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TIRONI | ASOCIADOS BOLIVIA

ANALYSIS OF THE TRADE AND BUSINESS ENVIRONMENT IN BOLIVIA

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EXECUTIVE SUMMARY

Bolivia lacks a growth strategy. In the past ten years, various policy initiatives have mainly been concerned with income redistribution rather than income generation. The result is mounting social demands against dwindling public resources. Hence, there is an enormous potential for social conflict, which in turn is may undermine democracy and all democratic institutions.

The strategy implicit in past policy initiatives has had the effect of concentrating almost all of the available external finance to the country in programs and projects directed at the social sector, particularly in education, health care, water and sanitation, development of rural areas and micro-finance. The considerable effort undertaken by Bolivia and the international cooperation to run these projects is, however, not sustainable in the long run, given that the country does not have the capacity to generate the resources required to finance them on its own.

In addition, emphasis on the social sectors and re-distributive strategies has had a negative effect on the productive sector, as it has detracted attention away from it and generated ambiguous policy directives and contradictory efforts that have reduced its competitive advantages and marginalized its productive capabilities. This situation may be clearly exemplified by the lack of meaningful commercial success in external markets and the ever-increasing competition Bolivian firms face in domestic markets from foreign competitors.

This situation has become critical. At present, it seems fair to suggest that the Bolivian productive sector lacks the critical mass of firms capable of sustaining cluster development, generate employment opportunities and, thus, economic growth. In the large majority of industries, productive activity is undertaken by very small firms - which employ less than ten workers and operate in the informal sector - that have little potential for productive efficiencies and have no access to technology, credit and new management tools. Support for these firms comes in the way of safety net policies aimed at keeping them alive, but without really helping them to grow and to compete in world markets.

Existing larger firms, with a labor force of fifty workers or more and which have the necessary attributes to compete in external markets have been effectively abandoned by the State. There are three arguments that may be used to validate this claim.

First, there are no consistent policies directed at encouraging the growth of large Bolivian firms, if anything the opposite is the case. Second, Bolivia has not seriously developed the support structures that exist in most countries in the world to promote exports and foreign direct investment, to the extent that firms that operate in export markets or have attracted foreign capital have done so largely by their own initiative and effort. Third, Bolivia is not a competitive milieu, imposing a number of additional operating costs to firms.

These additional costs come mainly, as it was pointed out in chapter four, from the lack of transport, services and other physical infrastructure, the difficulties and cost of access to credit, the prevalence of the informal economy, the regulatory constraints that increase the cost of labor, bureaucracy and corruption. Finally, it is also necessary to point out that the "neutral" management of the economy, which passed for responsible fiscal policy, has produced over the past fifteen years macroeconomic stability and an assortment of accompanying indicators to be proud of, but very little in the way of incentives for the growth of the productive sector and thus the real economy.

Another important element that has contributed to the reduction in the number of large formal firms in Bolivia has to do with the judicial insecurity that is widespread in the country. This team of consultants believes this to be one of the crucial elements that needs to be addressed if the country is to attract both foreign and domestic investment and to develop a market-relevant productive sector. The constant changes to the normative and regulatory framework, the weak enforcement of property rights, the lack of commercial trained lawyers and judges and judicial corruption introduce too big a risk factor for firms to properly plan for and undertake business opportunities existing in the country.

To address all these problems that have in the past hindered the development potential of the country and reduced the impact of the reform process undertaken over the past two decades, it is of the utmost importance that a coherent growth strategy be developed and an efficient institutional structure be put in place to implement new policy initiatives. In the next section, we utilize a public policy management model, developed by Phillip Kotler (et. al.) in his book The Marketing of Nations: A Strategic Approach to Building National Wealth (1998), to develop a growth strategy for Bolivia aimed at strengthening the productive sector, increasing exports and attracting foreign direct investment.

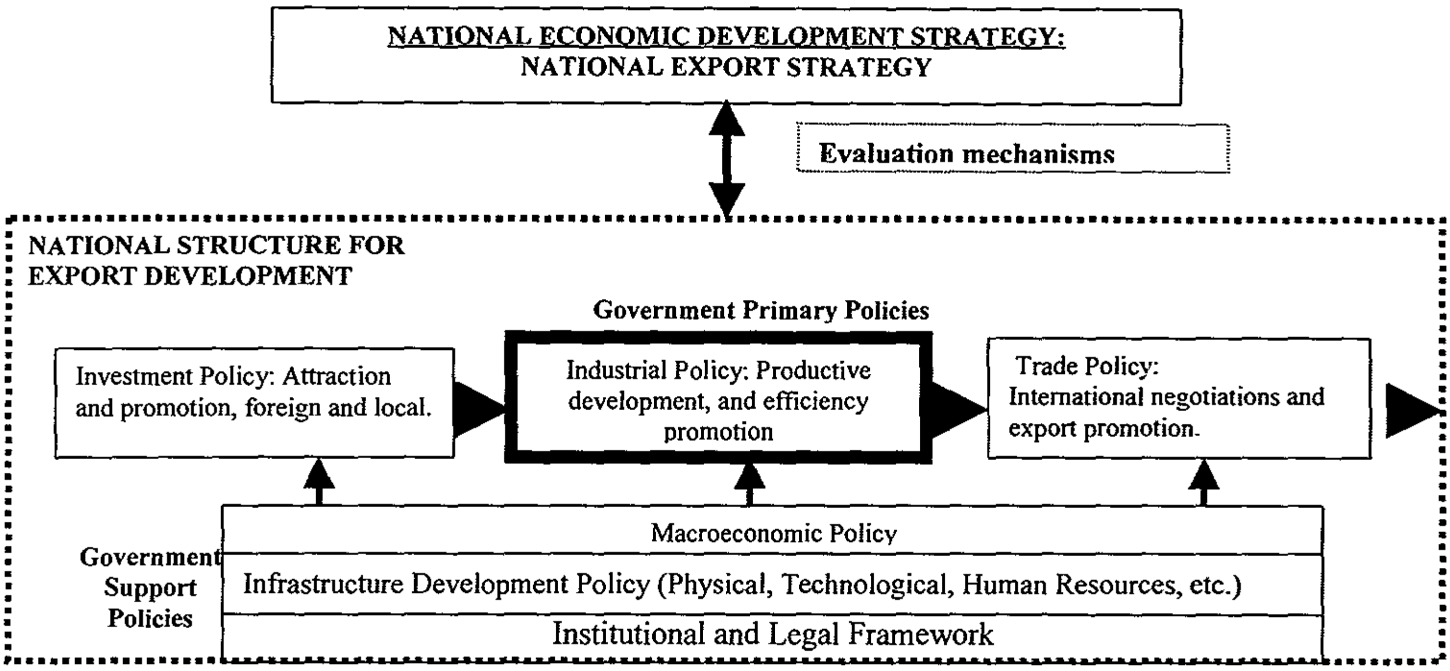
PROPOSED PUBLIC POLICY RECOMMENDATIONS: MODEL AND ISSUES

The model suggested is based on three important elements and its structure is shown in the graph below:

- the generation of an economic growth strategy based on the promotion of exports and the attraction of foreign direct investment,
- the development of a national export strategy capable of generating the income and social impacts that Bolivia requires,
- the organization of an institutional structure for the promotion and diversification of exports capable of generating a competitive and dynamic export portfolio.

POSSIBLE AREAS OF INTERVENTION FOR USAID-BOLIVIA

The proposal of the consultant team is that USAID concentrate its resources in helping to develop the institutional structure for a national export-led growth strategy. The suggested institutional structure to be developed is illustrated below:



The components of this structure are:

- Participation in and generation of a national growth strategy and a complementary National policy and institutional structure.
- Participation in the design and implementation of:
    - A national Industrial Strategy and related policies.
    - A set of laws to promote entrepreneurial initiative and human resource development.
    - A national Competitiveness Network, including a National Competitiveness Center. The proposal is to develop CORFO (Chile) and Fundación-Chile style institutions, which would include the agricultural experiences of SIBTA.
    - National Development Strategy Meetings, to be implemented by the board of directors of the National Competitiveness Center.

Development of a such national strategy implies development of supporting investment, industrial, trade, infrastructure and macroeconomic policies along the following lines:

Investment Policy

- Develop an aggressive policy to attract new investments and link this policy to a national industrial policy

Industrial Policy

- Analyze sector level constraints before defining policy interventions
- Adjust Industrial Policy to the potential of particular clusters
- Industrial Policy should aim to link firms at different ends of the size spectrum
- Develop an Institutional Structure for a National Export Industry

Trade Policy

- Develop an aggressive national trade policy oriented to support the National Export Strategy and increase the efficiency of local markets

Infrastructure Policy

- Build Transport Infrastructure on the basis of productive requirements
- Develop Financial Infrastructure especially non-bank sources of financing for firms
- Develop Human Resources Infrastructure and Steer the Education System to meet Productive Sector Requirements
- Develop a National Immigration Policy to Attract Certain Specialized Skills

Overall Institutional Framework

- Build a basic institutional framework necessary to implement the primary policies (Investment – Industry – Markets).
- Support the Sistema Boliviano de Productividad y Competitividad
- Support Institutional Administrative Simplification by Undertaking a Publication Program (Internet as Well as Paper) to Increase Transparency
- Upgrade Internal Business Processes in Key Public Sector Agencies
- Undertake a Reform Program for SENASAG
- Undertake a Reform Program for SENAPI

Legal Framework

- Create Bankruptcy Courts
- Strengthen DDRR (Derechos Reales) and INRA

- Provide Training and Education to Regulators
- Enact Anti-Trust Legislation and Provide Training Associated with Anti-Trust Issues
- Enact Legislation Allowing Tax Stability Contracts
- Enact Legislation Giving Precedence to International Treaties over Local Legislation
- Train Trade Negotiators
- Set up a Business Law Training Program

Macroeconomic Policy

- Macroeconomic policies for growth and exports
- Fiscal policy
- Monetary policy
- Access to credit
- Foreign exchange policy
- Reduce labor market rigidities
- Ensure diversification of exports

These recommendations are discussed in greater detail in Chapter VIII.

CHAPTER I

INTRODUCTION

Bolivia is at a crossroads. In less than four years, it is likely [1]to become part of the largest free trade area in the world. Preparation for this process of economic integration is one of the biggest challenges facing policymakers in Bolivia yet the issue occupies surprisingly little space in the public discourse on development in general, and trade in particular. Gearing up for a future free trade agreement requires a concerted and complex series of actions which run the gamut from reengineering productive processes at the firm and sector level, restructuring of the current trade negotiations process, creating an adequate legal and regulatory environment, reducing the costs of doing business and creating a level playing field for foreign and local investors. In sum, the impending trade integration challenges suggest the need for a coherent competitiveness strategy which encompasses various aspects of the trade and business environment.

This study analyzes the extent to which Bolivia's trade and business environment incorporates elements of a competitiveness strategy, in order to gauge how well prepared the country is for an eventual FTAA. It does so using the methodological approach used in the Global Competitiveness Report, which ranks countries along 2 indices: the Growth Competitiveness Index and the Current Competitiveness Index. (See Table 1 below and Annex I for more details). The Growth Competitiveness Index measures the growth prospects for countries for the next 5 years, in particular macroeconomic management, the quality of public institutions and technology. The Current Competitiveness Index utilizes microeconomic indicators—such as the efficiency of firm operations, their competitive strategies and the quality of the domestic business environment—to measure how efficiently an economy is utilizing its stock of resources and in this manner try to arrive at some estimate of the current productive potential of an economy. For those aspects of competitiveness for which there no good data exist (such as the efficiency of government institutions, the degree of sophistication of supplier networks) the indices rely on an opinion survey.

[1] Assuming that the FTAA comes to fruition

Table 1: Bolivia's Competitive Disadvantages

Criteria	Ranking (75 countries)
Growth Competitiveness	
Innovation	74
Information Technology and Communication	72
Legislation and Contracts	70
Macroeconomic Context (access to credit, interest rate spread, expectations of recession	73
Current Competitiveness	
Sophistication of Firm Operation	74
Quality of the Business Environment	74
Other Indicators	
Technology	74
Infrastructure	75
Public Institutions	74
Macroeconomic Environment (ease of access to credit)	72
Firm Practices	74

Source: Global Competitiveness Report 2001

As is clear from Table 1 and Annex 1, Bolivia ranks consistently low in all areas. The data from this ranking as well as the study team's belief that for small economies such as Bolivia's, export led growth is the only possible salvation forms the conceptual framework of this study. It takes as its starting point the government's Poverty Reduction Strategy and suggests that a stronger emphasis be placed on development of productive sector and export oriented strategies.

The study is organized as follows. Following this brief introduction, Chapter 2 presents the conceptual framework while Chapter 3 presents an analysis of current trade agreements to which Bolivia is a party. An analysis of the current business environment – the macroeconomic context, as well as transversal constraints – is contained in Chapter 4. Legal and regulatory constraints are discussed in Chapter 5 while Chapter 6 presents a discussion of selected sectorial issues. Donor interventions in the area of trade and business environment issues are analyzed in Chapter 7. Chapter 8 contains recommendations and suggests areas for AID interventions.

CHAPTER II

CONCEPTUAL FRAMEWORK

Bolivia's biggest problems are poverty and social exclusion. According to the National Census of Population and Housing (2001), 58% of Bolivians households are poor and live with unsatisfied basic needs. This percentage increases to 90% of all households in the rural areas. Other indicators of social exclusion show the same dramatic picture. Infant mortality rates are one of the highest in the world at 68/1,000 live births and adult illiteracy - 15 years and over - adds up to nearly 15% of the population (for other recent social indicators see Annex 2).

Poverty and social exclusion have always been a feature of Bolivian society, because governments have been unable or unwilling to confront these problems head on. The failure to address poverty and social exclusion effectively, particularly in the past twenty years and despite countless electoral offers and promises made to that effect, has substantially weakened the credibility of all public sector efforts with the Bolivian population. Hence, in the past few years different social movements, increasingly more violent but still small and fractured, have put into question not only the free market economic model, but also democracy and democratic institutions.

The escalating demands for a better deal for the poor have been met with the same answers from a number of different governments drawn from all sides of the political spectrum, thus the repudiation that the population has for the existing political parties and political institutions. The usual answer has been that there were limited financial resources to meet these demands and that doing so could put at risk economic stability and the satisfactory performance of the important macroeconomic indicators. On the other hand, corruption has been rampant and highly visible.

The poverty alleviation initiatives that exist today in Bolivia have been for the most part projects recommended by international cooperation and undertaken by the government with external financing. These are usually dispersed and badly coordinated, there is an exaggerated amount of effort duplication and most have an emphasis on safety net social policies. Also, there is an important amount of money that has been made available by the government and the international cooperation, which has generated a huge industry of non-profit organizations (NGOs) dedicated to implementing these type of projects.

All these factors put together have made redistribution issues become more important than growth issues in economic and social policy. Hence, public discussion in Bolivia is not longer about growth, which incidentally has averaged a modest 4% during the 1990s decade and has fallen to less that 1% in the year 2001, and concentrates on safety net and redistributive social policy. In a country where income generation at all levels is difficult, this course of action only promises confrontation in the future.

Given this situation, it is not surprising that there is only a small percentage of attention and public resources directed to a strategy for public sector development and the generation of long term employment and income opportunities. The country has spent nearly $us 2 billion in the last ten years in the process of institutional reforms, that have modernized and made the institutions of the State more efficient, but has spent by far smaller amounts, in comparison, in the creation of the conditions necessary for the productive sector to flourish and the reform of the private sector.

