based on data from the World Economic Forum and the World Bank in 2001, Bolivia is one of the most expensive and complicated countries in the region and in the world in which to set up a business. It is estimated that the cost is US$ 2,690 and takes between 82 and 157 days. Since that report, efforts have been made to reduce the cost and time taken to go through the process. The UPC reports significant improvements in streamlining the process, which can be seen in the table below. However, it also reports that the cost of setting up a business in Bolivia is now around US$ 1,300 to US$ 1,500, which is around 18 times the national minimum wage and is still higher than the per capita GDP.

Table 23: Results of the Simplification of Procedures to Open a Business

	December 2002		August 2006	
Procedures	**Time in days**	**N° Requirements**	**Time in days**	**N° Requirements**
Registration at the Commerce Registry	5	7	5	7
Tax Identification Number	1	6	1	5
Municipal Taxpayers Registry and Municipal Operating License	18	20	1	7
Employers Registration (Ministry of Labour)	34	17	1	3
Employers Registration (Health Fund)	3	11	2	11
Employers Registration AFP	2	4	2	4
Total	**63**	**65**	**12**	**37**

Source: UPC, Based on information from Government Institutions.

Many of the factors analysed above influence the different indicators, which specialised institutions, called risk qualifiers, evaluate to establish what is known as the "risk rating", often linked to the term "country risk". The aim of risk rating is understood to be an independent, objective, and technically supported opinion about the solvency and security of a specific financial instrument used by a specialised company or institution. This concept has been extended to rate the financial tools used by the governments and even to evaluate the climate for doing business or investing in countries.

The most important risk ratings in the works are Fitch, Moody's and Standard & Poor's, all of whom work in Bolivia[90], although most of their work is with businesses or the banking system. The ratings for Bolivia could not be used as this information is not public and does not show its evolution over the last few years. Only the Fitch risk ratings on country risk for the last seven years are shown on its web site (www.fitchratings.com).

[89] "Simplificación de Tramites: Estado Actual en Bolivia". Prepared by Anita Bhatia, June 2002.

[90] The first two risk raters Thomson Financial Bankwatch (now Fitch) and Duff & Phelps from Peru set up in Bolivia in 2000.

Table 24: Country Risk Rating for Bolivia

Year	Rating	Remarks
2000	BB +	Beginning of the Ratings
2002	BB	September, Change of Government
2003	B	Events in February
2003	B –	Resignation of President Sanchez de Lozada and assumption of Vice President Mesa
2005	B –	Anticipated National Elections. The rating goes from stable to negative
2007	B –	The rating negative becomes stable

Source: Report Fitch, New York. Design: SAXgr

As was to be expected, since 2002 the country has been beset by political and social instability and the country risk rating could only drop from BB+, the ranking enjoyed by Brazil, Peru, Costa Rica and Panama, to its current B-, which is on a par with Ecuador and Venezuela.

Given the above, it would seem logical to think that there are concrete aspects that should be worked on to improve the business climate and reduce perceived risk, with legal guarantees and institutionalization standing out. Other factors are of equal importance but if these two factors do not improve they will continue to have a negative impact on the others. We have not found any countries whose investments have risen without the main institutions running effectively and where the legal guarantees and property rights are rigorously respected.[91]

4.3. State Support for Access to the Market

As regards international markets, Bolivia has information on markets and the potential sales of domestic products both on the domestic and the foreign market. This potential is backed up by trade agreements that give domestic products preferential tariffs, allow them to be exported and reach the consumer at competitive prices. The main agreements currently in force are: the Cartagena Agreement (Andean Community), Trade Agreement No. 22 Bolivia – Chile, Trade Agreement No. 31 Bolivia – Mexico, Trade Agreement No. 36 Bolivia – MERCOSUR, and Trade Agreement No. 47 Bolivia - Cuba. The country also benefits from the Andean Trade Preference Act (ATPDEA), the Generalised System of Preferences with the United States, the Generalised System of Preferences with the European Union, the Generalised System of Preferences with Canada, the Generalised System of Preferences with Japan, the Generalised System of Preferences with Norway, the Generalised System of Preferences with Switzerland, and the latest Free Trade Agreement – TCP.

Efforts have been made in the past to set up and support institutions such as the INPEX, the Bolivia Exports Foundation, the UPC and others to support the development of foreign markets, among other aspects. Nevertheless, given the fact that the main base and growth of exports depends on minerals and hydrocarbons, it would seem that the use and management of these resources and of the trade agreements has been limited, with the exception of some non-traditional products, as shown in the table below.

[91] The high level of growth in the short-term of some economies that do not consider these two factors is usually due to exceptional circumstances that are not sustainable over time. Most countries aiming for sustainable development respect their institutions and the right to private property.

Table 25: Export Structure (Millions of US$)

Detail	1997	1998	1999	2000	2001	2002	2003	2004 (p)	2005 (p)	2006 (p)	2007(p
Minerals	480,9	435,6	400,8	425,1	334,5	347,6	369,3	455,8	544,3	1.060,4	1.372,1
Hydrocarbons	97,8	87,7	64,8	165,8	289,3	330,8	490,9	838,9	1.427,5	2.039,8	2.297.,4
Non Traditional	594,8	507,8	521,5	546,5	500,8	513,6	621,7	788,6	709,1	767,3	903,4
Others	101,7	165,7	151,8	207,5	231,5	180,6	203,5	177,8	240,4	366,9	309.5
Total CIF	1.275,1	1.196,8	1.138,9	1.344,8	1.356,2	1.372,7	1.685,3	2.261,0	2.921,4	4.234,4	4.882,4
Total FOB	1.166,5	1.104,0	1.051,1	1.246,1	1.284,8	1.298,7	1.597,8	2.146,0	2.791,1	3.863,0	4490,4

(p) Preliminary
Source: Based on "Informe del Milenio sobre la Economía en el año 2006"report and BCB web site

The government of President Morales showcased its Strategic Plan for the Integral Development of Small Producers (PEDIPP 2007–2011), which is part of the PND and is being administrated by the Ministry of Production and Small Businesses and the BDP. Despite the fact that the area of markets is one of the four pillars of the PEDIPP and that the producers have been insisting on the importance of generating and consolidating markets, until now the government's efforts have been spent on the financing pillar, mainly starting programs to finance small productive units with relatively low interest rates through the BDP. This perspective is not cited in the studies on factors that influence the business environment as of major concern to the Bolivian entrepreneur sector, as seen above. The government's efforts in financing, as well as in putting the People's Trade Agreement (ALBA-ACP) into action, have yet to yield fruits and its is obvious that they have not made progress as fast as had been hoped for[92]. Various factors may have had an influence, including the obvious limitations of the agreement to be an attractive arena for national exports given that most of the countries that have signed up are not in conditions to absorb national products.

The PEDIPP is made up of the following elements, the majority of which are still developing concepts, policies and instruments.

Table 26: Pillars of the Strategic Plan for Integrated Development of Small Producers

Recognition and Strengthening	Education for Development	Funding	Markets
• Brands	• Productive Recovery	• Development Banks	• Shopping state
• Quality	• Technology Agreements	• Systems of Guarantees	• Domestic Markets
• Productive Mapping	• Managers without borders	• Leasing	• Trans-boundary Markets
• Job	• CETIS	• Factoring	• International markets
• Income	• Management	• Warrant	• Market intelligence, sales
• Sales	• Quality	• Working Capital	
	• Security	• Machinery	
	• Innovation	• Infrastructure	

Source: SENADEPRO (National Service for Productive Development)

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92 The ALBA-ACP is the agreement to open markets among Bolivia, Cuba, Nicaragua and Venezuela. The aim in the first year was to mobilize substantial financial resources to support the development of this agreement. At the end of 2007 US$ 100 million had been committed, US$ 30 million disbursed and only US$ 12 million executed.

