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Institutions & Economic Growth in Bolivia

Why is Bolivia's record of economic growth so wretched? Some of the answer may lie in the failure to develop the economic institutions necessary to progress from a factor-driven to an efficiency-driven economy. Property rights are uncertain, transactions costs are high, and the ability to co-operate economically is stunted.

Why is this? Partly this comes from history: Bolivia developed as an economy centred on exploiting high-value minerals using cheap labour. The mines as large-scale, integrated operations had little need for market institutions other than property rights.

The other part is the governance of Bolivia. The state is weak, but capable of conferring favours when handing out the rights to mine, drill or farm, or when granting monopoly privileges, import protection and tax exemptions. By being particular in its favours, the state becomes a valuable ally for large-scale vested economic interests. Crony capitalism is thus encouraged.

But since the state is so particular, it lacks legitimacy and sooner or later – usually sooner in Bolivia – crises and protests bring down the administration. Even those within the circuits of cronies then have to reinvest in cultivating ties to the new administration. For everyone else, change creates more uncertainty.

The result is a state poor in delivering public services and unable to create a level playing field, while frequent changes of government make for unstable economic policy. Overall this produces a rotten business environment, one that deters investment by business of all scales, but one that is especially bad for small enterprises.

Introduction

Bolivia is one of the poorest countries in the Americas. Unlike most other countries in the region, where real incomes have typically doubled since 1950, Bolivia has actually seen real incomes fall in the last half century – see Figure 1. To make matters worse, the distribution of income in Bolivia is highly unequal[1] , so that two-thirds were living in poverty in 2002. Why is it that Bolivia has had so little success in economic growth and in alleviating poverty? It is not as though Bolivia has not tried to make changes both to improve economic performance and the distribution of incomes. Indeed, few countries have seen as many political changes as Bolivia; there have been as many as four different political regimes in power since 1950, ruled in turn by an oligarchy of mine and land owners, a revolutionary party after 1952, military regimes from 1964 to 1982, and a new democracy since then.

The two most marked periods of change have been the years following the 1952 revolution when, amongst other important reforms, the mines were nationalised and land transferred from estates to the peasantry; and since 1985 when drastic measures were taken to stabilise the macro-economy, liberalise markets, privatise public enterprises, reform pensions, education, the civil service, customs, etc., and to decentralise government with greater popular participation. But

1 The Gini coefficient in 2002 was estimated at 0.55: one of the world's highest scores.

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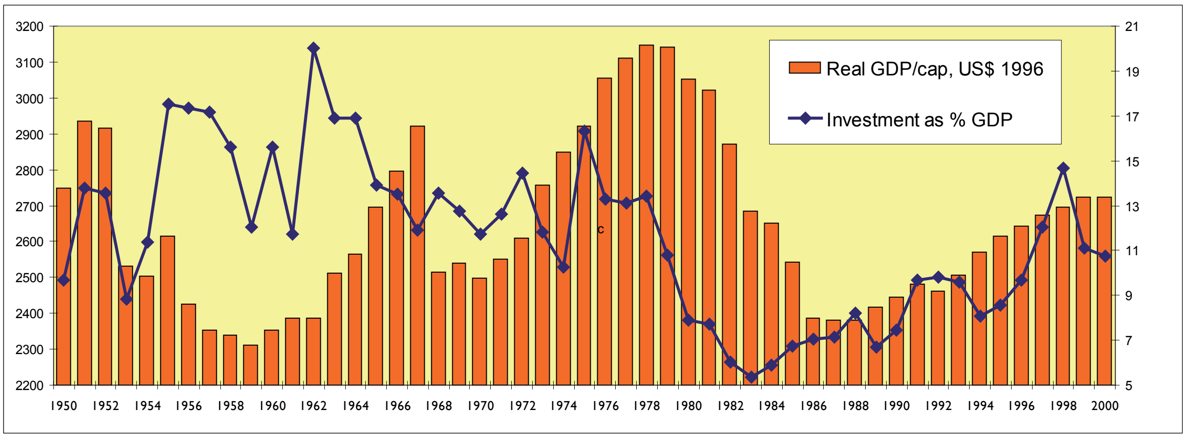

Figure 1: Real incomes and investment in Bolivia, 1950 to 2000

Source: data from Penn World Tables

neither period of reforms has been as successful as the proponents hoped.