In its place there has been, however, an acrimonious debate between the representatives of the private sector and the different governments in the past ten years over the responsibilities for economic development. The private sector suggests that the public sector has adopted an extremely orthodox view of the responsibility for economic development, to the extent of leaving even the generation of proposals for public policy to them, while the public sector has suggested that the private sector is inefficient and incapable of undertaking the challenges of competition.

The view of the team of consultants is that this situation needs to be reversed. The problems of poverty and social exclusion have the potential to undermine all the important economic, social and institutional reforms undertaken in more than twenty years of democratic rule. Also, safety net policies, in the economic and social areas, are not sufficient, and certainly not sustainable in the long run, as a mechanism for poverty reduction. This objective will only be achieved with a strategy that focuses on the creation of wealth in the country as its main instrument. The need for such a strategy, to organize and direct current public sector efforts towards the same objective, is all important.

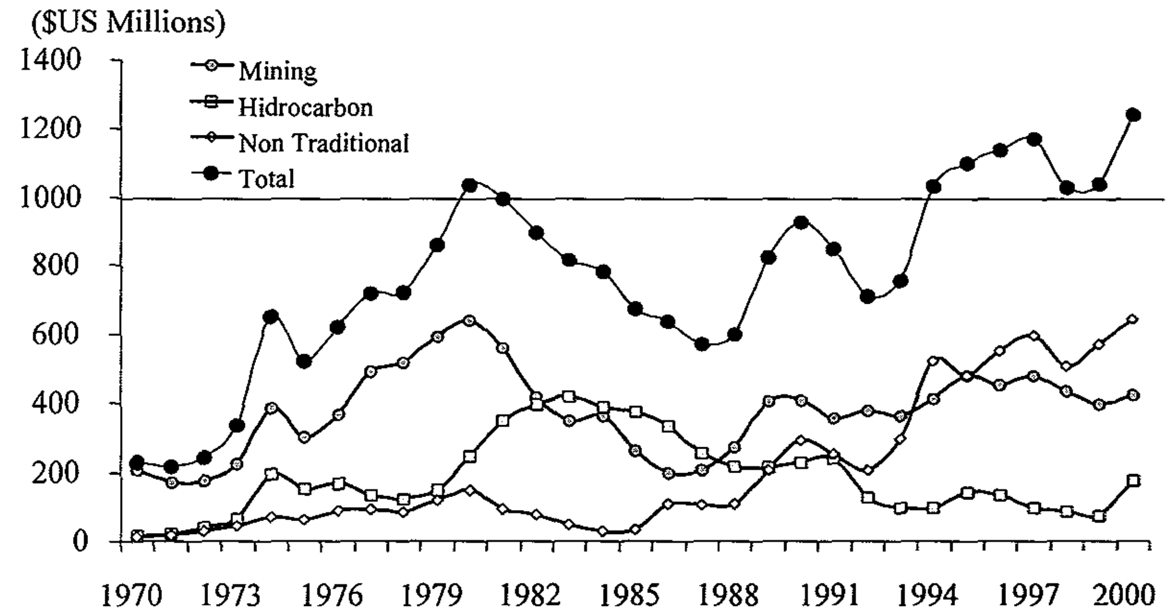
A strategy for wealth creation in Bolivia must be based on two fundamental provisions. First, that a true public/private sector commitment for the strengthening of the productive sector is in place and second, that there is a clarity of vision that the principal objective is the generation of employment and income opportunities for the population. The first provision is important to generate the necessary agreements to embark on a comprehensive private sector reform and to create the appropriate coordination structures to support all the initiatives undertaken. The second, to unequivocally select those activities that have the greatest impact on employment and income generation.

The importance of employment and income generation to the Bolivian economy can be highlighted by the fact that demographic estimates forecast that the work force in the country will grow by more than a million in the next ten years. This means that the economy will have to accommodate 100,000 new entrants to the labor market every year for the next decade. In the present conditions, these numbers are impossible to accommodate within the productive configuration of the formal sector, which means that this work force will undoubtedly migrate or add to the already substantial informal sector.

The numbers of new employment and income opportunities that need to be generated in Bolivia in the near future suggest that the wealth creation strategy for poverty reduction cannot be based on economic initiatives or activities directed to the domestic market, which is essentially too small. With a population of 8.3 million and a GDP per capita of around $us 1,000 a year, Bolivia's domestic market cannot sustain economic activities that will absorb the work force in the numbers required, simply, by population growth. Thus, Bolivia has to look to the external markets to generate sufficient economic activity in the country to effectively fight poverty and social exclusion.

In other words, the growth of exports appears to be the main instrument for employment and income generation economic activities and thus for wealth creation and growth. However, the performance of Bolivian exports in the past twenty years has been relatively poor, as can be seen in the following graph.

Graph 1: Bolivia's Exports, 1970-2000



Source: National Institute of Statistics, 2001

Four important conclusions may be drawn from these export data:

- Bolivian exports have fluctuated around the $us 1,000 million in value for the past twenty years, having reached this figure back in 1980.

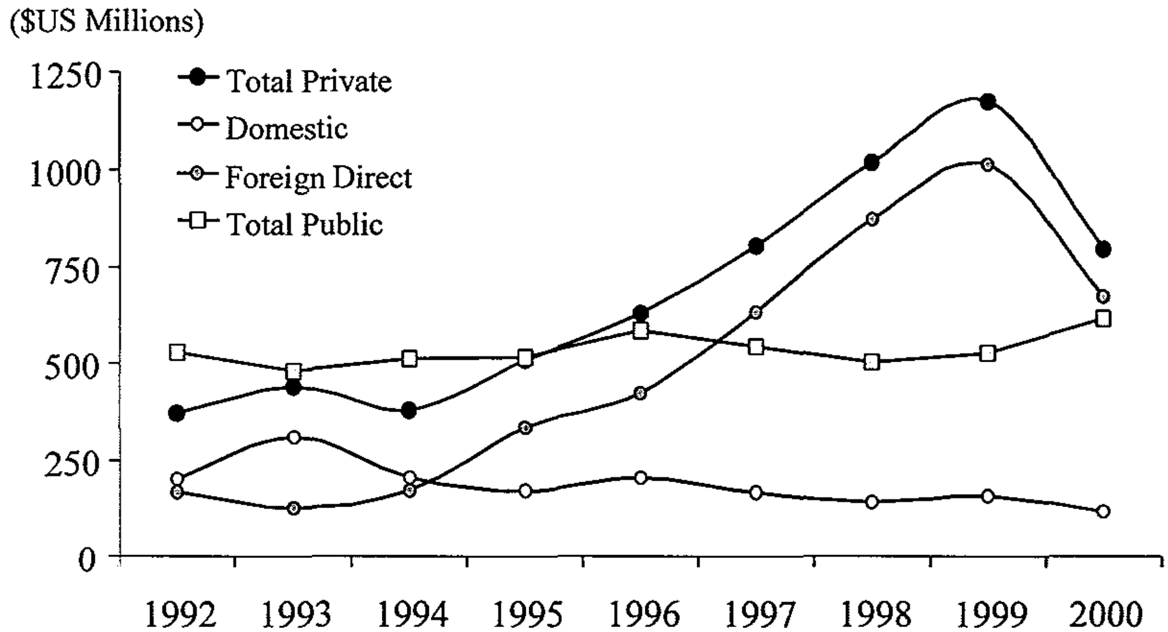
- The composition of exports between 1980 and 2000 has changed substantially. The predominance of mineral exports in 1980, was reduced in 2000, and non traditional products were the largest source of exports in that year. These include soy and soy derivative products, wood manufactures, cotton apparel, llama and alpaca wool products, brazil nuts, coffee, gold and silver jewelry and leather manufactures. In the year 2000, exports of natural gas to Brazil also became relevant to the export statistics.

- There is still a large dependence of Bolivian exports on raw materials and commodities. Only 15% of all Bolivian exports are manufactured and carry value added. Hence, international price fluctuations have affected negatively total exports, measured in value terms, as the country's terms of trade have deteriorated badly.

- Bolivian exports account in 2000 for less that 0.02% of global exports, and there is little possibility of making a larger impact as there are few isolated efforts at new product development. Hence, Bolivia's export portfolio is extremely restricted.

Given that Bolivia needs to focus its attention on external markets for the generation of domestic employment and income opportunities and to achieve this objective requires to increase substantially the value of its exports, the country should invest heavily in the formulation of an EXPORT PROMOTION STRATEGY. Additionally, and because of the lack of internal capital to further expand the potential of existing sectors and develop new export products, central to this strategy has to be the attraction of foreign direct investment (FDI). That is, the export promotion strategy needs to be complemented with an INVESTMENT PROMOTION STRATEGY.

Graph 2: Investment in Bolivia, 1992-2000



Source: Ministry of External Commerce and Investment, 2001

The situation regarding the performance indicators for investment in the country is somewhat complex and is depicted in the graph above. From this information it is possible to surmise the following conclusions:

- Before 1996, total public investment in Bolivia was more important than total private investment, confirming the large role that the State had prior to this date on the functioning of the economy.

- Total private investment started rising fast from 1994, as a result of the growth in foreign direct investment attracted to the country by the process of capitalization of public sector-owned enterprises.

- Domestic investment fell from a high in 1993 of nearly $us 300 million to less than $100 million in 2000, which suggests that national capital is small and difficult to engage in productive sector opportunities.

To attract new flows of foreign direct investment to Bolivia, with the objective of developing a new and enlarged portfolio of export products, will be difficult without a comprehensive reform directed at establishing in the country a new business environment conducive to this objective. To achieve this, it is of the utmost importance to design and implement a credible and highly focalized export and investment promotion strategy structured and articulated in the public sector, so that all areas of government responsibility should be directed to contribute and support the attraction of foreign direct investment and the growth of exports.

The reforms required to generate an adequate business environment in Bolivia for the promotion of investment and exports are politically sensitive and technically complex. However, if the objective is to reduce poverty and social exclusion from the perspective of economic sustainability, these reforms are not an option and the government will have to summon the political will to undertake them. Among the reforms that need to be tackled are macroeconomic, international, legal, financial, institutional and productive. The need for these reforms and the proposals for reform will be discussed in the subsequent chapters of this report.

One other element that seems to be important to consider in the discussion for an adequate business environment is whether the creation of general conditions is enough to attract investment or increase exports. In other words, is it sufficient for potential investors and entrepreneurs that the country establishes an adequate normative, regulatory and institutional milieu or is it the case that the attraction of investment and the promotion of exports will require more aggressive and sector specific measures? The view of the team of consultants is that general conditions will not suffice in the present situation and that tailor made sector specific measures will be required to lure investment into the country and develop a new export portfolio.

Behind this statement is a strong assumption. And this is that Bolivia has already lost the critical mass of firms capable of sustaining employment generating economic activity in all its productive sectors. There are no studies that have been systematically undertaken to back this theory, however the team of consultants believes that there is some evidence, mainly taken from the field work done for this study, that seems to point to the fact that this is true.

A very strong element in this perception is the finding that firms in Bolivia, especially those that are successful in export markets, have been forced to integrate vertically, because there seems to be very little of the support cluster in place in Bolivia or because firms cannot afford to incorporate in the production process the inefficiency of small local firms. Either way, all the export oriented productive sectors in Bolivia display the same pattern of firm composition, which in general is one or two strong and successful firms with a few smaller firms around them, either to supply the domestic market or planning to join the export market.

Additionally, one can also point to the fact that employment statistics by size of firm in Bolivia published by the National Institute of Statistics (INE) show that more than 83% of all the employment in the country is accounted for by firms which employ between 1 and 9 workers and that only 11% of this total is accounted for by firms that employ more that 50 workers, big firms according to the classification. The remaining 6% is accounted for by firms that employ between 10 and 49 workers. If this is true, and there is no reason to suspect that it is not, there are less than 250 big firms in Bolivia capable of generating long term employment.

Finally, and as a corollary to this chapter that has guided the development of this study, it is important to point out that in order to build an investment and export promotion strategy, it is also necessary to rebuild a productive sector with a critical mass of firms that could face the challenge of globalization and employment generation.

CHAPTER III

BOLIVIA AND THE INTERNATIONAL TRADE ENVIRONMENT

Bolivia is an open economy, and arguably one of the most open economies in Latin America. It joined the World Trade Organization in 1995 and abides by the rules and regulations of the Kyoto Protocol. Domestically, it has a flat rate structure of import tariffs, does not subsidize its production and openly promotes and encourages foreign direct investment. Moreover, it is a country that has embraced economic integration enthusiastically and has signed an important number of trade agreements with countries with which it has a commercial relationship.

CURRENT TRADE AGREEMENTS

Bolivia is a country signatory of the 1980s Treaty of Montevideo that created and put into effect the Latin American Association for Integration (ALADI), along with Argentina, Brazil, Colombia, Chile, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.

The objective of ALADI is to create a framework for the promotion of trade liberalization and the solution of trade related problems amongst its members, with a view to setting up the basis for a future Latin American common market. Within this framework, Bolivia has signed trade agreements with all countries in South America (with the exception of Guyana), Mexico and Cuba.

What follows is a brief description of these agreements in chronological order.

The Community of Andean Nations (CAN)

In 1969, Bolivia, Colombia, Chile, Ecuador and Peru signed an agreement, the so called Andean Pact, to explore opportunities for trade integration and promote trade liberalization among these five countries. In 1973, Venezuela joined the Andean Pact and three years later, Chile abandoned it.

After 22 years of weak results, the Andean Pact re-launched itself in 1991 as the Community of Andean Nations (CAN), initially conceived as a customs union and later a free trade area. Under this agreement, Bolivian products may be exported to Colombia, Ecuador and Venezuela free of duties and products from these countries enjoy the same treatment in Bolivia.

Since 1992 and until 2005, Peru has been exempted from the obligations pertaining to the free trade area, and its trade relations with the other members of the CAN have been determined bilaterally. Under the agreement between Bolivia and Peru, Bolivia enjoys a virtual free trade area for most of its products, except – most notably – for sugar, rice, wheat, milk, poultry and pork meat.

Chile (Ace-22 Bolivia-Chile)

In 1993, Bolivia and Chile finalized a bilateral agreement to improve and enhance trade between the two countries. This agreement was further strengthened in 1997 by increasing the number of products allowed to enter either country with trade preferences. At present, the agreement allows for 630 Bolivian products to be exported to Chile without paying import duties and 270 Chilean products to be imported into Bolivia with similar treatment.

México (Ace-31 Bolivia-México)

In 1995 Bolivia and Mexico established a bilateral free trade area with the objective of increasing trade between these two nations. At present, nearly 75% of all products traded between the two countries are free of import duties and it is expected that in 2010 all products will enjoy these treatment.

MERCOSUR (Ace-36 Bolivia-MERCOSUR)

In 1997, Bolivia signed an agreement with all member countries of the Southern Common Market (MERCOSUR), originally established by Argentina, Brazil, Paraguay and Uruguay. The objective of this agreement is to establish a free trade area between Bolivia and MERCOSUR by the year 2014. At the time of the effective date of the agreement nearly 50% of all the products negotiated were granted immediate 100% trade preferences. By the year 2005, more than 90% of all products will be allowed to enter Bolivia and MERCOSUR without paying import tariffs and by 2014 all products will move freely within the region.