Other opportunities to open up export markets with added value have been rejected by the government for the time being (ALCA), and there are no signs of other efforts being made to expand markets for the export of national products. Unlike other countries in the region, which have used their diplomatic corps to open up markets and link businesses for some time now, Bolivia is not taking advantage of the possibilities in international relations offered by the world today. This situation could be turned around by analysing the situation, and calculating the possibilities of well-paid jobs that these markets could generate, by developing policies that favour this opening up, and by having the political will to take advantage of the opportunities for free trade available to the country..

These initiatives should be backed up by a good climate in which to do business so that the national and international private sector also invests and generates employment. The role of the State, through trade policies and developing markets by means of political negotiations and trade agreements, is fundamental to business development in the country and for the generation of employment by setting up new businesses. Investment will rise, increasing the chances for the growth of the economy, which will mean more possibilities for the population earning income and will contribute to reducing poverty.

4.4 The nature of enterprises and their contribution to investment and employment

If we take into account that the main obstacles to having a climate that favours private investment are legal guarantees and institutional instability, it seems that we are heading into the field of political decisions which mainly concerns government authorities. In the short-term there should be an upsurge in national investment, supported by a better understanding of the situation and of identified opportunities for business, gradually generating more confidence in the system. Foreign investors would perceive this change later on and would eventually restart or expand their operations in the country. Now we will move on to what the nature of national businesses is and what they could contribute to the generation of employment.

By December 2006, there were 23,082 private firms registered in Bolivia, and in that year over 16,000 renewed their registration or set up, making this the number of legally operating businesses. The vast majority of firms (95% of the total) are ‘one-person companies’ or limited liability companies and only 4.3% of businesses registered are limited companies.

The number of formal businesses in the department of La Paz dropped in the last five years rose in Santa Cruz and remained almost the same in Cochabamba. It is interesting to note that the department of Tarija has doubled its share, which took it to fourth place in the departments with a large number of companies, followed by Oruro. On the central axis, La Paz, Cochabamba, and Santa Cruz are home to 77.80% of all businesses registered in Bolivia. The department registering the most new businesses in the last few years is Tarija, although it is only home to under 8% of the total number registered. Most formal businesses work in trade, real estate, construction, manufacturing, transport, storage, and communications. Together these sectors represent over 85% of the businesses registered in 2006.

Table 27: Business Structure for Economic Activity 2005–2006

Corporate Type	No. of businesses		%	
	2005	2006	2005	2006
Wholesale and retail; repair of motor vehicles, motorcycles and personal and household goods	4.850	5.275	24,5%	22,9%
Real estate, business and renting	3.896	4.473	19,7%	19,4%
Construction	3.184	4.087	16,1%	17,7%
Manufacturing	2.738	3.006	13,8%	13,0%
Transport, storage and communication	1.844	2.784	9,3%	12,1%
Hotels and Restaurants	1.032	1.009	5,2%	4,4%
Community, Personal and Social services	618	668	3,1%	2,9%
Education	481	460	2,4%	2,0%
Mining and Quarrying	332	369	1,7%	1,6%
Financial Intermediation	238	318	1,2%	1,4%
Social and Health Services	249	285	1,3%	1,2%
Agriculture, Hunting and Forestry	246	271	1,2%	1,2%
Electricity, Gas and Water	70	74	0,4%	0,3%
Activities of private households as employers and non-differentiated activities of private households as producers	0	3	0,0%	0,0%
Total	**19.778**	**23.082**	**100%**	**100%**

Source: FUNDAEMPRESA

However the data on employment show a different trend with the agriculture (40%), trade and hotels (20%), public administration (14%) and the manufacturing industry sectors being those that provide the most employment. Official records show that amongst small businesses, classified according to amount of sales[93], there are 6,187 small and micro business units. This seems rather low compared to data on micro businesses produced by institutions in this sector[94], which estimates around 500,000 units.

4.5 Advantages of an Improved Business Climate

Given the type of businesses set up in the national economy, small businesses are generally sensitive to the business climate, it is vitally important to work on legal guarantees and institutionality. This means giving out clear signals and taking concrete measures so that both the formal and informal sector perceive a more positive climate for investment, which will generate employment, raise production levels, and have a knock on effect of increasing income for all the links in the production chain.

It seems obvious that the potential for investment by this type of national businesses will not reach the levels of investment (between 8% and 12% of the GDP for the private sector) needed to take the economy to growth rates above current rates, at least not in the medium-term. Linking smaller national companies to larger national and foreign companies should enable the smaller ones to increase their productive potential. At the same time, this development would strengthen the capacity of national businesses to produce raw materials, which would serve as a base for better investment opportunities for larger, national and foreign businesses.

[93] Provisional data as businesses do not have to update their registration as yet

[94] Fundes 2004.

For this to happen it would seem that it is fundamental to make serious efforts to gradually lift the constraints facing the development of the private sector, and improve the business climate as identified in various studies already quoted. Nevertheless, these efforts cannot replace the need for the government to send out signs of a will to guarantee security and install clear "rules of the game" for those developing businesses, which are the main challenges facing the State in the short-term.

5. The Main Constraints to Development

This chapter identifies and discusses the main constraints to development in Bolivia, the options that exist to lift these constraints thereby improving the level of growth, rate of employment, productivity, earnings and capital in the country. Examining these constraints should enable the identification of ways in which growth can be generated in order to ensure that the poorest are included, under conditions of greater equality. Although there are many issues that could be considered to be relevant in the long-term, not all of those dealt with in this document can be considered to be restricting factors in this context, and recommendations on how to deal with them only highlight those actions that are, from our point of view, relevant to the goal of generating more and better quality employment for the poorest.

5.1 Structural Limitations

Low levels of investment

If we accept that investment is a prerequisite for any growth process given that, in addition to facilitating an increase in productivity, it offers the potential to improve productivity of the economy when new technology is incorporated, *the difficulties that arise in the process of developing private investment (national and foreign) are constraints that impede achieving higher rates of employment with greater productivity.* The inverse proportion of investment to the need of the country to grow should be covered by public, private and foreign investments. Although providing incentives to develop small and micro businesses is important and useful from the point of view of generating employment, investment has to be made throughout the private sector. The best results in growth are generally seen where the small and micro business sectors become links in the large business sector chain of productivity to work together to achieve higher levels of productivity and earnings.

A good business climate is needed for there to be higher levels of investment where long-term plans can be made on the basis of legal guarantees and the right to property. It is also important to show clear signs that public investment complements and does not compete with private investment, particularly in areas such as infrastructure and services. However, maintaining economic stability is just as important as the factors mentioned above. A possible return to economic instability, with structural public budget deficits is still a potential danger. The pro cyclical nature of fiscal policy will heighten economic cycles more and affect stability of income from domestic sales, adding uncertainty to the undertakings of the private sector. A heavy fiscal drive will lead to inflation thereby affecting expectations and the stability of the real exchange rate, and lead to a down-turn in competitiveness in the trading sectors of the economy. Fine-tuning these variables in the medium-term will be a key element to favour investments in the country.

