

Development Challenges in Bolivia

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Abstract

This policy brief presents a summary of the development challenges facing the country.

Key Words: Regional Integration, Economic Growth, Productivity and Growth, Economic Integration, Investment, Global Trade.

JEL Codes: H30, F15, F31, F32, F34, Q32



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Medium-Term Economic and Social Trends

The Bolivian economy grew almost threefold between 2005 and 2016. Economic growth came hand in hand with a favorable external context and a greater role of the state in the economy. This was reflected primarily by an increasing level of public investment and the creation of new state enterprises, both financed with public funds. The commodity boom boosted growth and international reserves, but since 2014 the macroeconomic situation has been deteriorating, although this has been partially offset with the buffers accumulated during the boom. The Bolivian economy grew, on average, 5% annually in 2005-2014, and 4.5% in 2015-2017.¹ This deceleration resulted from the reduction of traditional export prices, especially natural gas, which affected the fiscal and current account balances.

The economy depends, to a large extent, on the performance of its extractive sector, particularly mining and hydrocarbons. Exports from the mining and hydrocarbon sectors represented, on average, 78% of the total value exported by Bolivia in the last five years and reached 56% in 2017. In the fiscal area, proceeds from the sales of hydrocarbons represented, on average, 43% of the total Non-Financial Public Sector (NFPS) revenues in the last five years. These allowed the country to accumulate buffers in the form of international reserves (NIR), which reached a maximum of US\$15,477M (50% of GDP) in November of 2014.

Figure 1. Growth, Public Investment and Oil Price

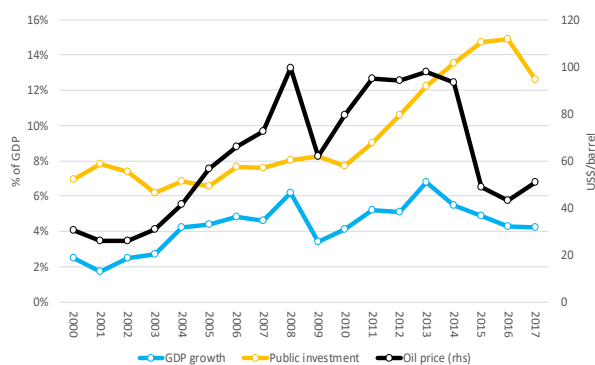
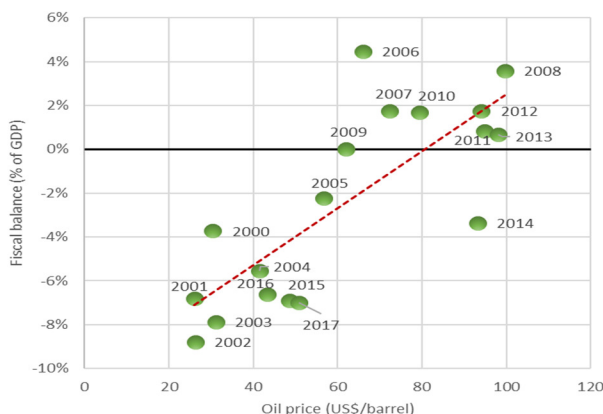


Figure 2. Fiscal Balance and Oil Price



Source: National Statistics Institute, Ministry of Economy and Public Finance and U.S. Energy Information Administration.

The growth rate was maintained due to the dynamism of public investment. The country did not experience the decline in growth suffered by other raw material exporters. The Government applied a countercyclical policy, which included high levels of public investment; during 2010-2016 it averaged 12% of GDP. This investment was basically financed with resources from the NIR accumulated during the boom years and with external debt, which reached US\$9,303M (24.6% of GDP) in 2017. This strategy has allowed

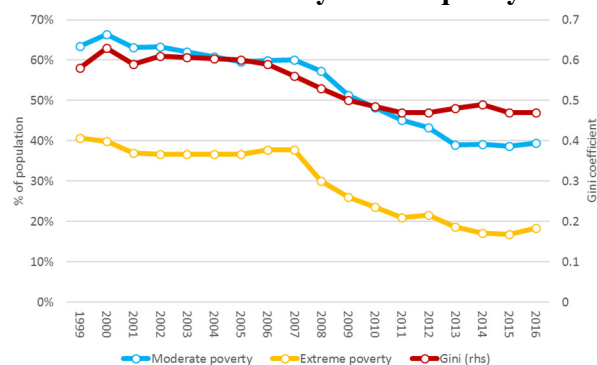
¹ 4.2% in 2017.



the Government to boost domestic demand and sustain growth rates, but it has also generated a deterioration in the fiscal balance that went from an average surplus of 1.4% of GDP in 2005-2013 to deficits in the order of 6% between 2014 and 2017. Likewise, there is evidence of a deterioration in the current account balance, which in 2017 registered a deficit of approximately 5% of GDP, in addition to a decrease in the NIR, which at the end of 2017 represented 27% of GDP. The decrease in reserves is associated with loans granted by the Central Bank of Bolivia (CBB) to public companies, as established in the State Investment Strategy, as well as with real appreciation of the currency, which is estimated at approximately 25% since the end of 2011.