Cuba (Ace-47 Bolivia-Cuba)

In 1998 Cuba joined ALADI formally. As a result of this new membership of ALADI, Bolivia and Cuba signed, in May 2000, a trade agreement with the aim of generating trade flows between the two countries. Under the agreement Bolivia grants 100% trade preferences to about a hundred Cuban products and Cuba allows 90 Bolivian products to enter the country without payment of import duties.

TRADE CONCESSIONS

Bolivia has also been the recipient of a number of unilateral concessions related to trade organized by developed countries in lieu of Bolivia's position as one of the poorer countries in Latin America and with a view to generating new employment and income opportunities through market access for its export products. The most important ones are:

Andean Trade Preference Act

In December 1991, the US enacted the Andean Trade Preference Act (ATPA) with the objective of production away from to promoting new economic opportunities in

Bolivia, Colombia, Ecuador and Peru and steering domestic away from coca production and drug trafficking. The ATPA grants access to the US market with trade preferences to more than 6,000 products originating in these four countries for a period of 10 years.

At present, the ATPA is no longer valid and its extension for another five years is under review in the US Congress. It is hoped that the new law will be passed before the end of May 2002. Also, the proposal under consideration allows for 100% trade preferences to be granted to textile and apparel products, leather goods and few other items which were not included in the original act.

USA, Europe, Canada and Japan, Generalized System of Preferences

Bolivia benefits from the Generalized System of Preferences (GSP) granted unilaterally to Bolivian products by the United States, Canada, the European Community and Japan. Under this system Bolivian products are permitted to access these four markets with trade preferences established under the clause of the most favored nation treatment. Under the GSP, all Bolivian exports are allowed into Europe and Japan virtually free of import duties. The regime is a little more strict in the US and Canada, but most Bolivian export products qualify for a 100% trade preference.

TRADE AGENDA

The trade agenda for the following years will see Bolivia participate in the following negotiations:

a. The strengthening of the Community of Andean Nations, to finally eliminate non tariff barriers to sensitive products.

b. The strengthening and deepening of the trade agreement with Chile, which will most probably include a discussion about the creation of a free trade area between the two countries.

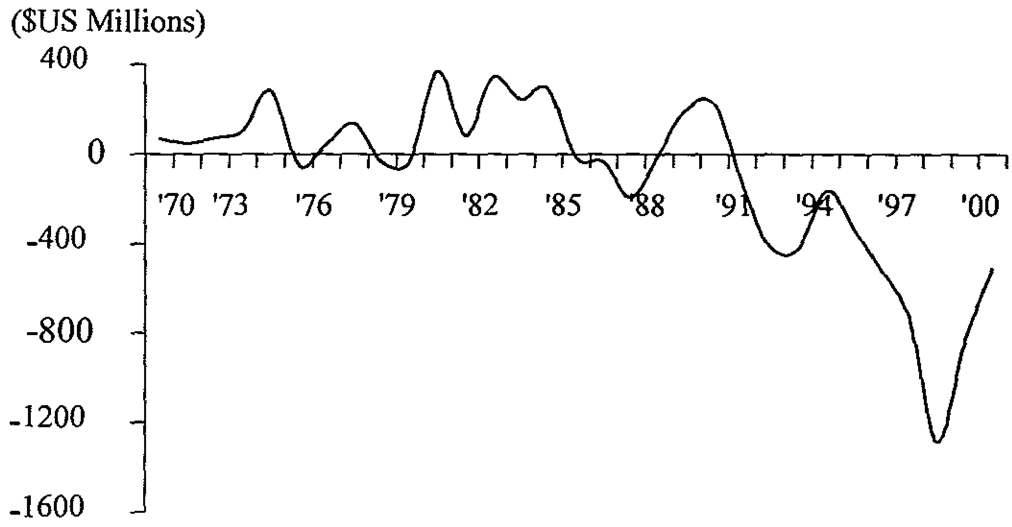
c. The configuration of a trade agreement between the Community of Andean Nations (CAN) and MERCOSUR, to effectively create a free trade area in South America.

d. The creation of the Free Trade Area of the Americas (FTAA).

EVALUATION OF THE TRADE AGREEMENTS

Bolivia's big push for integration is a relatively new phenomenon. The notable exception to this development is the agreement signed in 1969 to create the Andean Pact, now the Community of Andean Nations (CAN). All the other trade agreements were signed in the decade of the 1990s, which remarkably is the decade when Bolivia started to experience a chronic balance of trade deficit, which now exceeds $us 4.2 billion.

Graph 3: Bolivia's Balance of Trade, 1970-2000



Source: National Institute of Statistics, 2000

This continuous deficit in the balance of trade is obviously the result of imports that have increased substantially over the last decade and sluggish exports. The growth in imports may be attributed to a number of factors, of which the most important seems to be the growth of foreign direct investment (FDI) that was attracted to the country following the process of capitalization of state industries during the second half of the 1990s. The explanation for sluggish exports is more difficult, but in part may be attributed to the lack of a coherent export promotion policy in the country and the continuous decline in the prices of the commodities that Bolivia exports to the rest of the world.

A more interesting point to explore is, however, the utilization that Bolivian firms or companies have made of the trade agreements signed by the government and the implications that these have had for domestic competition. To undertake this task, we have summarized in Table 2 the statistics for exports, imports and the balance of trade for all the trade agreements signed by Bolivia for the years 1995 and 2000.

The data presented in Table 2 shows clearly that Bolivia has a trade deficit with all the countries with which it has signed a trade agreement, (with the exception of the Community of Andean Nations CAN), and that this deficit has increased substantially between 1995 and 2000. To properly evaluate the utilization of these agreements we will separate, in the following analysis, the Community of Andean Nations (CAN) from the other four ALADI agreements signed by Bolivia since the 1990s.

Table 2: Trade Agreements and Bolivia's Balance of Trade

Trade Agreement	1995 ($us Million)	2000 ($us Million)
Bolivia-CAN		
Exports	217.9	307.8
Imports	115.9	168.2
Balance of Trade	102.0	139.6
Bolivia-Chile		
Exports	25.2	25.6
Imports	106.9	163.1
Balance of Trade	(81.7)	(137.5)
Bolivia-MERCOSUR		
Exports	158.7	257.3
Imports	308.4	611.9
Balance of Trade	(149.7)	(354.6)
Bolivia-Mexico		
Exports	1.1	6.2
Imports	19.9	45.7
Balance of Trade	(18.8)	(39.5)
Bolivia-Cuba		
Exports	0.0	0.0
Imports	0.4	2.2
Balance of Trade	(0.4)	(2.2)

Sources: National Institute of Statistics, 2000 and Bolivian Institute for External Commerce (IBCE), 2001

Exports to the Community of Andean Nations (CAN) in 2000 represent nearly 25% of all Bolivian exports to the rest of the world, with $US 307.8 million. Imports, on the other hand, amount to $US 168.2 million and represent 8.5% of all imports. The result for 2000 shows a trade surplus of $US 139.6 million, which increased by $US 37 million or 36.9% since 1995.

However, there are three important points to make:

- 75% of all that is exported to the CAN consist of soy and soy derivatives such as cake, flour and oil.

- All exports of soy and soy derivatives to the CAN have a 100% trade preference, which the CAN does not grant to other countries outside its members.

- There is a strong possibility that if the CAN market is open to other producer countries, Bolivian exports of soy and soy derivatives could be seriously affected.

In the other four cases, Bolivia shows an increasing trade deficit between 1995 and 2000, mainly because the value of exports increased at substantially lower levels than the value of imports from each of the countries with which Bolivia signed trade agreements. This is particularly the case with Chile, Mexico and Cuba. In the case of MERCOSUR, Bolivia's exports increased by nearly $us 100 million over the five year between 1995 and 2000, exclusively due to sales of natural gas to Brazil. However, imports from MERCOSUR to Bolivia increased by more than $us 300 million during the same period, offsetting this export gain.

The relatively poor performance of Bolivia in relation to the utilization of trade agreements suggests that our commercial partners have been more adept at reaping the benefits from integration and using the agreements to gain a greater share of the Bolivian markets for their products than Bolivian firms. Three reasons may be put forward to explain this situation:

- Bolivia has negotiated trade agreements with its neighbors for geopolitical reasons and not with commercial objectives in mind.
- Private sector participation in the process of negotiation has been negligible and entrepreneurial decisions were made in general by public officials.
- There has always been a marked lack of coordination between government institutions in charge of international trade related issues.

The experience of Bolivia with trade concessions has not been much better as shown in Table 3 below. The country's utilization of the Andean Trade Preference Act (ATPA) has been marginal, with exports accounting for less than 3% of all exports made to the US by Andean countries. Additionally, Bolivian exports fell from more than $us 300 million in 1995 to less than $us 200 million in 2000, while imports from the US grew by more than $us 100 million over the same period. The result was an increased balance of trade deficit with the US, which was hardly the objective of the ATPA.

Table 3: Trade Concessions and Bolivia's Balance of Trade

Trade Concessions	1995 ($us Million)	2000 ($us Million)
Bolivia-US		
Exports	309.8	191.9
Imports	316.6	430.6
Balance of Trade	(6.8)	(238.7)
Bolivia-European Union		
Exports	305.2	250.8
Imports	276.6	223.6
Balance of Trade	28.6	27.2

Source: Bolivian Institute for External Commerce (IBCE), 2001.

The same case can be made for Bolivia's utilization of the trade preferences granted by the European Union. Despite enjoying virtual free access to European markets, Bolivian exports to the European Union have been falling steadily since 1995. A concurrent reduction in imports from this economic region allows Bolivia to maintain a small balance of trade surplus with the European Union.

An important conclusion can be drawn from the observation that Bolivia does not use in a significant way the trade concessions granted by a number of countries in the world and it has to do with the fact that Bolivia has a limited export supply of products. With the exception of a variety of minerals, natural gas, soy derivatives, wood manufactures and textiles, Bolivia has not developed a portfolio of production that can be competitively offered to the world.

As a corollary for this part of the study, it appears possible to assert that Bolivia's problem with international trade and trade integration has little to do with market access, but much more to do with the development of an export-oriented production of goods and services capable of sustaining an export oriented development strategy.

BOLIVIA AND THE FTAA

The effort to create the Free Trade Area of the Americas (FTAA) began in 1994 and since then Bolivia has had mixed feelings about the impending negotiations that are expected to be finished by the year 2005 (for an overview of the FTAA process see Annex 5).

Bolivia's position on the FTAA is divided, between those who see it as an opportunity and those who see it as a threat. The former argue that the country's low tariff structure (one of the lowest in the region) has already prepared Bolivian firms and companies for competition and that, as a smaller economy, Bolivia is in a position to negotiate longer periods to reduce import tariffs, time which should be used to strengthen the competitive efficiency of firms and to develop new products that could successfully be exported into the new barrier-free markets.

The second group of people is less optimistic. According to this view, has Bolivia a huge competitive disadvantage, particularly in terms of transport and service infrastructure, long term financing, human resources and technology. It is not surprising to find that the people that adhere to the second view of Bolivia in the FTAA are mainly concentrated in the private sector, whereas the first view is propagated by the public sector.

The weight of the evidence as to Bolivia's abilities to effectively compete in a Free Trade Area of the Americas (FTAA) seems to side with the private sector. In the year 2000, Bolivia's trade deficit amounted to $us 734 million, of which $us 642 million was accounted for by countries of the FTAA, that is 87.5%. In addition, Bolivia has trade relations with 26 of the 34 countries that are negotiating the FTAA agreement, and has a balance of trade deficit with 17 of them.(See Annex 6)

The solution to this particular problem is obviously not to withdraw from the negotiations, as this would have widespread political and economic implications for the country. However, Bolivia has to take a small economy position and try to negotiate as many concessions as it is possible to extract from the other participants in the process, so as to give it self enough time to put in place the institutional framework and support structures necessary to develop strong industries and competitive production.

CHAPTER IV

ANALYSIS OF THE BUSINESS ENVIRONMENT FOR FOREIGN DIRECT INVESTMENT AND EXPORTS

MACROECONOMIC CONSTRAINTS

With the implementation of its New Economic Policy (NEP) in 1985, Bolivia began to undertake a series of a structural reforms aimed at creating a market economy. The impetus for these reforms was a serious external debt crisis and macroeconomic unbalances which had led to the mid eighties hyperinflation. Embarking on these structural reforms meant the end of the state capitalism – development model.

The first generation structural reforms in Bolivia included radical fiscal and monetary adjustments, domestic and foreign market liberalization (except for land markets), and tax reform. The most significant second wave reforms included public service price deregulation, industrial restructuring and the capitalization/privatization of major state-owned companies, administrative decentralization and popular participation, educational reform, and reform of the pension system.

As a result of these reforms, significant advances were made on the monetary/financial side in institutional reform. Growth rates were stable until 1998, when the economy was adversely affected by external shocks, thus reducing growth rates. The following chart shows selected economic indicators, demonstrates the positive macroeconomic performance until 1998 and economic deceleration subsequently.

Table 4: Bolivia, Selected Economic Indicators

	1996	1997	1998	1999	2000
Inflation Rate (%)	12.4	4.7	7.7	2.2	4.6
Public Deficit (%GDP)	-1.9	-3.3	-4.6	-3.4	-3.7
Current Account Balance	-333	-553	-667	-488	-464
Gross Domestic Investment (%GDP)	16.2	19.6	23.1	18.9	18.8
Public Sector External Debt (%GDP)	3.4	2.6	1.2	1.4	1.3
Debt Service Ratio (% Export)	25	25.2	28.6	19	18.3
International Gross Reserves	1018	1403	1189	1211	1164

Source: IMF Bolivia Statistical Annex, 2001

During this period, significant strides were also made in the social sectors. Although poverty and social exclusion indices are still high, there were some notable improvements.

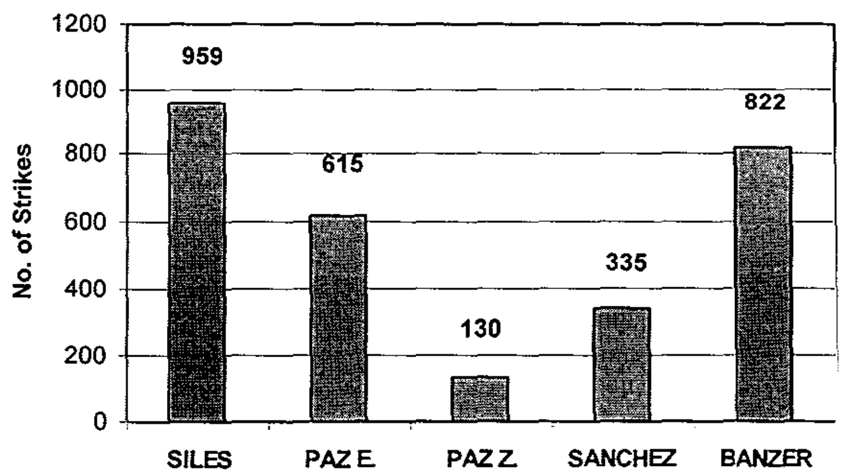
Table 5: Bolivia, Selected Social Indicators

Position on Human Development Index	104
Poverty Incidence	63.20
Urban	51.50
Rural	81.60
Extreme Poverty	36.50
Adult Illiteracy Rate	15
Under 5 Mortality Rate, per 1000	67.00
Life expectancy at birth (Years)	62.92
Health	
Physicians per 10.000 inhab	3614
Health Centers per 10.000 inhab.	3
Percent of Income Received:	
Income Distribution in Cities	
By highest 20 percent of households	54
By lowest 20 percent of households	4
Gini Coefficient	0.51

Source: IMF Bolivia Statistical Annex, 2001

However, social conflict continues to be an issue, according to the Ministry of Labor, in the last four years, there have been 822 strikes[2]. Social problems have had a negative impact on the investment climate and have had adverse effects on competitiveness and exports.