To attract investment, from national or international sources, the country needs to compete with other countries around the world that have the same goal; mainly those that are better positioned in the region, such as Colombia, Chile, and Peru, which should be taken as points of reference for national policy-building as they are currently the largest receptors of foreign investment. Also, attracting foreign investment should not only limit itself to the extractive sectors which, are usually capital-intensive and have a limited capacity to create employment and contribute to pro-poor growth, as witnessed over the last ten years. Attracting direct foreign investment in labour-intensive sectors aimed at production mainly for foreign markets will generate not only higher levels of productive employment but also incorporate technology that will enable productivity to increase, which later will bring in better rates of pay.

Instability in the business climate
The businesses set up in the national economy, generally medium or small businesses, are highly sensitive to the business climate, and if not enough importance is given to legal guarantees and institutionality this may become a restricting factor to attracting investments, which in turn will have a negative impact on development.

Other factors are of equal importance but if these two factors do not improve they will continue to have a negative impact on the others. We have not found any countries whose investments have risen without the main institutions running effectively and where the legal guarantees and property rights are rigorously respected. This means giving out clear signals and taking concrete measures so that both the formal and informal sectors perceive a more positive climate for investment, which will generate employment, raise production levels, and have a knock on effect of increasing income for all the links in the production chain.

For this to happen it would seem that it is fundamental to make serious efforts to gradually lift the constraints facing the development of the private sector and improve the business climate as identified in various studies analyzed in Chapter IV. Nevertheless, these efforts cannot replace the need for the government to send out signs of a will to guarantee security and install clear "rules of the game" for those developing businesses, which are the main challenges facing the State in the short-term.

Weak capacity of the Bolivian public sector institutions to implement public policies
The weak institutional capacity of the public sector in Bolivia to manage relations among the different sectors of the population, as well as with international cooperation, particularly when it comes to negotiating and implementing projects, may become a restricting factor for the country's development. Improving institutional capacities requires hiring a professional, well-trained staff, which has not been helped by lowering the salaries in the public sector that has led to experienced professionals leaving and a decrease in institutional capacities in public administration.

The process to promote pro-poor growth should be supported by a State that provides a decent framework of policies and has the capacity to implement them. Experience from other countries shows that the role of the State to facilitate growth is to provide public services, social protection systems and to create the institutional conditions necessary for a more inclusive and equitable growth. To achieve this, policies need to be adopted and implemented effectively, which in turn implies that the institutional structures and governance must be in place to be able to design and implement the policies. These experiences also show that institutions are a priority and that all efforts to reform or construct solid, pro-poor institutions must take into account the need to first identify a limited group of specific institutions that favour growth and support them at all costs.

The fragility of the income base of the Treasury (TGN)
Over the last couple of years the state of the TGN seems to have improved in comparison to the first half of this decade. Nevertheless, expenditures have risen quicker than income, which could lead to instability in the future if this trend continues. The internal debt has also risen and in the last six years has outstripped the cost of the foreign debt, limiting the benefits of the fiscal relief caused by different measures to alleviate the foreign debt. Although it has been seen that the SPNF is in better shape than it was in the first half of this decade, it is also obvious that this is because of decentralization and that the TGN has hardly moved on from where it was. The rise in income stemming from implementing the new Hydrocarbons Law in 2005 only increased the TGN income by a little over 25%, the rest was distributed among the prefectures and municipalities, and to a series of institutions that received a share by lobbying the government, which sparked a series of conflicts yet to be resolved. This is why it is important to design automatic and non-conflictive mechanisms to distribute income from royalties and taxes from the extractive industries to the economy. This should include a mechanism that assures long-term fiscal stability and a decent balance between income and responsible expenditure among the central government, the regions, municipalities, and universities.

The fact that the TGN is more fragile than the rest of the public sector should be reversed since if the TGN becomes unstable it will have dangerous repercussions on the economy as a whole and it will restrict development. Setting up and implementing a Macroeconomic Stabilisation Fund using income from taxes on hydrocarbons would enable the weak points in Bolivia's macro economy to be strengthened. While setting up this fund it is also necessary to design and apply a system called "Cyclically Adjusted Budget Balance"[95]. A policy to maintain fiscal norms, with a stable long-term structural outcome would enable the government to determine how to accumulate or use resources from taxing hydrocarbons whether in a period of expansion or contraction. A fiscal policy that helps to stay as close as possible to the underlying trend in the economy to grow would also help to reduce uncertainty and improve the economy growth rate in the long-term. Studies analysed show that between 1991 and 2002, the difference between the real deficit and the structural deficit varied between –0.5% and 1.7% of the GDP. Therefore, by keeping the fiscal rate stable, long-term growth can be maximized, limiting the impact of macro situations that are booming or slumping. This analysis shows that the economy would currently have an "adjusted budget surplus" of around one percentage point lower than what has been seen to be the result of the

[95] Antelo Eduardo (2003), "El Balance Fiscal Estructural Cíclicamente Ajustado (BFECA), Asistencia Técnica, Corporación Andina de Fomento, La Paz, 2003.

growth in the GDP. A Stabilization Fund would keep expenditure levels stable despite possible booms or slumps, which would stabilize the economy to a great extent.

The risks of pro-cyclical policies for employment and productivity
Pro-cyclical factors can accentuate boom phases but they can also aggravate problems and loss of jobs during a slump. Those worst hit by an exaggerated economic cycle are less-informed sectors with a smaller capacity to defend themselves. In both the booms and slumps of the economic cycle there are economic agents that are more vulnerable, usually in low-income sectors and the smallest businesses. The financial sector is also affected and tends to accentuate pro-cyclical behaviour by restricting access to credit in slumps and extending more in booms. During recessions, those economic agents with less liquidity in the short-term end up suspending productive activities, limiting their learning process and income from productivity, which would enable them to increase their income in the long-term. *This has been how the country's economic policy has been managed in the last twenty years, restricting development that should otherwise have taken place.*

Limited access to credit
If access to credit in the country is not increased and offered to all, then this will restrict a more balanced development as the financial system will continue to concentrate income in the hands of a few families and businesses. It is important to continue to increase access to credit for all sectors of the economy as this will trigger economic growth from the bottom up, supporting the poor sectors and achieving economic independence and higher levels of production. A rise in micro finance companies in the country over the last few years has led to an increase in the number of borrowers, many of whom are small producers, accessing these services. The growing competence of this sector and the liquidity it brings to the system has also led to a drop in the cost of borrowing and longer pay-off periods. The setting up of the BDP could strengthen this process if it plays its role correctly as an intermediary, favouring the refinancing of financial intermediaries in better conditions to transfer funds to their clients and clearly signals that the banking system is healthy. It is important that the State backs financing the private sector, complementing the supply of financial resources with training programs for small entrepreneurs, employees and workers in productive sectors where there is potential to create competitive advantages for the economy. The State would be able to contribute by revising the current laws on access to credit, for example, making better use of property (contracts, inventories, equipment, machinery, harvests, produce, etc.) as collateral for loans. Accepting only property or personal guarantees limits the population that can access credit and the potential for the economy to grow.[96]

Rigidity of labour laws
The national labour laws could be an important restriction on investment and on the creation of jobs as they tend to overprotect existing jobs and may dissuade businesses from creating more job openings. The impact of labour laws on individual and group labour relations and employment should be analysed when weighing up the different internal and external factors that affect employment

[96] Heywood Fleisig, Nuria de la Peña and Juan Carlos Aguilar (1997). "Legal Restrictions on Security Issues Limit Access to Credit in Bolivia". The International Lawyer, Spring 1997.

in a country. Bolivia is one of the few countries in the region that has substantially changed its labour laws, despite the fact that DS 21060 and other laws tended to make labour relations more flexible, the General Labour Law of 1942 still remains as the foundation. This Law is confusing and makes it difficult to determine the value of indirect salary costs. This confusion could be the root of the number of unregistered or vulnerable workers. As a result of the historical inconsistency between these laws, the law regarding new ways of organising work is hardly ever applied because it does not coincide with the needs of employers and workers and few people know about it.