Poverty and inequality levels have been reduced during the last decade. Between 2007 and 2015 Bolivia managed to significantly reduce levels of moderate and extreme poverty, as well as inequality in income distribution. For example, the incidence of moderate and extreme poverty decreased by approximately 21pp in this period in both cases, while the Gini coefficient went from 0.56 to 0.47, reflecting a decrease in income inequality. These reflected improvements in labor income, especially from those in the lower part of the income distribution, as well as the positive redistributive effect of monetary transfers made by the government to vulnerable groups such as the elderly, pregnant women, children and students in the public education system. However, since 2015, there has been a reversal in these decreasing trends as a result of the slowdown in the Bolivian economy.

Figure 3. Evolution of Poverty and Inequality Indicators



Source: National Statistics Institute.

Medium-Term Economic and Social Outlook

Economic growth will likely moderate as a result of the new normal of commodity prices. The outlook for oil prices, the main reference for the export price of Bolivian natural gas to Argentina and Brazil, is conservative in light of greater U.S. crude oil supply in recent years. Prices have increased in the last few months, although some projections estimate that the price of a barrel of oil will not surpass US\$55 by the end of 2022—50% less than the price that led the Bolivian economy to grow at rates of 6%. Still, these projections are fraught with large potential errors. In the next few years, the economy is expected to grow at rates of approximately 4%, and at such a rate continuing to reduce poverty levels will be more challenging.



Risk Factors

The main challenges in the medium term are related to fiscal deterioration, further losses in reserves, unfavorable results from gas exploration projects and lower international prices of raw materials. In the medium term, the country should try to improve its fiscal balance, especially if the price of oil does not reach levels like those observed in 2013-2014. This would also help to balance its level of foreign reserves.² On the other hand, local and foreign investors are supporting exploration for new reservoirs of natural gas to meet commitments assumed with Argentina and Brazil, as well as to comply with the supply of the domestic market. Externally, risk factors are associated with a negative shock to the prices of raw materials, especially oil and minerals, which may compromise the growth of the Bolivian economy.

Development Challenges

The economy still faces challenges related to access to water and sanitation, health, social protection and quality of jobs. The country exhibits a gap of coverage of water and sanitation services in rural areas. According to the 2012 population census, only 40.3% of rural dwellings had safe drinking water, and 37.5% had sanitation facilities. The health gap is mainly related to the high infant and maternal mortality rates which, despite improvements in recent years, are the second highest in Latin America and the Caribbean. In the labor market, the gap with other countries of similar income per capita is reflected in the high percentage of self-employed, informal and vulnerable workers.

The country's informality is among the highest in the region. The informal sector accounts for around 80% of Bolivia's labor market. This is largely related to labor costs, which could also partially explain the level of private investment in the country. For example, local private investment was close to 5% of GDP in 2017, while public investment reached almost 13%. Similarly, Foreign Direct Investment (FDI) reached 1.4% of GDP in 2017, mainly concentrated in extractive activities.

Bolivia also faces significant productivity gaps. The country's labor productivity is the lowest in the region. According to the Conference Board, a Bolivian worker has 12% of the productivity of a U.S. worker³. This result is associated with high informality and an unattractive business climate, as can be seen in the *Doing Business 2018* indicators (World Bank, 2018), where Bolivia ranks 152 out of 190 economies. Another factor that limits labor productivity is the Bolivian economy's high number of small enterprises, which in most cases are informal. However, this represents an opportunity as well, because small changes can bring about significant improvements in productivity.

Conclusion

Conclusions and recommendations. Bolivia has experienced unprecedented economic growth during the last decade as a result of the accumulation of capital—mainly public investment—and a favorable external scenario, although the latter has turned into a scenario of economic deceleration since 2014. The country's

² The most important fall in reserves occurred during 2015 and 2016. In 2017, international reserves remained at the levels observed towards the end of 2016.

³ See <https://www.conference-board.org/data/economydatabase/>.



main challenge is to maintain high rates of growth in the years ahead without causing further macroeconomic imbalances. This task will require, among other things, productivity gains. Moreover, the country must not neglect the importance of increasing international trade and the diversification that could come with it. Infrastructure and social protection gaps must also be closed to improve the well-being of Bolivians.

Bolivia has space to face these challenges. Despite the slowdown in growth and the fiscal and current account deficits of recent years, Bolivia shows economic stability, with high levels of international reserves (27% of GDP), low inflation (2.7% for 2017) and higher growth rates than most economies in the region (4.2% in 2017). In addition, the prospects are positive regarding the evolution of natural gas and mineral prices for the current and following years. The reasonably favorable trend in commodity prices could allow the country to gradually reduce its fiscal and external imbalances, maintaining a high growth rate and continuing to reduce poverty and inequality.



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