Graph 4: Number of Strikes Under Different Governments, 1982-2000



Little progress has been achieved in solving microeconomic problems, such as rural productivity, technological development, human capital, employment quality, absence of road infrastructure, weak institutional development, and little small and micro-business

[2] Between 1982-1984, at the peak of hyperinflation, there were 933.

development, to name a few. Many such restraints hinder the business environment and adversely affect investments and exports.

Historically, both in Bolivia and Latin America, unequal access to income-generating assets by the poor has created a political and economic scenario that restrictive, even more, the opportunities for the poor people. Lacking education and any type of productive asset, the poor are condemned to low productivity and low paying jobs, which segregate them from mainstream the economic circuit, reduce their political participation and seriously restrict their freedom of choice and personal liberties. In turn, this social exclusion limits their access to education, to productive jobs, and to fundamental liberties, i.e. the exercise of their civil rights.

Table 6: Economic Growth and Poverty Reduction

	Growth 4%	**% Annual**	**Growth 6%**	**% Annual**
	Rural	**Urban**	**Rural**	**Urban**
1st Decile (+ poor)	131 years	99 years	63 years	48
2nd Decile	105	57	50	27
3rd Decile	89	39	43	19
4th Decile	76	24	36	12
5th Decile	65	11	32	6
6th Decile	53	0	26	0
7th Decile	40	0	19	0
8th Decile	28	0	13	0
9th Decile	10	0	5	0
10th Decile (+ rich)	0	0	0	0

Source: George Gray Molina's estimates using data from INE and UDAPE

According to Inter-American Development Bank data, if the GDP per capita – income indicator – were to grow at the same rate as in the nineties, 1.43%, or its equivalent 4.5% GDP growth, it would take Bolivia 49 years to double its wealth and 139 years to equal Argentine income per capita. With its current productive levels, human resources stock and productivity, Bolivia is doomed to have a growth rate of around 4%. Hence, there is need for radical and swift changes in investment and export policies.

Table 7: Projections of the Economically Active Population

CITY	2000	2010	INCREASE
Santa Cruz	682,068	978,484	296,416
La Paz	902,102	1,172,710	270,608
Cochabamba	567,846	779,469	211,623
Chuquisaca	213,403	290,253	76,850
Potosi	276,033	349,381	73,348
Tarija	155,485	219,579	64,094
Beni	130,983	189,575	58,592
Oruro	141,497	174,657	33,160
Pando	234,27	32,256	8,829
Total	**3,092,845**	**4,186,365**	**1,093,520**

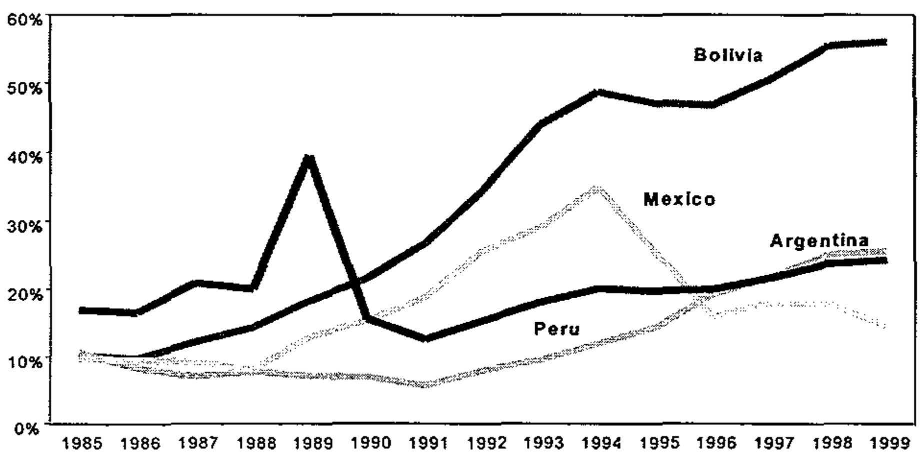
Source: Horst Grebe's estimates using INE data.

Evolution of the Main Macroeconomic Indicators

Access to credit is central to the increase in investment and, consequently, the development of the private sector. Since 1985, Bolivian companies have had greater access to credit, as can be seen in the graph below. However, it must be stressed that access to credit has been concentrated in only a handful of big companies and has been insufficient for more integrated development. High interest rates and administrative obstacles to access credits are difficulties many Bolivian companies face.

The private sector also faces administrative obstacles to access credits, including rigid collateral requirements and high transaction costs when getting credit.

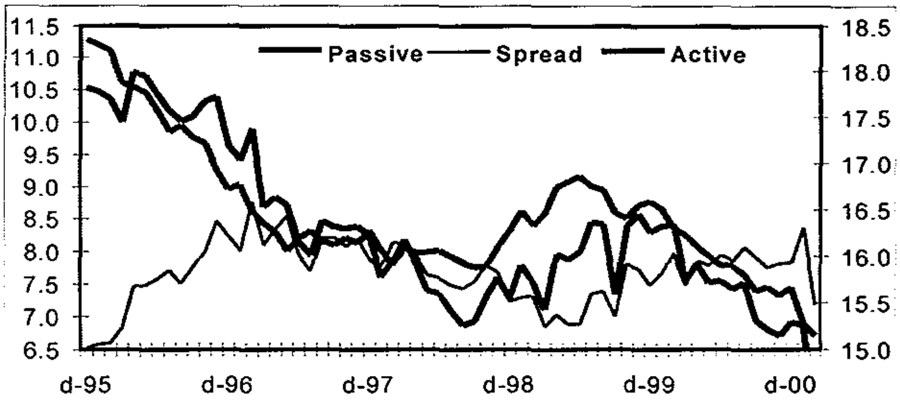
Graph 5: Private Sector Credit as a % of GDP



Source: Interamerican Development Bank, 1999.

During the first years of the NEP, active and passive interest rates were high by international standards; however, starting in 1994, there was a significant, though insufficient, reduction in interest rates. In the last three years of the nineties, passive interest rates in US dollars were still above 14%. These high interest rates result from macroeconomic policies and bank administrative rigidities. (See graph below)

Graph 6: Interest Rates and Spreads



Source: Central Bank of Bolivia, 2000

Bolivia's floating foreign exchange system – the Bolsin - allows in theory the absorptions of external shocks and maintenance of the value of the Boliviano. However, since 1985, there has been an appreciation of the real exchange rate, hindering exports and raising the price of imports. In both cases, the private sector has been affected, first due to the added difficulty of entering international markets and second, given the strong dependence of Bolivian companies on foreign machinery and supplies and the rate of exchange, national companies face high input costs, which in turn reduces their competitiveness.

Labor market rigidities also affect investments and exports. Rigidities include high severance payments, a mandatory three-month trial periods for workers, high overtime costs and high social benefits.

Tax reform in Bolivia dates to past 1985 stabilization program. One of the pillars of the August 1985 stabilization program was fiscal adjustment based on a drastic reduction of public expenditure and a presumed rapid increase in income. To consolidate stability and balance in public accounts, in 1986, the National Congress passed the Tax Reform bill. This Law created an 8-tax structure –most of which are indirect and some of which were corporation and personal capital taxes[3]. The tax reform also established a tax co-participation system, which set aside 75% of the internal revenues for the National Treasury, 20% for the municipalities, and 15% for the state-owned universities.

By the end of the eighties, the reform had had no significant impact. Income continued to be tagged to state-owned companies' sale of goods and services, especially the oil industry. The reform was perfected in 1994, through Law 1606, which included the consolidation of the Unified Taxpayer Registry (RUC), the improvement of the Taxpayers

[3] The major taxes created were: Value Added Tax (VAT), Complementary VAT (CVAT), Transaction Tax (TT), Consolidated Customs Duties (CCD), Presumed Corporation Income Tax(PCIT), and Specific Excise Tax (SET), applicable to the sale of alcoholic beverages, cigarettes and jewelry, among others.

administration and oversight unit (GRACO). This new reform also included other important changes, such as the replacement of the Presumed Corporation Income Tax (PCIT) with the Corporation Profits Tax (CPT).

In order to transfer the State-owned companies to the private sector, tax systems for the mining, electricity and hydrocarbons sectors were modified. For the latter, a new Special Tax on Hydrocarbons and Byproducts (STHB) was created. All these changes account for the later rise in revenues. In the nineties, the tax reform started rendering results. Tax revenues showed sizeable increases from 7.2% of the GDP in 1990 to 14.5% in 1998. Generally speaking, the tax system is not a hindrance to the development of the private sector and exports, except for the fact that there is no tax mechanism intended to promote exports.

The External Sector and Natural Gas

Natural gas exports are and, no doubt, will continue to be one of the engines for growth. Yet, it is crucial to highlight some collateral adverse impacts of relying too much on natural gas. Once again there is a danger that Bolivia's economic future and poverty reduction prospects depend primarily on one non-renewable natural resource. Gas could come to play the role that silver and tin did in the past, creating unrealistic expectations and an elevated level of dependence on a single commodities.

International experience suggests that countries that have based their development purely on raw materials, after a short-lived euphoria, grew at lower rates in the long term than those economies poor in oil and mineral resources.

Several explanations account for this phenomenon. One explanation focuses on the revenue-oriented attitude of the elites; that is, the Government and the private sector only focus on getting the royalties, taxes and profits from the primary sector disregarding other sectors. Another reason is that the gas industry does not create supply chain linkages with the rest economy. The most plausible explanation however, for why countries fritter away the advantages of a natural resource is the one called Dutch disease.

Dutch disease was the name given, following the experience on the Netherlands in the 1970s with expansion of its natural gas production, to the negative impact of a windfall increase in foreign exchange earnings from a particular source (usually natural resources exports) on the rest of an economy. The disease has two aspects: the resource movement effect and the spending effect. The expansion of the booming sector pulls factors of production towards it and bids up their prices, and as a result, other tradable sectors become less profitable and contract: this is the resource movement effect. In so far as extra income arising from the booming sector is spent on non-tradable goods, this bids up the prices of such goods relative to those of tradable goods, resulting in an appreciation of the real exchange rate. This exchange rate appreciation makes the tradable sectors less competitive in international and domestic markets and they contract further. This is the spending effect. Although usually linked to a natural resources boom, the Dutch disease, it is suggested, can also transmitted through massive foreign exchange resource inflows associated with coca plantation, for instance (see graph below):

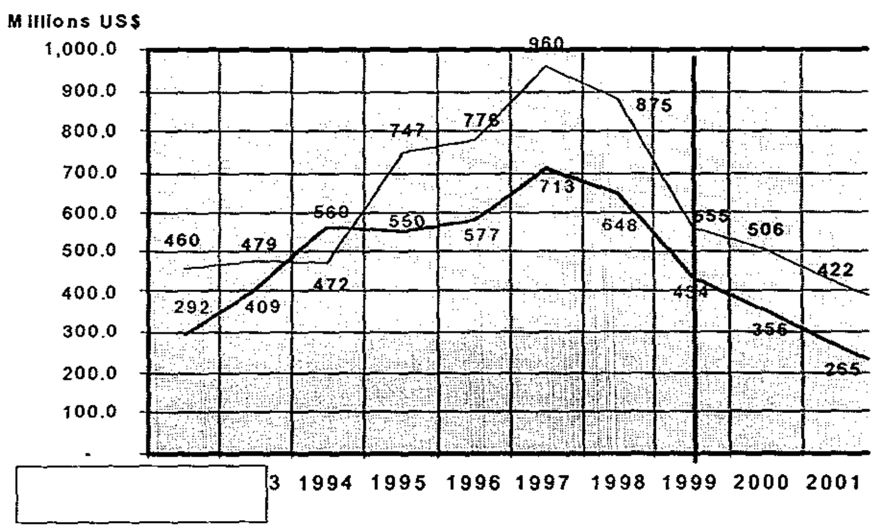
Table 8: Bolivian Exports

	1980 ($us Million)	2000 ($us Million)	Rate of Growth (%)
Bolivia	1,036	1,242	19.8
Peru	3,898	6,412	64.5
Ecuador	2,481	4,942	99.1
Colombia	3,924	11,565	194.7
Chile	4,705	15,619	231.9
Brazil	20,132	53,235	164.5
Argentina	8,021	23,332	190.8

Source: IMF / CEPAL 2000.

The possibilities for Dutch disease related problems arising are greater in a country with little diversified exports and little diversified total value sold abroad since 1980 which is the case in Bolivia (see Table 8). As the following graph shows it was only in the late nineties that Bolivian exports surpassed the 1-billion-dollar mark.

Graph 7: Smuggling and Drug Trafficking in Bolivia, 1992 - 2000



TRANSVERSAL CINSTRA NTS TI FIRE GN D RECT NVESTMENT AND EXPIRTS.

This section analyzes transversal[4] constraints to the trade and business environment in Bolivia. These include but are not limited to the role of infrastructure, the role of institutions engaged in trade promotion and negotiation, the role of the informal economy,

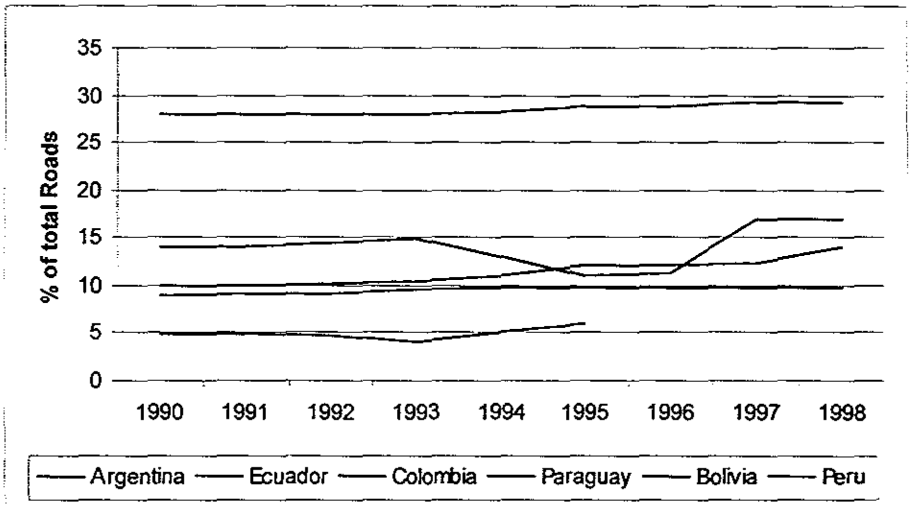
[4] Transversal is defined to mean those constraints that are not sector specific, using the general definition employed in the Global Competitiveness Report put out each year by the World Economic Forum.

labor and human capital, financial issues, bureaucracy and corruption, and the public-private sector interface.