Mismatch between supply and demand for qualified workers
Analysing the demand for workers in general has shown that young Bolivians are not trained in the professions and trades needed by the labour market, which limits their ability to find good job opportunities that pay in line with their needs and skills. This gap between the supply of employment and the demand restricts development. Until now the State universities and technical colleges have not taken into account the requirements of Bolivian society and economy, and continue to churn out professionals in areas that are saturated without concentrating enough on technical education. Neither has the State designed policies on building a skilled workforce, something which is fundamental if the workforce is actually to work and develop the productive sector. These public policies should emphasize technical vocational education for the poor so that they have increased access to better jobs.

The policies and initiatives towards having a skilled workforce, particularly for the poor (including women and indigenous peoples), would gradually force out discrimination in the workplace based on gender or ethnicity. The increased productive capacity of this type of worker, once qualified, would make him/her more attractive to the more modernised sectors of the economy opening up the possibility of earning a higher wage such as those offered in the export or manufacturing sectors. This would also enable the worker to move more easily around the country and find better paid jobs and better working conditions.

The inefficient functioning of the markets
Inefficient functioning of the markets, informal barriers to new actors entering certain markets, a dearth of information on how they work, and the limited capacity of the State to regulate these sectors[97] *are constraints to development as long as the necessary adjustments are not made.*

The State should be the key institution that drives back the high levels of disparity between urban and rural incomes. It should also identify and correct failures that arise from lack of access and information that are currently impinging on the economy. This would mean making changes in the institutions and offices that are part of the State so that a decided effort is made to support the public entities in charge of attending to these needs.

The risk of not focusing on the use of income from gas for pro-poor policies
The increasing revenue from gas flowing into the economy, unknown in Bolivia until now, has led to a sense of boom times in the administration of public finances and to a significant rise in current expenditure in the last two years as well as to a trend towards allocating annuities to differ-

[97] To assure that resources are effectively allocated, customers are protected and the sector is developed on the basis of society's needs.

ent sectors of the population based on predictions of income from gas. This trend has appeared in the form of a series of bonuses billed as the right to public resources, which are given to different sectors of the population. Although this may be a way of alleviating poverty in the short-term, by means of direct transfers, different studies question the sustainability of this type of policy and the need to invest better in generating conditions that favour sustainable productive employment. *The ineffective use of public resources from taxing the production and sale of hydrocarbons may limit development as it commits the State to new financial duties that can not be sustained by genuine sources of income and that do not use these dynamic sources to diversify the economy to include activities that make it possible to incorporate more added value.*

The resources generated from gas should be used for more productive purposes, for example, to make the road and transport networks more efficient, support production, train human capital, and others to integrate areas of the country that until now have been overlooked as well as to integrate the poorest into the national economy and production cycle.

5.2 Short-term Constraints

Limited ability to negotiate new trade agreements to trigger pro-poor growth
Bolivia has developed its non-traditional exports with the backing of a limited number of trade agreements, mainly with the Andean Community of Nations (CAN) and the ATPDEA with the United States. Given the openness of the Bolivian economy there should be trade policies that take advantage of these commercial agreements. *Current policy does not favour this type of trade agreements and may be a significant restriction to increasing productive activities that generate employment with higher levels of productivity and higher wages, thereby committing to pro-poor growth in the future.*

Expanding the duration of the ATPDEA agreement with the US after 2008 is surrounded by uncertainty given the permanent state of tension with that country. On the other hand, Peru and Colombia have expanded their free-trade agreements with the US and this could lead to problems in the future regarding the two important trade agreements that Bolivia currently holds. Likewise, the negotiations between the CAN (including Bolivia) and the European Union for a trade agreement will be more difficult and take more time with limited possibilities of expanding non-traditional exports to these regions in the short-term. While the government continues a policy that does not lead to an opening up of the economy, it seriously limits the possibility of developing sectors that produce more, take on more qualified workers, and pay higher wages.

Dearth of policies on the private sector, the micro, small and medium businesses (PyMEs), and large companies
Because of the fact that the current PND does not assign a clear role to medium and large companies within the development model it proposes to implement, it is also introducing a serious restriction for future growth and the possibilities of sustained benefits for the poorest. Limiting the role of foreign direct investment (FDI) in the extractive sectors (only whilst the cost of raw materials is high), also limits the introduction of cutting edge technology into the sectors with comparative advantages and higher levels of competitiveness. This also limits the possibility of generating highly productive employment in sufficient quantities to absorb the increasing labour supply. This is also related to the constraints surrounding the trade agreements as these are the type of businesses that can link in with micro businesses and the

PyMEs to develop productive capacity so as to be able to compete in the international market. Although these economic agents are not supported and there is no clear policy defined for them, they cannot develop and contribute to pro-poor growth. It is difficult to show that by promoting a traditional production model enough well-paid jobs can be created, enough to have a significant impact on reducing poverty levels.

The productive heterogeneity of the Bolivian economy results from the parallel moves to de-industrialise the country and the proliferation of low productivity service industries, a growing informal sector, and high intensity of unskilled work. The micro and small productive units use simple technology that does not enable them to produce goods of the quality demanded by large companies or linked to the export market. This gap in productivity can be solved by modernising small productive units as well as providing training to improve product quality so that larger, more efficient businesses can form partnerships with smaller businesses, which are gradually absorbed into the formal sector of the economy. If we accept the UDAPE[98] premise that there is a direct relation between poverty and informality and therefore that the poor cannot rise out of poverty when they remain as small "informal" businesses, then there is a need to design and implement policies that enable these sectors' productivity to increase, identifying possible linkages and looking for alternative products for export so as to enable the sectors to benefit from competitive advantages that would give rise to better wages and a gradual formalization.

Growing external migration and the loss of qualified human resources

The recent wave of mass emigration mainly to Europe and the United States has reduced the technical capacity of the workforce and the offer of skilled labour in the various sectors, principally at the level of technical skills. This has been felt in the construction and mining industries where in 2007 there was a shortage of skilled workers (electricians, welders and others) and the cost of labour has shot up because of these shortages. *The permanent loss of human capital added to the ongoing brain drain of professionals moving abroad in search of better job opportunities over the last ten years may restrict the country's development if policies to replace these resources are not designed and implemented in the medium-term.* This situation draws attention to the need to develop public policies on technical training in order to renew and multiply the supply of skilled labour and to be prepared to face the challenges of increasing productivity and developing business opportunities aimed at export markets.

[98] Op. cit.