The lack of economic growth can be explained, at least for the last quarter century, by too little investment – see Figure 1 – with investment-rates rarely exceeding 10% of GDP a year. But why so little investment? Arguments typically advanced include the poor state of physical infrastructure, government services, inadequate institutions, political instability, and marked dualism in the economy that leaves the majority of workers in informal enterprises starved of capital, know-how and legal protection. But these merely beg the question of why these conditions? Most recent commentaries, be they by the IMF or local researchers working for UNDP, now look to deeper factors to explain the malaise, and in doing so they probe areas of institutions – in the sense of the 'rules of the game', and the governance of Bolivia. To these two we now turn.

The state of economic institutions

There are clear problems in all three key sets of functions that economic institutions need to fulfil: property rights, enabling transactions in markets, and facilitating co-operation in production.

Some key **property rights** are uncertain. For example, much of the high potential land lies in the east, but parts of this are subject to claims from indigenous groups for their ancient rights over hunting and gathering territories, or else to complaints from small farmers who allege that large and powerful interests have taken over land either illegally or illegitimately. Ownership of fields of oil and gas is in flux, as seen by the 1 May 2006 announcement of the (re-)nationalisation of these. Within the last few years, two foreign-owned companies have seen their franchises to operate water supply systems rescinded. It is thus easy to argue, as the World Bank does, that uncertainty is a major deterrent to investment, especially by foreign capital.

Looking at institutions governing **transactions**, financial markets often fail to provide businesses and citizens – especially small-scale enterprises and poor households – with the means to save, insure and obtain credit. Lack of information plagues such markets, as does the lack of effective public underpinning such as prudential regulation of finance. In contracting, trust between potential business partners is commonly lacking, so that anything other than spot transactions are difficult to arrange.

The same lack of social capital that makes for too little trust also affects the ability to **co-operate** in production and supply chains. Observers have noted the paradox by which Bolivians will organise quickly and effectively to defend their interests from common threats; but do not seem able to carry the same spirit of solidarity into their business deals.

But why have these economic institutions not been better developed? A compelling hypothesis refers to the way in which the most important enterprises have been organised in Bolivia historically and in the present. Mining and extracting oil and gas are enterprises where economies of scale apply, so that typically the companies whether private or state-owned have been very large. Their institutional needs have been limited, often just to assignation of property rights; the classic case was the state monopoly company for mining set up after 1952, Comibol. This body integrated all functions within its organisation, from extraction of ores to processing, transport and export marketing. It did not require functioning institutions other than its rights to exist and trade as a legal monopoly; all co-ordination was carried out within the company, according to hierarchy, not markets. The large-scale estates that operated much of the land before 1952 had similar features; the challenge was more one of internal organisation, than dealing in markets where the full range of institutions would have been in demand.

But surely those parts of Bolivia's highly dualistic economy that were not large-scale, monopolistic companies – and here we are talking about the myriad of informal enterprises that dominate in farming, trading, and manufacturing – would have wanted institutions that functioned better? To explain why they were never effective in either making the case to government, or ensuring that government was prepared to help improve the institutional environment, we have to look at the second key to the malaise, governance.