Infrastructure

One of the biggest problems facing Bolivian industry is the deplorable condition of the road network. A 1995 World Bank study pointed out that only 6 percent of roads in Bolivia are asphalted, compared with 19 percent in Argentina and 6 percent in Peru (see Graph below). Worse, there is evidence that conditions have deteriorated since decentralization in 1996: in 1996 preventive maintenance was carried out on only 8 percent of the road network compared to 30 percent in 1995. In 1997, some departments spent only 19 percent of their budget on road maintenance.

Graph 8: Proportion of Asphalted Roads in Latin America



Source: Microeconomic Constraints to Growth in Bolivia, World Bank, June 2001.

The condition of the road network significantly increases the operating costs for businesses and renders most industries uncompetitive with similar operations in neighboring countries. Table 9 shows transportation costs for some important products.

Table 9: Transport Costs between major cities in Bolivia for selected industries, 2000

Food Products			
From / to	La Paz	Santa Cruz	Cochabamba
La Paz		0.13	0.43
Santa Cruz	0.12		0.22
Cochabamba	0.87	1.05	
Textiles			
From/to	La Paz	Santa Cruz	Cochabamba
La Paz		0.57	0.73
Santa Cruz	0.34		NA
Cochabamba	0.81	0.26	
Chemical Products			
From / to	La Paz	Santa Cruz	Cochabamba
La Paz		0.60	0.43
Santa Cruz	0.23		0.52
Cochabamba	1.19	0.55	
Metal Products			
From / to	La Paz	Santa Cruz	Cochabamba
La Paz		0.24	0.82
Santa Cruz	0.10		0.43
Cochabamba	0.35	0.42	
Leather			
From / to	La Paz	Santa Cruz	
Cochabamba	0.38	0.48	
Wood			
From / to	La Paz	Santa Cruz	Cochabamba
Santa Cruz	0.08		0.09

Source: Microeconomic Constraints to Growth in Bolivia, World Bank, June 2001.

Of these, the cost in the wood industry at .08 per ton/km is among the lowest in Bolivia, yet it compares unfavorably to transport costs for a similar product in Brazil or Canada, where the costs of transport are 0.03.5 and .05.5 respectively. If wood industry costs are any indication, this suggests that Bolivian firms face transport costs that are 140 percent higher than those in Brazil.

These costs obviously have a major impact on the competitiveness of Bolivian firms. One of the consequences of the high cost of infrastructure is the high level of inventories maintained by Bolivian firms: on average Bolivian firms maintain inventories of raw materials that are 129 percent higher than those maintained by firms in the US,[5] and keep inventory sufficient for 36 days of production of their most important inputs. Large

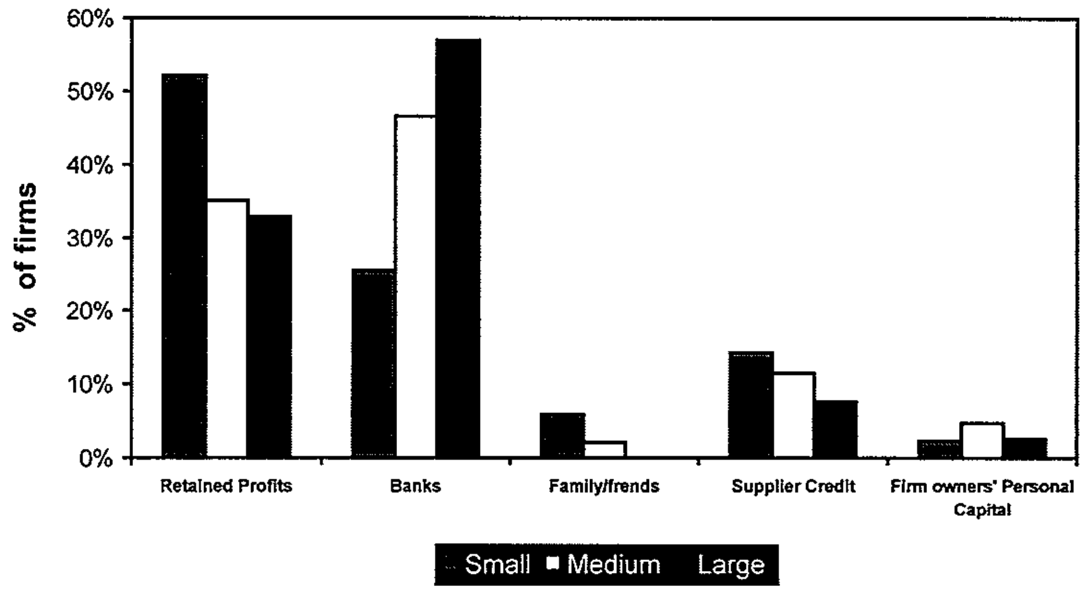
[5] Guasch, J. Luis and Joseph Kogen, "Inventories in Developing Countries", World Bank, mimeo, 2000.

firms maintain enough inventory for more than 50 days of production while small firms keep as much on hand as needed for 27 days of production. Add to this the fact that most inputs are imported and the cost of operating for a Bolivian firm becomes truly prohibitive. Firm level surveys have established that as much as 46 percent of inputs are imported—and that this phenomenon is not confined to large firms.

Finance

Firms in Bolivia face severe financing restrictions. Bolivian firms depend primarily on bank credit as their principal source of finance. For 60% of firms surveyed in a business firm study[6], bank credit is the principal source of finance.

Graph 9: Sources of short -term firm finance (by size)



Source: Microeconomic constraints to Growth in Bolivia, World Bank, June 2001.

Firms' owners are highly risk averse. Very few put their own capital at risk. Retained earnings are a principal source of short term finance for only 43% of firms and for 30% for long term finance.[7] Small firms tend to depend more heavily on retained earnings 2% of small firms depend on this for short term needs while 37% use this to fulfill long term financing needs.

The level of dependence of Bolivian firms on bank credit is much higher than in other countries. A 1999 study[8] on 8 developing countries showed firms generally had less long term credit than firms in developed countries. But in the case of Bolivia, long term

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[6] Microeconomic constraints to growth, ibid.

[7] Data on firm dinace section and survey references are from Microeconomic to Growth, ibid

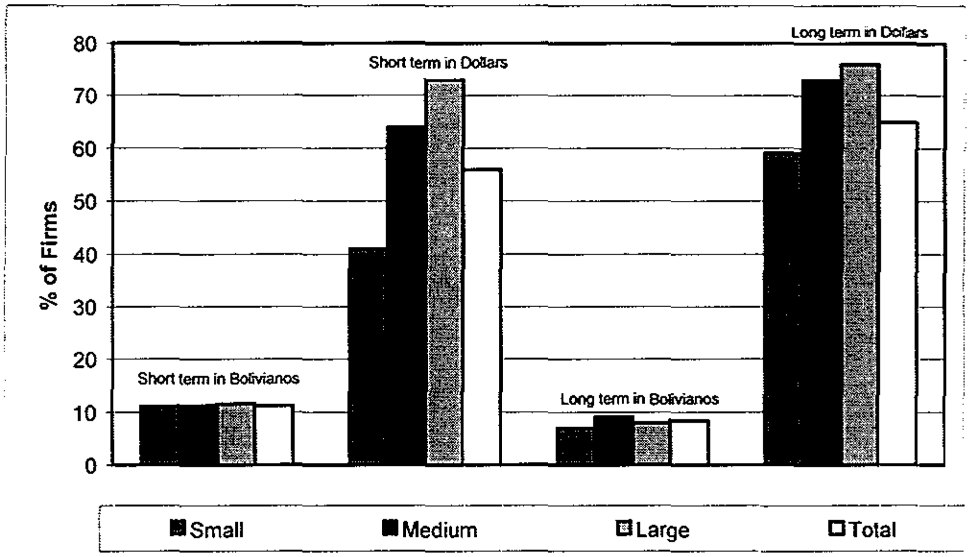
[8] Demirguc-Kunt, Asli y Vajislav Maksimovic (1999). "Institutions, Financial Markets, and Firm Debt Maturity." Journal of Financial Economics. 43:295-336.

debt is a common feature of firm financing. 1999 data shows that more than 69% of the outstanding bank credit was long term bank credit[9].

Moreover as the following graph illustrates, bank credit-as is the banking system in general – is highly dollarized. The steady devaluation taking place is adversely affecting the ability of firms to pay back their dollar denominated debts.

[9]Superintendency of Banks, Bolivia

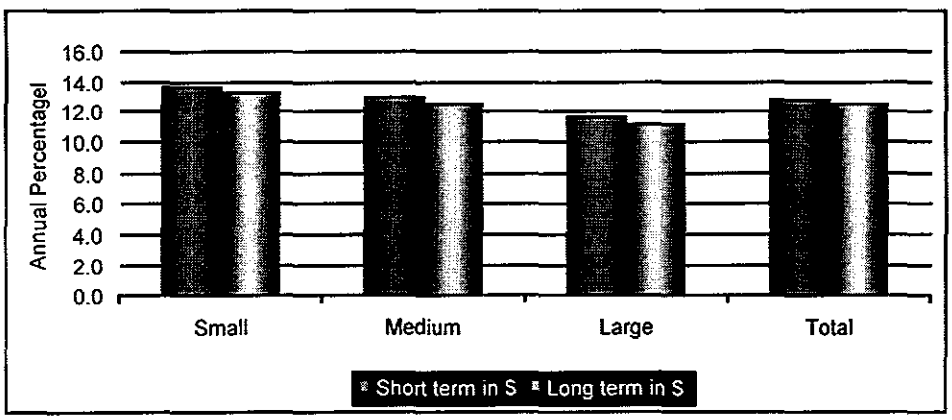
Graph 10: Firm Obligations in Bolivianos (by size and time)



Source: Microeconomic Constraints to Growth in Bolivia, World Bank, June 2001.

Irrespective of firm size, firms face high interest rates. As shown in the graph below, small firms tend to pay higher interest rates (14.7%) compared to large firms (12.5 %). The small difference (usually the spread charged to small and large firms is much higher) highlights yet again the lack of alternative to bank credit as a source of finance.

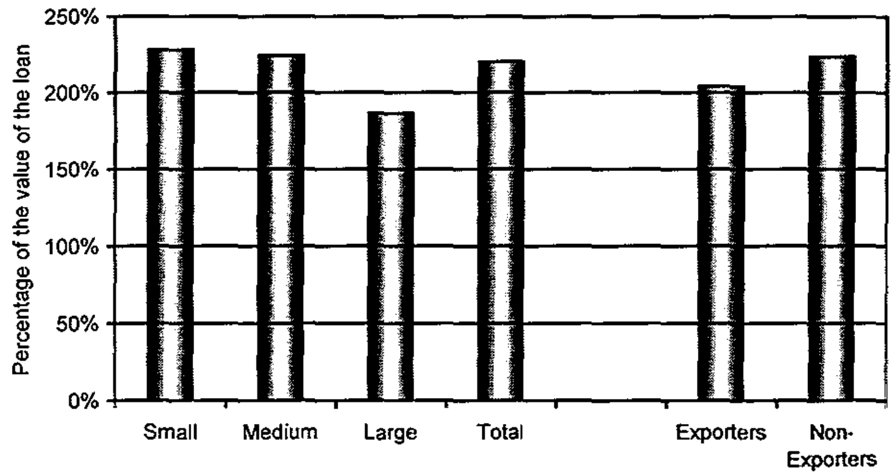
Graph 11: Interest Rates on Loans (by size and time)



Source: Microeconomic Constraints to Growth in Bolivia, World Bank, June 2001.

To compound the problem, collateral requirements are high, especially for small firms and non-exporters.

Graph 12: Collateral required to secure loans with the Banking Sector, 2000



Source: Microeconomic Constraints to Growth in Bolivia, World Bank, June 2001.

Firms surveyed in a 2001 study noted that on average collateral requirements were 220% of the value of the long term loan. Small firms pay 230% and large firms 190%. These are extremely high collateral requirements. In Bulgaria for instance, firms' pay no more than 158% of the value of the loan. Second, types of collateral accepted depend on the size of firm: small firms having a harder time using objects (machinery, inventory) other than real property as collateral.

Lack of reliable information and the difficulty of enforcing contracts are among the reasons why collateral requirements are a constraint in Bolivia. 58% of small firms do not have audited accounts, compared to 13% of medium sized firms and 2% of large firms.

Institutions for Export Promotion and Trade Negotiation

The Bolivian trade and business environment is marked by a paucity of strong institutions. In areas relating to investment and export promotion, there are overlapping functions due to a multiplicity of institutions. Export promotion for instance is managed between the Ministry of External Commerce and CEPROBOL. A small team located in the Ministry of Foreign Affairs single-handedly manages the formal process of negotiating a variety of regional, bilateral and multilateral accords. The process is often fragmented due to the ad-hoc and often contentious nature of participation from the Ministry of External Commerce. Private sector participation is sought but in a perfunctory fashion. In sum, the process of trade negotiations in Bolivia needs radical overhauling. Negotiations are conducted in an ad hoc fashion with responsibility split between the Ministry of External Commerce and the Foreign Affairs Ministry; in certain cases (as in those concerning opening of the US market to textiles and other issues related to the amplification of ATPA) negotiations are handled at the Presidential level with assistance from embassy officials in

Washington. In either case, there are no well established mechanisms for soliciting input from the private sector.

The Role of CEPROBOL

Nominally the institution charged with investment and export promotion, the agency is hampered by the lack of a sufficient operating budget and a consequent inability to attract high caliber staff. The agency works on an annual budget of $300,000. Other regional agencies (PROMPEX, PROCHILE) manage budgets that are at least 10 times that amount. At present CEPROBOL is receiving some form of technical assistance from the Investment Marketing Department of the Multilateral Investment Guarantee Agency of the World Bank but the assistance is limited to a few operational improvements. A full scale strengthening of the agency, with concomitant resource increases, is long overdue.

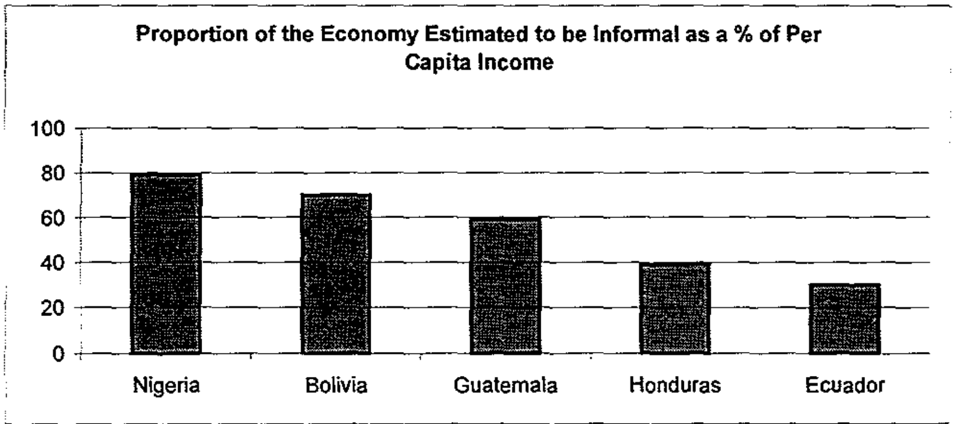
Trade negotiations in Bolivia are, with few exceptions, an ad-hoc process. Bolivia's record in trade negotiations is poor. A significant explanation behind this performance must be placed on the divorce that exists between the public and private sectors, particularly relating to the objectives that each pursues in integration and trade negotiations. It has not been uncommon for trade negotiations to be initiated without the full knowledge and support of the firms that are likely to benefit or lose from the agreement. In this respect, and given the results outlined in chapter 3, it seems reasonable to argue that Bolivia's enthusiasm for trade integration in the past two decades owes much more to political considerations than to commercial considerations.