6. Conclusions and Recommendations

The main objective of this document was to describe a range of challenges that Bolivia faces as well as the opportunities the country has to achieve pro-poor growth in the next few years. We have also tried to provide some suggestions as to how pro-poor growth can be achieved more efficiently. Finally, the different sections contain an analysis of the possible impact that the current government's policies will have in the long-term, including the proposals made in the PND, their priorities, series of actions, and basis for implementation.

This last chapter offers some recommendations to the Swedish International Development Agency (Sida) that could contribute to the discussion and preparation of the next country strategy for Bolivia. We have tried to aim our analysis at answering the following questions:

– How can Sida support pro-poor growth and ease some of the constraints to development?
– Which actors should Sida work with?

The Swedish Cooperation sees its main role as "providing assistance to generate target conditions that enable the poor to improve their living standards"[99]. Concentrating on poverty reduction is justified by the need to promote the fact that the poor have the right to participate and play a role both as beneficiaries and as actors in the economic, political, institutional, and social development of their country. Sida feels that the best known analytical framework on economic growth in developing countries until now has not looked into budget mechanisms that would ensure that the poor benefit and participate to the full. What is more, although the pro-poor approach has contributed to drawing the world's attention to poverty reduction policies, the potential role of the poor as actors in their own development and public policies that would ensure their full participation have not been probed enough.[100] We know that economic development and pro-poor growth are dependant on political, economic and social factors, and so constraints on pro-poor growth are probably political, economic and social as well. Even if the IEA does manage to identify the main constraints to pro-poor growth, it is essential to understand the power structures and political and social conditions to be able

[99] Sweden's Policy for Global Development

[100] Lundström S. and Ronnås Per: "Integrated Economic Analysis for Pro-Poor Growth" in Poverty in Focus, International Poverty Centre, March 2007.

to look for better ways to contribute to lifting the constraints and do a more in-depth economic analysis.

Policies such as maintaining macro economic stability, respect for property rights, integration into foreign trade and setting up a favourable climate for investment and business have always been on the politicians' agenda over the last 20 years, but the results have been mixed in different developing countries. What we have seen over time is that these policies may work well for one country but have limited success in others and may even have unwanted effects.

Experience has also shown that countries that try to lift all restricting factors by passing reforms at the same time are not as successful at making the qualitative leap to generating more favourable conditions as those that concentrate on attacking the root of one or two of the main constraints[101]. In the 1990s, Bolivia went through a series of reforms that were applied at the same time and had mixed results. For different reasons, the reforms do not lead to the qualitative leap expected adding this experience to the studies that pinpoint this result as being expected from reforms being applied as a package. That is why it is important to identify the two constraints that have the greatest impact on the country's growth and development and analyse possible solutions within the current framework of policies.

How to support pro-poor growth

The promotion of pro-poor growth will be best served by supporting the generation of sufficient, sustainable, and productive employment opportunities. We have seen that investment in value added manufacturing for foreign markets shows a tendency to generate more, better quality, higher paid employment. To attract productive investment to the country means coordinating efforts on many fronts, where the government should be a key player encouraging the private sector to participate along with development partners.

These efforts should include the following:

- Promote a business climate that attracts investment, and work on generating greater confidence in the country's policies and institutions favouring the stability of rules of the game that are competitive with those found in other countries in the region that are competing for investments,
- Focus attention on the issues that affect the competitiveness of Bolivian firms to identify possible bottlenecks and anticipate possible risks by constantly analysing with the private sector,
- Work on developing efficient public investment to construct and improve the productive infrastructure, train workers and contribute to other areas in order to support the productive and export sectors, which will help reduce investment risk,
- Prioritise training and educating the work force, coordinating with export companies to ensure that workers are trained in skills needed by the sector,
- Design pro-active strategies for enhanced market access and trade concessions with trade partners and trade blocks,
- Promote and develop public policies that generate incentives for private firms to engender productive linkages and specialisation, which will support firms competing on international markets,

[101] Hausmann, R., Rodrik D. Velasco A. (2005) "Growth Diagnostic", mimeo, John F. Kennedy School of Government, Harvard University, Revised March 2005.

- Design strategies to strengthen labour intensive, value added export sectors with the resources available from the exports of hydrocarbons and other products from extractive industries.

Promoting pro-poor growth also means building public institutions that are capable of efficiently designing, implementing, and administering the public policies and resources available and having a State that is committed to growth and has clear ideas on how to promote it. Promoting pro-poor growth will only be successful if the State lays down a clear set of policies and has the capacity to implement them. This includes providing public services, working on social welfare systems, and creating the institutional conditions for more inclusive and equitable development. Policies need to be effectively designed and implemented if they are to have any effect, and so the institutions in charge of implementation and governance must be strengthened to carry out their roles. Experience shows that institutions are key to the process. Any efforts to reform or construct solid, pro-poor institutions must first identify a small number of specific institutions that work on pro-poor growth and give them unlimited support.

Which actors to support?

Sida should first support the national government but public institutions should not be the only focus of their work. At the national level, the relevant public office – with which Sida should start an open dialogue about the constraints to pro-poor growth and the contribution that Sida can provide to help lift them – is the Ministry of Planning and Development. This is where the main constraints to growth should be identified and analysed along with a joint plan of action on how to eliminate these constraints.

Promoting a business climate that attracts investment is the main task of the government, which must generate credible policies and build dependable institutions. The dialogue between the government and Sida should emphasise the factors that would improve the business climate. Different studies done by the international cooperation, including Sida (for the UPC, for example) have led to the identification of factors that have to be worked on to better position the country for investment. Developing a work plan with the MPC and the Ministry of Production to work on these factors would lead to a constructive joint analysis and common goals being clearly identified form the very start. The variables that affect the competitiveness of national businesses could also be included to identify possible bottlenecks and foresee potential risks.

Concerns about the efficiency, quality, and impact of national public investment should be high on the agenda for discussions with the MPC (as well as the VIPFE and UDAPE) given how crucial it is for pro-poor growth. The whole investment process needs to be analysed from pre-investment, through the budget process to an evaluation of the results of investment. This analysis becomes even more vital when it is shown that the level of public investment will practically double in the near future compared to levels in the first half of this decade. This is why the capacity to follow-up and evaluate of those working in public investment, particularly those in decentralised institutions, needs to be strengthened so that the investments have a greater impact.

Another area where Sida can have a huge impact is improving the workforce's level of technical training. Helping to train young people in areas that are needed by employers is paramount to sources of employment where production is intensive and wages high. Sida's experience in education and technical training in Bolivia should be used to identify where it can have some bearing on technical training aimed at meeting market needs.

Given that Sweden is part of the European Union should enable Sida to work with the government on the importance of opening up to foreign markets and having a proactive strategy to negotiate concessions with trade partners and trade blocks. Opening up to manufacturing or producing goods that incorporate added value is critical to generating quality, well-paid employment, and having an impact on pro-poor growth.

Sida has also supported the Bolivian private sector in the past and this experience should be used to start up a dialogue on possible business policies that would build linkages and favour specialisation. The relation that Sida has built up with business associations should enable them to identify how better to improve the government-private sector dynamics so that the two can work together in the future.

Finally, all work where Sida can concentrate its actions in the future on the areas suggested above should be accompanied by institutional strengthening projects for the main public institutions that are responsible for designing and implementing public policies and managing the tax payers' money in this area, with the aim of encouraging the emergence of a State committed to promoting pro-poor growth.