Governance in Bolivia

The paradox of governance is that the state has proved weak – in providing public goods and services and in setting a level playing field for all citizens in both judicial and administrative functions – and yet repeatedly Bolivians turn to the state to request favours and seek remedy for grievances. They do so with good reason. The same weak state that cannot exercise key functions for the general good, can, however, confer particular favours. It can allocate property rights. It can grant monopoly privileges, provide protection from imports, exempt enterprises from tax, and so on. Hence there are good reasons to try and gain influence within the government. Large-scale enterprises have thus curried favour with politicians and senior civil servants to advance their interests in what can be seen as 'crony capitalism'. But the same particular favours[2] that government confers, also robs it of legitimacy in the eyes of the rest of the population. It is thus not long before unrest and opposition mounts. Unless the administration is either unusually successful economically[3], or ruthless in maintaining its grip on power, sooner or later it falls. Generally in Bolivia it is sooner rather than later: since 1950 there have no less than 29 different administrations.

The political instability brings costs to the large-scale interests who have to re-invest in their networks of cronyism[4], as well as to the general populace who wait with bated breath what new policies the incoming government puts in place. Thus uncertainty for investors is as pervasive as it is frequently renewed.

As for economic institutions, governments with short time horizons, with a civil service packed full of political supporters with little experience of administration, are in no shape to deliver reforms and to foster the institutions necessary to underpin a successful economy. Governments in the 1990s did not shy away from deeper reforms to the economy; but found that whilst small cadres of talented technocrats could implement the measures necessary for macro-economic stability, they alone could not take on the more demanding and wide-ranging tasks of changing taxes, pensions, public ownership of enterprises, and improving the civil service. When they tried to engage the general rank and file of the civil service in such reforms, the limits of capacity were soon clear. Consequently many of the well-intentioned reforms have only partly been carried out.

All in all, the particular characteristics of governance in modern Bolivia produces a rotten business environment, one that deters investment by business of all scales, but one that is especially bad for small enterprises.

There is something of path dependency in all of this. Bolivia's sad history of being organised by foreign rulers to extract primary resources using cheap local labour has produced patterns of economic enterprise and social organisation that entail fundamental economic weaknesses[5], structural deformations in the economy, and chronic social injustice. Patterns have been established that are difficult to break, even with the many and sometimes dramatic changes of government that the country has seen in the last fifty-plus years.

Is there any hope?

In many of the hypotheses presented, there are closed circuits and vicious spirals where progress seems all but impossible. But that would be to overstate the case. Some recent changes, both large and small, hold promise.

For example, the 1994 and 1995 laws that brought in measures for popular participation and decentralisation have created more possibility for innovations at local level in economic organisation – including the peasant economic organisations (OECA) – and for groups marginalised from the political mainstream to confidently assert their identities and rights. This latter process has just reached the heights of winning the elections for a party dedicated to remedying the injustices suffered for centuries by indigenous Bolivians – the majority of its citizens.[6] More prosaically, some institutional innovations have been seen in the economic sphere, of which micro-finance would be an example.

Moreover, if there have been vicious circles in the past, the same processes may work in reverse as virtuous circles. Path dependency may exist, but the same outlook also suggests that major changes can be started from small ones.

2. Favours are not just bestowed on business interests. Sincethe restoration of democracy in 1982 those political parties winning power – almost always in complex coalitions – have rewarded their party activists with public jobs. This both undermines the professionalism of the civil service and brings the administration into popular contempt.

3. The longest lasting administration in recent times was that of General Hugo Banzer who ruled between 1971 and 1978. He was ruthless, but more important he was lucky; his government coincided with a boom in the prices of primary commodities and the economy boomed – see Figure 1.

4. Here is perhaps one difference with some Asian regimes where rapid economic growth has been achieved. In these cases the regime has lasted in power for a decade or more, so the investment in political relations made by large-scale economic interests has been an infrequent cost to business.

5. Porter's ideas about economic stages may apply in this case; Bolivia remains first and foremost a factor-driven economy and stuggles to move to being one driven by considerations of economic efficiency, let alone innovation. Transition from one state to another is recognized as a difficult – and largely institutional – challenge.

6. Whether those who see themselves as indigenous form the majority or not has been sensitive in recent debates, with a leading NGO interpreting census data to show 62% as indigenous, while the official statistical agency reported a statistic of 49%.