A change in the trade negotiating process implies several profound institutional changes. First, the conflict between the roles of the Ministries of Foreign Affairs and External Commerce must be resolved probably by the specific enumeration of responsibilities for trade negotiating tasks in one Ministry. Second, the role of the private sector and the mechanisms for incorporating views of the private sector in the negotiating process needs to be defined. One example that illustrates how poorly the process works is the state of preparations in Bolivia for the FTAA. Preparations for the FTAA are conspicuous by their absence. Unlike other Latin American countries which have formed their own trade negotiating commissions in order to ready themselves for the eventual implementation of FTAA, Bolivia has done little or nothing in the way of preparation even for negotiations. It participates with other Andean countries in a number of thematic roundtables but domestically very little has been done to ready the country for the FTAA.

The Informal Economy

Precise measurements of informality are notoriously difficult: suffice it to say that Bolivia has one of the highest levels of informal economic activity in the world. Estimates of the size of the informal economy (as measured by the number of informal manufacturing firms) range from anywhere between 54,000 and 95,000 establishments. Other estimates suggest that there may be as many as 335,000 informal establishments in Bolivia. Comparative studies on levels of informality suggest that Bolivia ranks only below Nigeria in the level of informality in the economy.

Graph 13: The informal Sector in Bolivia

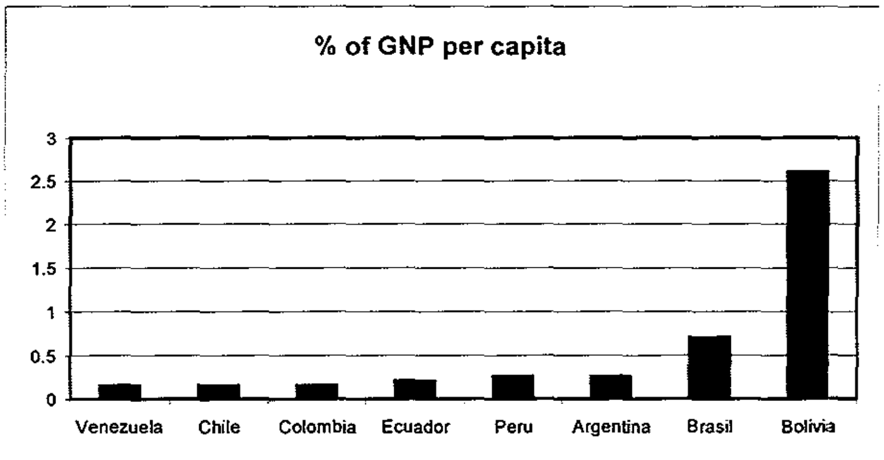


Source: A. Bhatia's estimates based on Johnson et al, 1999 "Corruption, Public Finance and the Unofficial Economy", World Bank Policy Research Working Paper 2169.

The high level of informality in Bolivia can be explained by primarily two factors: the costs (both entry and operating) of being formal and the perverse incentives offered by the current Bolivian tax regime. The first explanation, which has as its theoretical basis the work of Hernando de Soto, suggests that firms remain informal because the costs of complying with the rules of the game are too high. Being informal in the de Sotian sense means being incapable of creating and exploiting adequately certain rights: the right to convert property into collateral (because of deficiencies in land titling); the right to credit (because of deficiencies in collateral laws). The failure of governmental machinery to create and secure these rights imposes a high cost on firms who rationally choose to remain informal. In Bolivia, this has amply been demonstrated to be true: the costs of formal entry (registration requirements in the commercial registry) and the costs of compliance with other operating requirements are so high that it does not make economic sense for the great majority of firms to comply with these norms. As an NBER study pointed out, it takes 20 different procedures, 82 days and an average cost of 3 times per capita income ($2696) to open a firm in Bolivia, a cost unsurpassed by any other developing country. [10] Three institutions are involved in the firm registration process: Impuestos Internos, the Commercial Registry (which has recently been privatized) and the Alcaldia and they suffer from varying degrees of bureaucratic inefficiency.

[10] Djankov et al, " The Regulation of Entry", National Bureau of Economic Research, Working Paper , 2000

Graph 14: Cost of Opening a Firm



Source: Djankov et al, "The Regulation of Entry", National Bureau of Economic Research, WP 7892, September 2000.

The tax regime in Bolivia offers a perverse set of incentives: the Regimen Simplificado, a tax regime for those in the lower income brackets, with a lower marginal tax rate offers an incentive to formal sector firms to escape tax obligations by declaring themselves part of the Regimen Simplificado.

The level of informality takes a toll on industrial productivity in Bolivia. Anecdotal and empirical evidence shows that levels of productivity are generally much lower in informal sector firms than in formal firms. Moreover, levels of informality are inversely correlated with GDP growth[11]. Additionally, one needs to consider the levels of employment accounted for by the informal sector (micro sized and many small firms) and the contribution of the sector to GDP. Table 10 illustrates.

[11] Loayza, Norman. " The Economics of the Informal Sector: A simple Model and some empirical evidence from Latin America", Policy Research Working Paper No 1727, World Bank, Washington DC, 1997.

Table 10: Characteristics of Economic Units, 1999

Firm Size	GDP	GDP	Urban Employment	Rural Employment	Total Employment	Total Employment
(# of employees)	(million) Bs	%				(%)
Micro (1-9)	12,404	25.52	1,411,970	1,571,533	2,983,503	83.1
Small (10-19)	1,330	2.74	147,277	23,014	170,291	4.7
Medium (20-49)	1,630	3.35	108,674	14,302	122,976	3.4
Large (50+)	31,759	65.34	277,436	35,014	312,450	8.7
Adjustment	1,479	3.04				
TOTAL	**48,904**	**100**	**1,945,358**	**1,643,863**	**3,589,221**	**100**

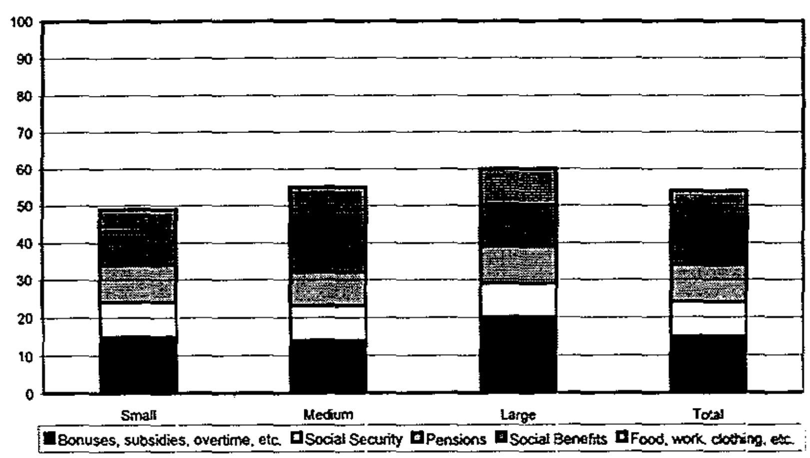
Source: Viceministry of Microempresas, based on INE data.

In the case of Bolivia, more than 80 % of employment is accounted for by the microsize firms while their contribution to GDP is only 25% percent. Inversely, large firms account for as much as 65% of GDP but less than 10 % of employment. If Bolivia is to reverse the productivity losses associated with large informal sector economic activity, it will need to structure a set of policies that address the costs of administrative compliance (see more on this below in the section on bureaucracy and corruption) as well as restructure tax regime incentives to remain informal.

Labor and Human Capital

Human capital resources in Bolivia are still low. Although many social indicators (see Annex 2 for details) the country lacks skilled labor. Moreover, labor costs are high, driven upwards by non – wage costs. As noted earlier, a rigid labor law creates problems to employers wanting to five workers, thus hindering their ability to take needed business decisions.

Graph 15: Non-wage costs as a % of Total Labor Costs (by firm size)

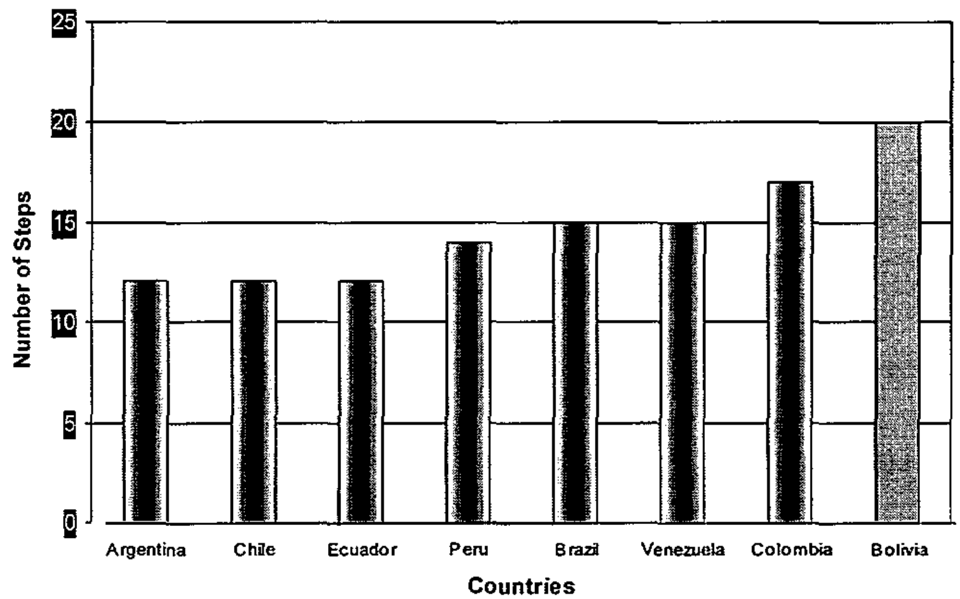


Source: Microeconomic Constraints to Growth in Bolivia, World Bank, June 2001.

Bureaucracy and Corruption

There are several government initiatives underway to reduce corruption. These include institutionalization of certain critical institutions (Customs, Revenue Service, National Road Service) as well as creation of a legal basis for anti corruption measures (anti-corruption law, law on transparency). Experience from other countries clearly demonstrates that one of the most effective ways to combat corruption is the creation of a professional civil service with adequate compensation levels that eliminate the temptation to extract rents from public office. Second, using information technology to eliminate interactions between citizens and public sector officials also reduces the incidence of corruption. Third, eliminating unnecessary procedures for completion of administrative procedures also reduces corruption.

Graph 16: Number of Steps Needed to Open a New Business in Bolivia



Source: Microeconomic Constraints to Growth, World Bank , 2001

Public-private Sector Interface

Private sector associations in Bolivia, with few exceptions, are not truly representative of the interests they purport to represent. Participation in association in Bolivia is high in both absolute and relative terms. (See Table 11 below).

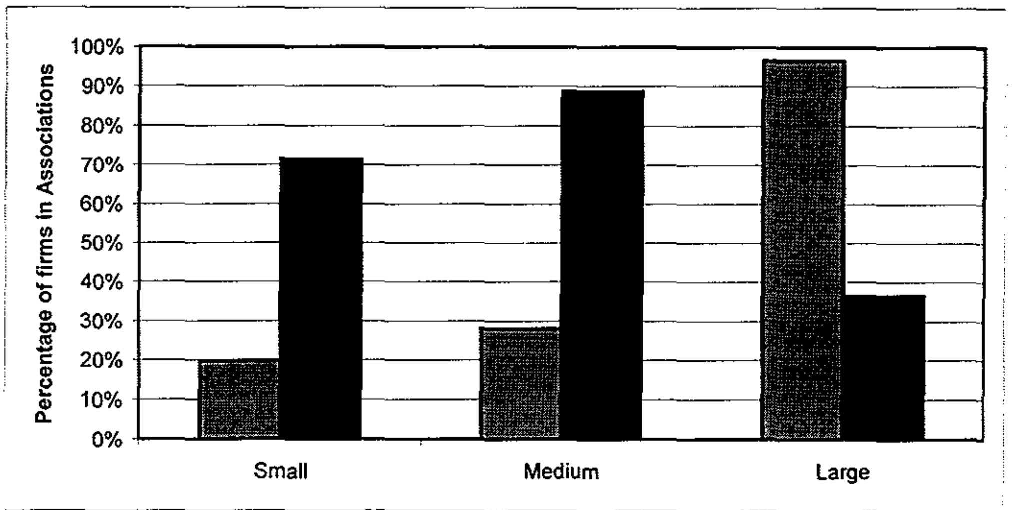
Table 11: Participation in Business Associations (by country)

Country	*Percentage of firms that belong to business associations*
BOLIVIA (2000)	*81.3%*
INDIA (2000)	*86.3%*
POLAND (1998)	*28.9%*
SLOVAKIA (1998)	*31.5%*
RUANIA (1998)	*44.2%*
RUSSIA (1998)	*74.4%*
UKRAINE (1998)	*67.3%*
VIETNAM, Hanoi (1996)	*55.0%*
VIETNAM, Ho Chi Minh (1997)	*34.6%*
RUSSIA (1994)	*42.3%*

Sources: Poland, Slovakia, Rumania, Russia, Ukraine, 1998: Johnson et al.; Russia, 1994: Recanatini and Ryterman (2000); Vietnam: McMillan and Woodroff (1998); Bolivia, India and Morocco, 2000, FACS World Bank.

In fact, compared to worldwide averages, participation in business associations in Bolivia is very high: 71% of small firms belong to associations as compared to less than 20% on average worldwide; 88% of medium sized firms in Bolivia belong to associations as compared to only 28% worldwide, and 96% of large Bolivian firms belong to an association compared to less than 40% on average worldwide. In many cases, the associations have been captured by particular interests who claim to speak for the majority but do not. Interestingly, associations in Santa Cruz tend to be more representative than their La Paz counterparts and more vocal in their demands. If de Tocqueville's thesis that the strength of associations reflects the strength of a country's democracy is true, then Bolivia's democracy still needs deepening.

Graph 17: Participation in Business Associations (by size of firm)



Source: WBES, 1999; Bolivia, 2000, FACS World Bank.

The main business associations are: the Confederation de Empresarios Privados de Bolivia, the Cámara National de Industria, the Cámara National de Comercio, the Cámara de Exportadores, CAINCO and CAO. Smaller firms are represented by associations such as the Comite de Enlace which brings together players such as FEBOPI and INBOPIA. In general, the larger organizations' discourse with the government is confrontational and there are few instances of concerted private public sector coordination for the resolution of particular issues.

Table 12: Benefits Received by Members in Business Associations

Decided to participate in the association because it helped them (% of positive responses)	Russia (1994)	Bolivia (2000)	India (2000)
- to obtain capital at market rates.	24.6	--	--
- in obtaining cheap capital.	40.3	--	--
- in obtaining bank capital.	--	7.5	10.3
- in acquiring imported inputs.	55.2	8.6	37.5
- get technical information.	--	42.0	--
- in getting information about important markets for their products.	50.9	40.0	73.5
- define quality control norms.	--	17.3	27.4
- in certification of their members.	--	18.0	22.8
- brand have recognition.	--	3.5	--
- get in conflict resolution.	--	21.4	33.8
- coordinate with the government for the benefits of their members.	--	19.5	74.4

Source: Russia, 1994: Racanatini and Ryterman (2000); Bolivia and India, 2000, FACS World Bank.