Annex: Development Dynamics

Annex 1. Illiteracy Rate: National and Indigenous Population over 15 years of age,by Sex and Department–2001

Department	Total Population			Indigenous Population		
	Total	Men	Women	Total	Men	Women
Chuquisaca	26.97	18.38	34.79	33.01	22.76	42.54
La Paz	11.39	4.85	17.56	15.92	6.70	24.64
Cochabamba	14.53	7.42	21.16	18.72	9.53	27.23
Oruro	10.61	3.58	17.29	14.44	4.83	23.45
Potosí	28.42	15.36	39.97	31.95	17.39	44.73
Tarija	14.10	7.91	20.09	19.46	10.57	30.30
Santa Cruz	7.26	4.26	10.26	14.07	7.02	22.34
Beni	8.88	6.18	11.86	19.28	12.64	29.74
Pando	10.37	7.89	13.75	11.05	8.07	17.99
Total	**13.28**	**6.94**	**19.35**	**19.61**	**9.87**	**29.03**

Source: INE; Prepared by SAXgr

Annex 2. Unemployment and Open Unemployment Rates by Geographic Area andby Ethnic Languages: 1999–2006

Indicators Of Employment	1999			2006 (P)		
	Nat.	Urban	Rural	Nat.	Urban	Rural
Unemployment Rate(Uc)	2,9	4,7	0,4	3,4	5,3	0,8
Indigenous	2,8	4,7	0,3	2,8	5,4	0,7
Non Indigenous	2,9	4,8	0,5	4,3	5,1	1,3
Open Unemployment Rate (Our)	4,3	7,2	0,5	5,1	8,0	1,2
Indigenous	3,7	6,2	0,3	4,1	8,1	1,0
Non Indigenous	5,1	8,5	0,7	6,6	7,9	2,1

(p) Preliminary. Source: UDAPE; Prepared by SAXgr

Annex: Employment

Annex 3. Projection of the AEP Urban Rural, 1990–2010 (Growth Rates)

Areas	1990	1995	2000	2005	2010	90-95	95-00	20–2005
Urban	1.183.374	1.519.393	1.922.022	2.386.602	2.916.353	5.0	3.1	3.0
Rural	1.104.315	1.135.567	1.170.823	1.214.130	1.270.012	0.6	0.6	0.7
Total	2.287.689	2.654.960	3.092.845	3.600.732	4.186.365	3.0	3.1	3.0

Source: INE – Projection of the Economically Active Population, 1990–2010.

Annex 4. Employment Structure (%)

Organisation Modality of Labour	**1990**	**1995**	**2000**	**2003**
Male Employed				
Formal	44,5	40,7	42,9	41,2
Informal	55,5	59,3	57,1	58,8
Female Employed				
Formal	23,1	22,5	27,9	24,2
Informal	76,9	77,5	72,1	75,8

Source: INE, Statistical Yearbook 2005. Prepared by SAXgr

Annex 5. Index of Nominal Average Remuneration in the Private Sector by Occupational Groups of All Economic Activities Base Year 1995 = 100

Period	**Manager**	**Profes-sionals**	**Other Pro-fessionals**	**Employ-ees**	**Other Employees**	**Workers**	**Other Workers**	**General**
2003								
Annual	229.16	165.32	167.15	182.13	159.38	169.55	157.83	181.1
I Quarter.	242.84	160.31	167.55	179.59	154.33	166.83	157.24	181.24
II Quarter.	237.98	164.24	166.92	181.1	161.02	170.62	160.89	182.97
III Quarter.	219.6	169.09	166.95	184.11	160.05	171.7	158.04	180.58
IV Quarter.	216.21	167.62	167.18	183.72	162.13	169.04	155.16	179.62
2004								
Annual	211.1	165.86	161.75	173.18	180.97	199.45	176.64	182.99
I Quarter.	209.5	162.73	161.37	166.06	177.7	193.15	179.67	179.34
II Quarter.	206.5	165.79	160.69	170.13	181.4	200.92	177.72	181.54
IV Quarter.	217.3	169.06	163.2	183.33	183.81	204.28	172.54	188.11
2005								
Annual	217.97	176.04	168.07	188.31	185.1	204.18	185.31	191.63
I Quarter.	214.42	176.09	167.78	190.18	184.42	205.68	177.18	191.04
II Quarter.	221.51	175.98	168.35	186.44	185.78	202.69	193.45	192.22

Source: INE, Statistical Yearbook 2005.

Annex 6. Export Companies: Average Income by Economic Activity

Economic Activity	Average Income in Bs.
Agriculture, Livestock, Hunting and Forestry	1,378
Mining and Quarrying	5,393
Manufacturing	2,083
Wholesale and Retail	2,370
Transport, Storage and Communication	1,810
Real Estate, Business and Renting	842
Community, Social and Personal Services	3,836
Total	**2,400**

Source: INE, IBCE, UDAPE, Employment and socio-economic perceptions in the Bolivian Export Companies

Annex 7. Average Nominal Wages in Private Sector

Economic Activity	Average Nominal Wage in Bs.
Meat products	1,351
Milky products	1,552
Mill products	1,325
Noodles and pasta	993
Beverages	2,004
Textiles	1,286
Chemicals products	1,573
Construction	1,821
Trade	1,956
Restaurants, Bars and Canteens	754
Average	1,461

Source: Ministry of Labour and INE

Annex 8. Employed Population by Labour Market Segment (Hours/week and permanent incomes in Bs of 1990)

Indicator	1996	2000	2001	2002	2003	2005
Formally Employed Population						
Hours Week Worked	44,48	46,62	45,91	47,73	48,38	47,43
Revenue	890,03	876,61	844,48	859,9	897,5	836,28
Informally Employed Population						
Hours Week Worked	41,96	46,58	39,94	44,68	44,14	48,32
Revenue	497,76	354,92	315,84	370,6	333,1	368,89
Semi Business						
Average worked hours	50,14	47,99	47,15	50,38	51,22	47,99
Revenue	842,45	462,31	441,33	482	469,8	391,08
Familiar						
Average worked hours	39,12	46,21	37,79	42,61	41,58	37,79
Revenue	378,12	326,98	278,35	330	284	238,01

Source: UDAPE

Annex 9. Employed Population by Labour Market Segment (%)

Indicator	1996	2000	2001	2002	2003	2005
Total	100	100	100	100	100	100
Domestic	4,6	4,2	5,1	3,9	4,4	3,8
State	11,6	10,7	11,3	10,7	9,7	9,8
Business	20,8	24,2	22,3	21,3	22,6	27,2
Family (A)	46,8	48,3	47,2	46,5	46,5	42,3
Semi Business (B)	16,2	12,6	14,1	17,6	16,7	16,9
Informal Employed A + B	63.0	60,8	61,3	64,1	63,2	59,1

Source: UDAPE, Economic Performance in Third Quarter 2006. Special Report on Employment.

Annex 10. Sectoral Structure of GDP (in percentages)

Economic Activity	1990	1995	2000	2001	2002	2003	2004	2005
Agriculture, Forestry, Hunting and Fishing	16,74	16,3	15,48	15,76	15,53	16,44	15,9	16,1
Mining and quarrying	11,17	11,2	10,45	10,13	10,18	10,41	11	12
Manufacturing	18,5	18,7	18,01	18,21	17,9	18,1	18,4	18,3
Electricity Gas and Water	1,75	2,25	2,24	2,22	2,22	2,23	2,22	2,2
Construction	3,35	3,67	3,82	3,5	3,99	2,86	2,92	2,89
Trade	9,68	9,4	9,21	9,12	9,14	9,12	9,14	9,06
Transport Storage and Communication	10,16	10,9	11,62	11,78	12,05	12,19	12,2	12,1
Financing, Insurance	11,08	11,8	15,3	15,08	14,33	13,49	12,8	12,4
Community, Social Personal and Domestic Services	4,84	4,76	4,93	4,99	5,03	4,98	4,96	4,86
Restaurants and Hotels	3,56	3,53	3,44	3,47	3,46	3,37	3,33	3,22
Public Administration Services	10,96	10,2	9,86	9,95	10,07	10,14	10,1	10,1

Source: INE, Statistical Yearbook 2005.

Annex 11 Urban area: Average Length of Unemployment (In months)

Indicator	1996	2000	2001	2002	2003	2005
Average	19,5	23	18	17,8	15,1	13,3
By Group of Age						
Under 25 years old	11,9	11,9	10,9	8,5	6,8	8,6
From 25 to 44 years old	29,1	21,5	18,9	20,5	23,1	16,0
Over 45 years old	12,7	51,2	32,9	30,9	22,6	12,1
By Sex						
Male	9,8	12,6	14,0	10,6	7,8	8,5
Female	31,5	31,7	21,9	24,0	21,4	17,8
By Education						
Primary or less	24,3	30,9	24,0	20,0	16,6	11,3
Secondary	16,0	18,5	13,8	16,8	9,6	14,4
Graduate	19,7	15,2	15,5	15,8	23,6	13,9

Source: UDAPE, Economic Performance in Third Quarter 2006. Special Report on Employment.

Annex 12. Productivity, 1999–2006 (in Thousands of Bs)

No.	Branch Of Activity	Years								General Average
		1999	2000	2001	2002	2003 (P)	2004	2005	2006	
1	Livestock	2,1	2,2	2,1	2,0	2,1	2,1	2,3	2,1	2,1
2	Exploitation Of Mines And Hydrocarbons Extraction	38,3	40,9	47,8	57,1	45,8	44,7	38,3	44,70	44,7
3	Manufacturing	8,8	10,1	9,5	8,9	8,8	9,2	9,2	9,2	9,2
4	Electricity, Gas And Water	55,5	26,7	31, 0	58,7	31,0	40,4	39,7	40,4	40,4
5	Construction	3,9	3,3	3,9	4,1	2,4	3,3	2,4	3,3	3,3
6	Trade, Restaurant And Hotels	3,4	3,6	3,3	3,7	3,2	3,5	3,6	3,5	3,5
7	Transport And Communications	12,9	15,2	13,4	14,6	14,0	13,5	11,0	13,5	13,5
8	Finance And Business	34,7	26,7	30,8	31,9	32,2	30,1	24,4	30,1	30,1
9	Public Administration, Social And Communal Services	2,0	1,9	1,8	2,0	1,8	1,90	1,8	1,9	1,9

Source: INE, Statistical Yearbook 2005 and UDAPE, Economic Performance in Third Quarter 2006.
Special Report on Employment
(p) Preliminary Data

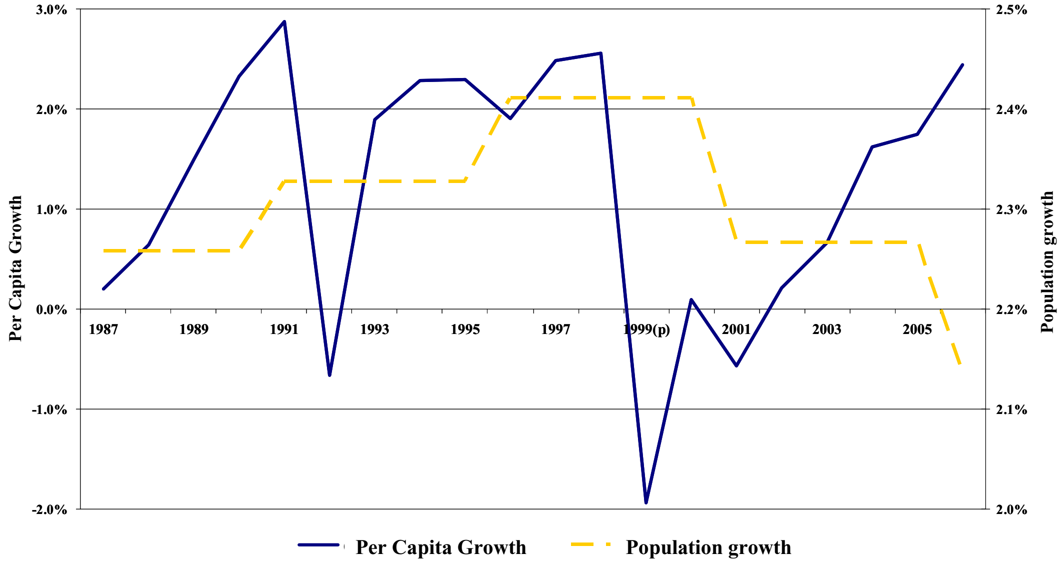
Annex: Macroeconomy

Annex 13 State Revenue from Hydrocarbons without extension to Argentina (Low Prices Scenario)

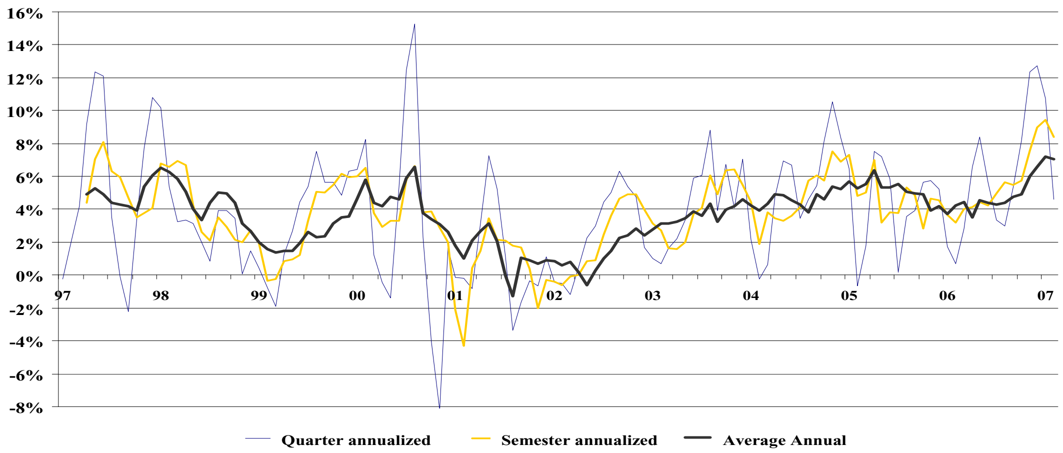
Year	State Revenue (US$ Million)			Tax Earnings	Total	% of Income at dwell
	18%	32%	YPFB			
2007	354	629	273	159	1415	72%
2008	330	586	263	158	1336	73%
2009	299	531	136	180	1146	69%
2010	268	477	124	166	1036	69%
2011	240	426	112	147	925	69%
2012	219	390	100	135	844	69%
2013	202	359	92	127	779	69%
2014	194	344	87	122	747	69%
2015	182	324	84	114	704	70%
2016	178	317	82	112	689	70%
2017	173	308	80	107	668	70%
2018	171	304	80	108	663	70%
2019	165	293	79	106	643	70%