CHAPTER V

ANALYSIS OF LEGAL AND REGULATORY CONSTRAINTS

The main objective of this chapter, as determined by the scope of work, is to identify propose possible solutions to the legal problems in the business environment in Bolivia. The following is a brief analysis of the main legal issues identified during the course of our work.

Some of the issues were identified through interviews with members of the business community, some had already been identified by previous studies and some issues were identified during the course of several years of experience working with foreign and national investors.

Surprisingly, very few comments and issues were identified related to the legal environment *per se*. Other than a few comments on specific areas and more emphatically on bankruptcy and labor legislation, the issues brought to light were far more related to the application, implementation and interpretation of existing laws. The sole major problem in this area is the constant changes to the SIRESE (Sistema de Regulación Sectorial) Law implemented, mostly, as a result of political, circumstantial convenience.

JUDICIAL INSECURITY

The expression "judicial insecurity" is a broad term encompassing a series of problems that range from judicial corruption to the inability, on the part of the system of Superintendencies, to properly interpret and apply the new regulations emerging from the SIRESE Law.

We believe there are three major problems with Bolivia's judicial system. One, corruption, permeates the whole system and is extremely difficult to deal with. The second, lack of business sophistication on the part of judges, is far more tractable. And the third, the various problems of related to or derived from labor courts, is also very difficult to solve.

Our investigations show that foreign investors are extremely reluctant to bring controversies before Bolivian courts of law. We also found they have very seldom used alternative methods of dispute resolution, such as arbitration, in Bolivia. As to labor courts, since there is no truly viable alternative method to resolve labor disputes, foreign investors find themselves without a choice but to litigate before labor courts very often.

On the other hand, Bolivian investors do bring their disputes before Bolivian courts of law. Since the problems that affect the Bolivian judicial system affect Bolivian investors as well (in spite of their greater tolerance thereof), disputes are progressively being brought before arbitral tribunals. But, as is the case with foreign investors, Bolivian investors have no way to avoid labor courts and are therefore subject to the same problems foreign investors face when they do so.

While arbitration has finally been accepted by Bolivian investors as well as by the Bolivian Government (in spite of having serious doubts when the time comes to accept and implement negative decisions), we firmly believe that solving the problem of corruption is essential for a favorable business and investment environment. This is true, among other reasons, because there is a host of issues that cannot be legally dealt with through arbitration, such as, precisely, the execution of arbitral decisions.

The solution to the problem posed by corruption in Bolivia's courts lies outside the scope of work of this document. Thus, we shall focus on the second problem identified by our research and investigation.

A common complaint on the part of investors is that Bolivian judges lack the necessary business sophistication and knowledge to be able to decide on increasingly complicated matters brought before them. This is particularly true of cases where judges are asked to rule on bankruptcy procedures. It is a well known fact that bankruptcy procedures require rather detailed knowledge of accounting and, at least, some business experience.

Bolivia's bankruptcy rules (contained in the Commercial Code) are extremely inefficient. Their biggest draw back is the almost automatic presumption of fraud and bad faith they create. Since fraud is a criminal offense under the Bolivian Criminal Code, such a presumption results in the bankruptcy judge having to defer the case to the attorney general's office, which in turn results in the bankrupt company's officers and directors being criminally prosecuted. As can be easily imagined, no company officer is going to, willingly, subject himself to criminal prosecution. This fact, combined with the fact that Bolivian companies are, to a great extent, owned by families or by very closely knit economic groups, means that company owners prefer to flee the country (when bankrupt) rather than face the public humiliation that results from criminal prosecution.

In spite of this substantial flaw, it would still be possible to use the procedure set forth in the Commercial Code (and there are a few, very few, examples of how it can be done) if judges before whom bankruptcy cases are brought were able to better understand financial and business information presented to them. In other words, even the existing procedure could be used in a far more judicious manner, achieving acceptable results (and avoiding the fraud/criminal prosecution pitfall), if the judges could distinguish, for example, between simply bad business decisions and truly fraudulent behavior. We believe this problem would not be solved by simply modifying the Commercial Code, because it is very likely that these same judges, faced with a new procedure which corrects the flaw, would still manage the process in an inefficient manner, simply because they would still not understand the underlying business logic which must underpin all successful bankruptcy procedures.

The problem with labor courts is similar to that of the Bankruptcy procedures described above, in that Bolivia's Labor Law is outdated and inefficient and in that labour courts misapply it , partly because of ignorance. But it is different in that the inadequacy of the original Labor Law has been mitigated to a great extent through several partial amendments. Thus, the problem with labor courts is that they combine a lack of understanding of a highly complex maze of regulations and amendments with an intolerable degree of corruption.

As was the case with civil law courts, the problem of corruption is beyond the scope of this work. On the matter of the inadequacy of the existing labor legislation, an entirely new law would be required to solve the problem, and that is likewise, a problem that exceeds the agreed scope of work.

WEAK PROPERTY RIGHTS

Another key issue identified through the study is the problem of weak enforcement of property rights. It is very clear that in order for investment, foreign or national, to be attracted and kept, investors must feel secure that the property acquired really and unquestionably belongs to them[12]. Likewise, lenders to those investors must also feel that property granted to them as part of security for their loans, belongs just as unquestionably to borrowers. One consequence of the lack of certainty is higher interest rates and a reluctance to lend unless it is only to the most profitable and less risky undertakings. This analysis applies to both urban and rural property.

This problem has two different aspects derived from the physical location of the property in question. As property can be urban and rural, the types and characteristics of the problem are different depending on where the property is located. In Bolivia urban property is registered before the Registry of Real Property (*Registro de Derechos Reales* or *DDRR*) whereas rural property is, initially, registered before an entity called National Institute of Agrarian Reform (*Instituto Nacional de Reforma Agraria* or *INRA).* Once registered before the INRA, rural property must also be registered before DDRR. However, in the case or rural property, the problems exist at INRA´s level, long before the documents arrive at DDRR.

Our research shows that the problems at DDRR are basically: (i) lack of computer and organizational technology; (ii) it is a practically un-audited source of funds for the judicial system; and (iii) corruption.

Our research shoes that the problems at INRA are basically: (i) lack of computer and organizational technology; (ii) lack of means and funds; (iii) a very high degree of political meddling and interference; and (iv) corruption.

[12] Some time ago, a scandal was brought to light because it was discovered that the central computer at the La Paz office of DDRR was connected to home computers owned by some officers of the Registry who were able to modify, delete or move, registrations, obviously for a fee. The result of this was that it was truly impossible to know for certain whether any property really belonged to whomever presented a property certificate, because it could changed, moved, modified or simply deleted.

LACK OF ANTI-TRUST LEGISLATION

A completely new area of analysis in Bolivia has emerged as a result of the broad privatization effort undertaken by this country during the last few years. A series of companies are now competing in open markets where only government owned companies used to operate a few years ago. As markets evolve, problems that did not exist before are starting to appear. One of these problems is competition and anti trust legislation. It is important that investors know the rules of the game in advance, particularly in a country with a very small internal market where economies of scale are so difficult to achieve. Part of the problem is the lack of adequate legislation (including detailed regulations and procedures) and part of the problem is lack of understanding of the authorities' role in this regard. Just as an open market system lends itself to abuse by participating companies, a lack of understanding of the role that SIRESE authorities must play in this regard can have results that seriously curtail the operations of the market.

This is a more difficult problem to pinpoint exactly. Investors have complained of the SIRESE officers' lack of understanding of the concept of antitrust itself. Furthermore, they find that the solutions issued thus far by SIRESE authorities are contradictory and sometimes complicate matters even further, mainly because such authorities do not understand the business logic behind the questioned actions. In other cases, the authorities fail to find (or are unwilling to do so, due to circumstantial political convenience) clear evidence of anticompetitive actions when even egregious conduct on the part of some companies is incontrovertible.

Even though clearer rules, regulations and laws would help, we believe it is necessary to develop the necessary understanding, on the part of SIRESE officers, of the objectives and means of antitrust legislation as well as of the results that should and can be expected.

LACK OF STABILITY IN THE TAX SYSTEM

Taxes and the tax system were two issues that also emerged from the studies. Once again, the problem of the knowledge and stability of the rules of the game were the crucial problems. Investors require clarity and stability, especially when it comes to the tax system. The current system, in Bolivia, is subject to abrupt changes and to uncertain interpretations. Binding opinions are extremely difficult to obtain and very often have a negative effect because the cases alert tax authorities to problems they ignored in the past. Opinions gathered on the new Tax Code were, as a rule, negative. Investors apparently feel that the new Tax Code tips the balance of power totally in favour of the tax administration without providing them with the necessary certainty and long term stability.

On this matter, our research indicates that stability is, above all, what investors seek. Therefore, they repeatedly mentioned the fact that other countries provide legal mechanisms to provide such stability as well as to provide clear guidelines for the interpretation of the rules, regulations and laws[13].

Of course, a new Tax Code that, at the very least, gives investors the impression of creating a level playing field with tighter provisions but with equivalent defense mechanisms for those cases where an abuse of authority or a misinterpretation or miss application of the law are perceived to exist, would be necessary, however, the in depth analysis of such problems lies outside the scope of work and is thus left to other studies or documents.

FAILURE TO GIVE PRECEDENCE TO INTERNATIONAL TREATIES VS. LOCAL LEGISLATION

There seems to be a lack of clear legal guidelines as to the priority that should be awarded to international treaties *vis a vis* local legislation. The current Tax Code provides the only guideline when it comes to which should be the legal precedence. The current Tax Code clearly provides that international treaties should be given preference over local laws. However, given the very specialized nature of the Tax Code it is very hard to extend its provisions to other areas of the law, such as intellectual property, protection for investments, etc. This results, once again, in a certain degree of uncertainty when foreign investors rely on treaties to invest in Bolivia, but find themselves with a situation where those treaties are ignored, misunderstood or simply not applied.

There is little we can add to the general description of the problem provided above. Part of the difficulty in this case arises out of the lack of understanding, on the part of local judges and authorities of the legal structure created by the existence of treaties that contain provisions that are different to those contained in Bolivian legislation, but part of it is also the very complex problem of dealing with the constitutionality of treaty provisions and their opposition to principles of *ordre públique* contained in Bolivian law. This latter problem is not unique to Bolivia and requires a very solid (from the point of view of the conceptual analysis) judicial structure, something Bolivia is very slowly beginning to develop.

LACK OF TRADE NEGOTIATION SKILLS

An interesting result of the enquiries, research and accumulated experience is that Bolivia routinely faces several very complex and often very technical negotiation processes using the same or practically the same team of individuals, which, in addition, changes with every new administration. There is no systematic, organized and qualified structure of trained individuals who can act on behalf of Bolivia in such fora. This has very unfavorable results because an improvised team, on the Bolivian side, faces a team of professional negotiators, on the other side, which has all the necessary information and technical knowledge and skill.

[13] The case of Chile is the one most often cited. In Chile investors can enter into Tax Stability Contracts with the Chilean government based on specific legislation that allows such contracts and provides them with the necessary stability and security.

Even though this is not an issue highlighted by our research carried out with investors, but rather indirectly resulting from their complaint about the Bolivian government's inability to obtain favorable commercial results in negotiations with other countries, we believe it is important enough to mention it in this report.

When Bolivian negotiators face teams from other countries (or even companies or agencies) they do so with a dearth of information on the matters that are being discussed. Furthermore, the parties truly affected by the results of those negotiations frequently ignore how and with what position the government is negotiating their interests. In addition to the lack of information and feed back, Bolivia's negotiators are not professionals trained to do so, they do not have any practical experience in negotiations, they are often unable to communicate in languages other than Spanish and they are improvised members of one or more ministries that change over time. The imminent approach of FTAA urgently requires that this problem be addressed in the very short term.

LACK OF TRAINED COMMERCIAL LAWYERS

Finally, a common complaint of investors, national as well as foreign, is the lack of properly trained lawyers. Investors claim they are unable to find in Bolivia, lawyers capable of speaking several languages, of understanding complex business structures and of providing advice at an international level of proficiency. This fact forces investors to seek legal advice abroad, at a much higher cost or, in some cases, to import lawyers from other countries to act as in house counsel to foreign companies domiciled in Bolivia with the corresponding increase in cost for the company.

Bolivia's university system is geared towards producing litigation lawyers useful for the local market, but totally ignorant of business procedures, logic and mechanisms. Language proficiency and knowledge of complex internationally used legal structures are not encouraged or are even ignored by such universities. Our research has proven, beyond any doubt, that all post graduate courses currently being offered in the so called "business law" are totally unsuited for the requirements of the modern market for legal advice. Amongst other reasons, because the teachers at those courses are, themselves, ignorant of the real requirements and problems being faced by investors in Bolivia and by Bolivian investors abroad or dealing with foreign entities.

CHAPTER VI

ANALYSIS OF SELECTED SECTORS AND SECTORAL CONSTRAINTS

The competitiveness of Bolivia's firms and industrial sectors in international markets is the ultimate determinant of the country's overall competitiveness. Therefore, it is not sufficient to only identify transversal constraints to export-led economic growth; information about the conditions under which the firms operate is essential. Therefore the purpose of including sector level analysis in the study is to enrich the understanding of transversal factors as well as to help refine sectoral policy options in light of the FTAA.

WOOD SECTOR

General Description

The sheer size of Bolivian forests is impressive. Data for 1999 show that the sector generated nine thousand jobs in 1999, contributed 3% of GDP and accounted for exports of US$ 109 million (11% of Bolivian exports). Natural forests in Bolivia cover an area of approximately 53 million hectares, representing 48% of the country's surface[14]. This forest area represents almost 10% of the tropical rain forests existing in South America. Besides natural forests, Bolivia has 30,000 hectares of planted forests. Of this, 1.000 thousand hectares are *certified* tropical rain forest, accounting high for more than 13% of the existing forest area in the country. Such a level of certification puts Bolivia in first place in the world in the area of certified tropical rain forest.

Production

In general, the installed capacity of the Bolivian forest industry is very small in comparison with the potential represented by the existing forest resources in the country. In addition, current production levels are much lower than installed capacity. This is true of both major products-sawnwood and value-added wood products.

The potential production of wood products amounts to 20 million cubic meters a year. Sawnwood installed capacity is 1.5 million m3/year, which represents only 8% of the potential capacity, and the value-added wood installed capacity is a 0.45 million m3/year. The actual industry operating rate average is 30% for sawnwood and 50% for value-added wood production.

Domestic Market

Projections for the year 2010 suggest that the domestic market will be able to absorb 0.7 million m3/year in sawnwood products and 0.21 million m3/year for value-added wood

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[14] Most of these are concentrated in the eastern part of the country (Santa Cruz, Beni, La Paz and Pando).

products, which would represent almost 46% of the actual installed capacity in both sub sectors.

International Market

The world market for tropical wood has a value of US$7.2 Billion and for value-added products US$21.7 billion. Bolivia's share of the total world market is only 0.6% (for sawnwood)[15] and 0.3% (for value-added wood products). This underscores the fact that Bolivia's participation in the international market is minimal. As mentioned earlier, in 1999 exports amounted to $ 109 million and the failure of the industry to reach significantly higher export levels demonstrates that the problems are predominantly supply side problems such as those related to price, quality, etc.