Source: M. Medinaceli, Different Scenarios in Tax Earnings from Volumes Produced and Hydrocarbons' Prices

Annex 14. Per Capita Growth

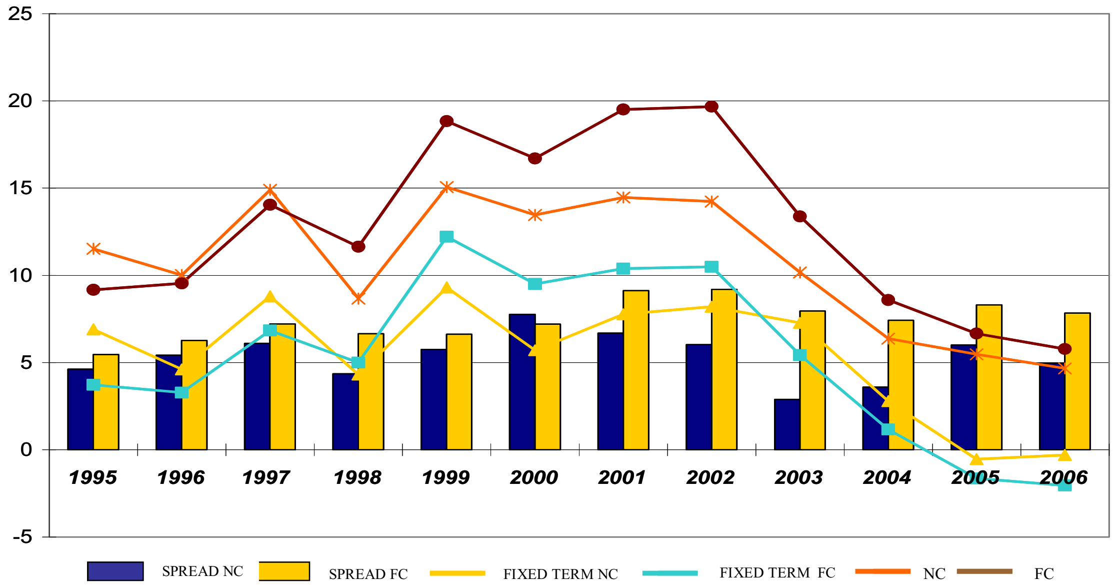


Annex 15. CPI Quarterly Update



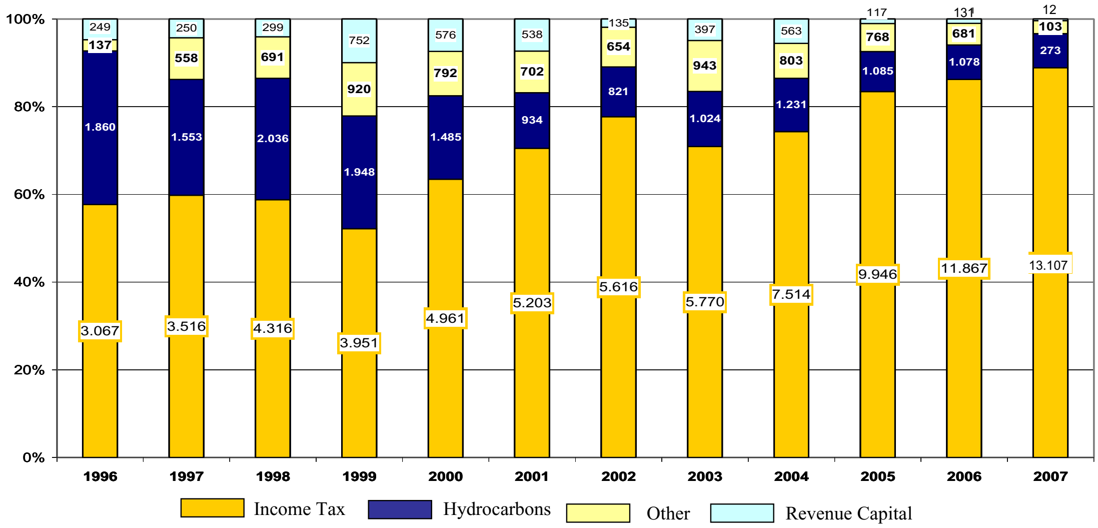
Source: INE, Prepared by SAXgr

Annex 16. Interest Rates and Spreads by Currencies



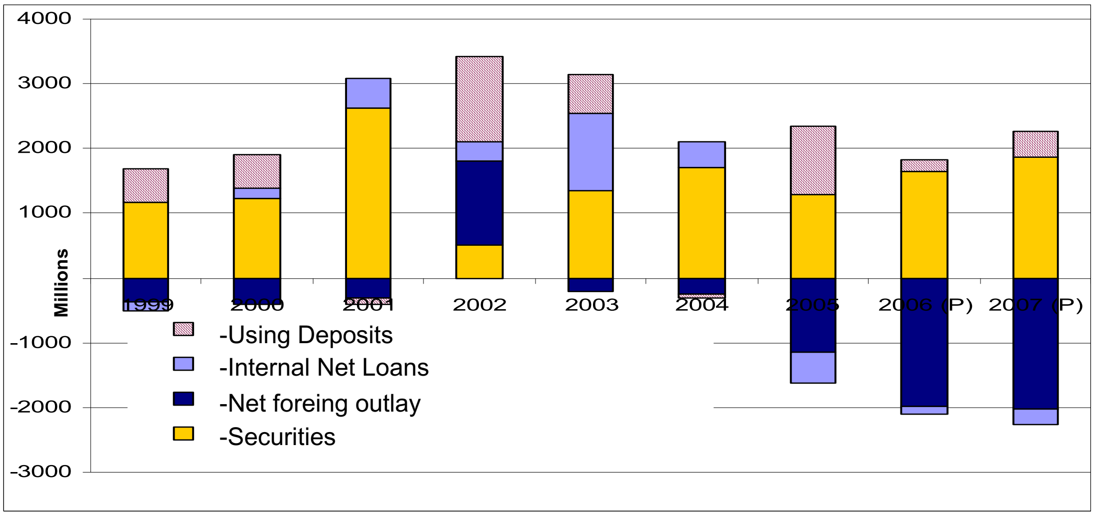
Source: Central Bank of Bolivia

Annex 17. National Treasury, Total Revenues 1996–2007 (Millions of Bolivianos)



Source: Vice ministry of Treasury and Public Debt, 1997: First Quarter Preliminary Data

Annex 18. Financing the Deficit 1999–2007 (Millions of Bolivianos)



Source: Vice ministry of Treasury and Public Debt

Annex 19. Fiscal Balance Structurally Adjusted (FBSA) and Observed

Balance	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Def (Sup) SPNF	-4,4	-4,2	-4,4	-6,1	-3,0	-1,8	-1,9	-3,3	-4,7	-3,5	-3,7	-6,5	-8,7
Def (Sup) FBSA	-4,5	-4,9	-4,3	-5,8	-3,0	-2,7	-2,8	-4,4	-7,0	-4,4	-4,0	-5,4	-7,4

Source: Eduardo Antelo, (BFECA), CAF 2003

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