Competitiveness Analysis

Much of the failure to adequately tap potential export markets can be explained by an inefficent cost structure. A study prepared for the Bolivian Forest Chamber, shows a benchmarking of main costs in the production chain for sawnwood in Bolivia and Brasil (see Table 13 below).

Table 13: Benchmarking of Main Costs in the Production Chain for Sawnwood, Bolivia and Brazil

ACTIVITY	Component	Bolivian costs		Brazilian costs	
		US$/m³	%	US$/m³	%
Forest	Stumpage	10.77	3.4	5.92	4.2
	. Forest Patent (Bol)/Private Property (Bra)	6.67	2.1	5.22	3.7
	. Management Plan	0.10	0.1	0.10	0.1
	. Pre-harvesting Inventory	4.00	1.3	0.60	0.4
	Harvesting	19.73	6.2	12.30	8.7
	. Planning/Supervision/Control	2.50	0.8	1.80	1.3
	. Road and Woodyard Construction	6.23	2.0	4.50	3.2
	. Felling	1.06	0.3	1.00	0.7
	. Skidding and Piling	9.94	3.1	5.00	3.5
	Transport	12.70	4.0	9.00	6.4
	. Loading	1.10	0.3	1.00	0.7
	. Transport	10.50	3.3	7.00	4.9
	. Unloading	1.10	0.3	1.00	0.7
SUBTOTAL		**43.20**	**13.7**	**27.22**	**19.2**
Industrial	Processing	50.00	15.8	25.00	23.5
	Transformation Losses	52.80	16.7	33.27	17.7
	Transport (Sawmill - Kiln Drying Facility)	52.80	16.7	-	-
	Drying and Classification	45.00	14.2	15.00	10.6
SUBTOTAL		**200.60**	**63.5**	**73.27**	**51.8**
Trade	Trading	2.00	0.6	2.00	1.4
	Transport (Kiln Drying Facility – Port)	70.00	22.2	39.00	27.6
SUBTOTAL		**72.00**	**22.8**	**41.00**	**29.0**
TOTAL		**315.80**	**100.0**	**141.49**	**100.0**

Source: Bolivian Forestry Chamber, 1999

[15] The world market for sawnwood is roughly $ 7.2 billion.

As can be observed from the data presented, there is an extremely accentuated difference between Bolivia and Brazil. The total cost of production for sawnwood in Brazil is US$ 141.49/m^3, while the same product in Bolivia costs US$ 315.80/m^3. This is a difference of 123%, which explains the lack of competitiveness of Bolivian products in the international market.

Regarding value-added wood products, the difference in the cost (of logs delivered to the factory) between Bolivia and Brazil is basically linked to the size of the average volume removed from forests. In Bolivia only (3 m^3/ha) make it to the factory, directly affecting productivity, while Brazil, the average volume removed is 20 m^3/ha. Estimates suggest that with higher removal rates be (12 m^3/ha), the cost of logs delivered to the factory drops to US$ 25.80/m^3, representing a reduction of 67% compared to the current cost of US$ 43.20/ m^3. This suggests that there are significant economies of scale in increasing the amount of logs delivered to factories and that this cost in an important explanatory factor for the overall lack competitiveness of Bolivian products.

Costs of industrial processing activity are also markedly different in Bolivia and Brazil. In Bolivia processing costs reach US$ 200.60/m^3, while in Brazil these reach only US$ 73.27/m^3, resulting in a difference of more than US$ 126/ m^3. Thus there is 72% difference in the production cost between both countries (US$174.31/ m$^{3)}$.

Transportation costs, both in Bolivia and Brazil, are significant. In Brazil, the distances from the mills to export ports are longer (2,100 km on average) than those in Bolivia (1,200 km); however, transport costs are higher in Bolivia. In this case, the difference between Bolivia (US$ 70.00/m^3) and Brazil (US$ 39.00/m^3) is almost 80% (US$ 31/ m$^{3)}$.

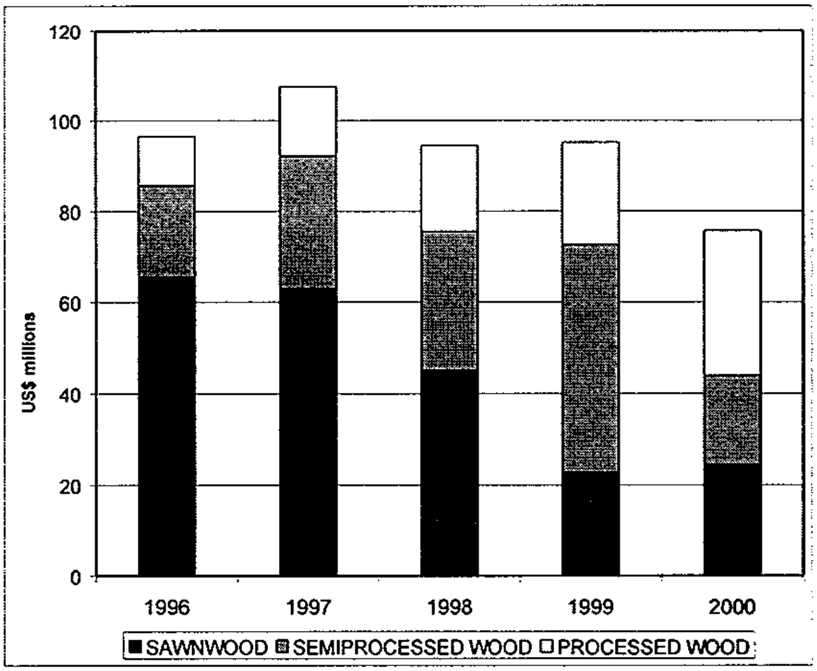
Marketing factors are also important. Due to insufficient marketing expertise, Bolivia has not yet been able to convert its status as the country with the largest amount of certified forest area in the world into a significant competitive advantage, nor has it been able to capture that segment of the market that places a premium on such certification.

Present Situation

The present export situation is alarming. Exports of sawnwood have fallen from US$65.5 million (1996) to US$24.4 million (2000). In semiprocessed wood export fell, from US$50 million (1999) to US$19.5 million (2000). Although processed wood exports rose from US$10.9 million (1996) to US$31.9 million (2000). Overall sector exports have fallen from US$107.4 million (1997) to US$75.8 million (2000).

In the Forestry subsector, the number of firms has been reduced drastically-from 93 companies in 1997 to 73 in 2001. Overall, sector debt has fallen from US$180 million (1999) to US$50 million (2002), because of pressure from the banking sector. As such, the liquidity levels of firms in the sector are extremely low. Employment opportunities generated by the sector are low, pushing a number of firms into informality. Manufactured wood product firms currently are the least affected by the downtward trend in the sector.

Graph 18: Wood Exports in US$ millions, 1996-2000



Those firms that are managing to survive are doing so essentially by a process of vertical integration, trying in effect to reproduce the complete cluster inside the firm. This is a very risky option, becouse of the need to significantly increase the company's investment and also the lack of experience in new areas of business. Some of the companies that have adopted this strategy are: La Chonta (manufacture); Mabet, which has diversigied from manufacturing and United (Alpha Furniture), which work as part of an international holding operation.

Development Strategy

Industry associations have formulated a vision of the sector's potential, in "Bolivia's Forestry Sector Strategic Plan" [16]. This document envisages a future potential (10 years) of billion US$. The strategy proposed consists of designing and implementing a plan that organizes the development process of the forestry sector. The main target of the proposed strategic plan is the creation and consolidation of a *cluster*, with the forestry sector as an anchor. In order to achieve the development proposed the strategic plan considers three phases as follows: Phase 1- Restructuring: During this first phase the work would focus in restructuring the forestry sector to enhance its competitiveness. This will require actions to be implemented by the government and by the private sector; Phase 2 – Consolidation: As a result of the actions implemented in Phase 1, it is expected that the forestry sector will have increased it competitiveness and thus will be able to attract investments (national and international) and consolidate; Phase 3 – Expansion: During this phase the forest industry would expand. This expansion would include modernization of existing mills and the establishment of new industries.

[16] See chapter entitled "Impact of Adoption of the Strategic Plan".

The Strategic Plan is weak on marketing ideas and plans. Other associations such CAMEX have articulated a marketing plan which considers concentrating efforts in the US market. In general however, much more attention needs to be paid to this aspect of sector development.

Constraints to Growth

This section summarizes the constraints to growth enumerated in earlier sections:

- The installed capacity of the Bolivian forest industry is very small in comparison with potential represented by the existing forest resources in the country, and installed capacity is much higher than current production levels.

- The lack of competitiveness of Bolivian products in the international market is related to: **Forest activity**: the low average volume removed from forests in Bolivia (3 m^3/ha), which directly affects productivity. When larger removal rates are considered (12 m^3/ha), the cost of logs delivered to the factory reaches US$ 25.80/m^3, representing a 67% cost decrease compared to the current situation of US$ 43.20/ m^3; **Industrial activity**: in Bolivia the costs of industrial processing are not competitive in that the process costs are 72% higher than similar costs in Brazil (benchmark); **Trade activity**: transportation costs, both in Bolivia and Brazil, are significant, however, the transport costs are higher in Bolivia. In this case, the difference between Bolivia (US$ 70.00/m^3) and Brazil (US$ 39.00/m^3) is almost 80% (US$ 31/ $m^{3)}$.

- Bolivia's forestry sector does not have an export promotion strategy integrated with the overall sectoral strategy. The above-mentioned strategic plan does not include an strategic design, rather it is a compilation of various activities deemed to be necessary for sector development.

- The country's image in international markets is poor.

- The new Forest Law recently adopted by Bolivia, in spite of having contributed significantly to conservation and preservation of forest resources, has not been able to effectively promote the sustainable development of the country forestry sector. This is particularly important when considering the need to attract foreign direct investment (FDI).

- Transport costs are high because of the lack of a road and rail network.

- The absence of a market strategy and an export promotional program that incorporates many different aspects of the export process such as financing adversely affects exports. Ceprobol, the Bolivian Export Promotion Agency, does not have the necessary resources to effectively promote the sector.

- The low liquidity of the sector can also affect the export performance.

TEXTILE SECTOR

General Description

The Bolivian textile and garment sector generates more than 12% of the total employment of the manufacturing sector, account for 3% of gross manufactured products and accounts for exports of slightly less than US$ 40 million a year. The sector consists of about 160 formal firms and 6,000 informal firms. 62% of the formal firms are small enterprises, 18% are medium sized and 20% are large. Informal firms are mainly small and micro enterprises.

There are four major producing cities in Bolivia (La Paz, El Alto, Cochabamba, Santa Cruz). Wool garment production is concentrated in La Paz and El Alto. Cochabamba and Santa Cruz are the main centers of cotton garment production, though the largest cotton manufacturer is based in La Paz.

Production

The textile and garment sector in Bolivia covers two different sectors: the wool and cotton. Bolivian wool production is based on having a large population of Andean cameloids. Bolivia has the largest population of llamas worldwide (2.5 million) and the second largest population of alpacas worldwide (350,000) second only to Peru. Based on this population, Bolivia has the potential to use 700 tons of alpaca fiber and 3,500 tons of llama fiber, which could produce 1.5 million raincoats or 5.5 million sweaters.

Cotton sector production is mainly based on import of foreign raw materials. Knitting export production uses Peruvian yarns and canvas production uses fabrics from Chile, Brazil or Argentina. The sector is characterized by two different groups of companies: one group consists of large firms, mainly concentrated in La Paz. These firms produce T-shirts, pullovers and shirts, mainly for the U.S. market. The other group consists of medium and small informal firms located in Cochabamba and Santa Cruz. This group concentrates mainly on T-shirts, jeans and other trousers.

Domestic Market

The domestic Bolivian market has limited potential, because of its size and low purchasing power. Formal sector firms face unfair competition from smuggled goods and from having to compete with informal sector firms. The main strategy used by the major firms to compete, is vertical integration with the distribution channels and the strategy used by small companies is to function as informal enterprises. Unless problems such as contraband and informality are addressed, formal sector firms will continue to operate at a competitive disadvantage.

International Market[17]

World trade in fabrics and textiles is highly concentrated. In 1999 the two largest exporters accounted for almost half of overall supplies to international markets (EU: 31%

[17] This section is excerpted from the ITC report.

and P.R.China: 17%), and the next six for over a quarter (P.R.Korea: 8%, USA: 6%, Japan: 5%, Pakistan: 3%, India: 3%, Turkey: 2%). The European Union is also the largest import market (26% of world imports in 1999), followed by USA (9%), P.R. China (8%), Mexico, Japan and Canada (3% each)."

World trade in cotton fabrics and textiles amounted to 2.7% of global merchandise trade in 1999. Global annual imports averaged US$24 billion per year between 1995 and 1999, of which *cotton fabrics* represented just over three-quarters (US$18.3 billion per year). Annual imports of *textiles* averaged US$5.6 billion, consisting of cotton bed covers, table linen, etc.

World exports of cotton clothing are less concentrated than trade in fabrics and textiles. The current leading exporters are China (some 21% of total world exports), the European Union (20%), USA, Mexico and Turkey (4% each), People's Republic of Korea and India (3% each), as well as Bangladesh, Indonesia and Thailand (2% each). Bolivia has only 0.025% share of the world market.

World trade in clothing and accessories has grown by an average of 6% per year over the past decade, although recently the rate of growth has slowed down sharply, with no more than a 1% annual increase in 1998 and 1999. Trade in these goods is estimated to have amounted to about 3.4% of total world merchandise trade over the past six years. Between 1995 and 1999, annual world imports of cotton and blended cotton clothing and accessories are estimated to have averaged US$ 91.2 billion. Imports increased by an average of nearly 5% per year, from US$ 83.7 billion in 1995, to US$ 96 billion in 1998, but decreased slightly, to US$ 95.4 billion in 1999.

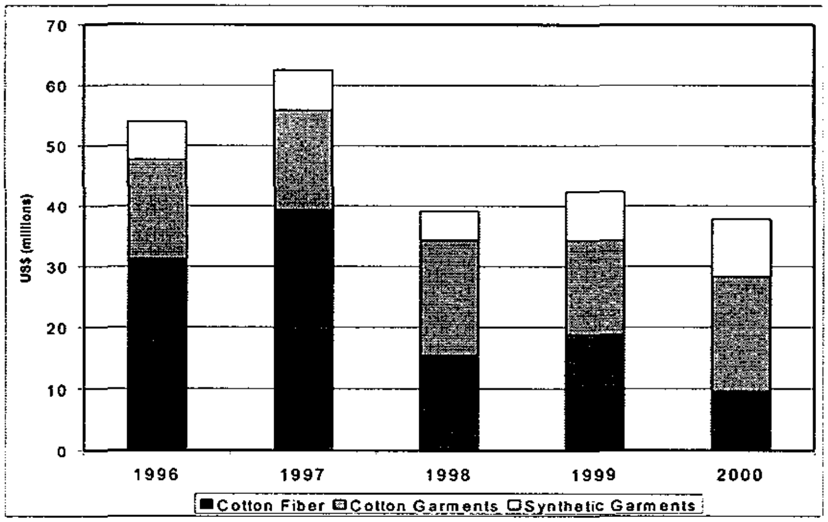
World import trade is, in contrast, highly concentrated. The three largest import markets for clothing currently account for nearly three-quarters of the total trade (EU 36%, USA 30%, Japan 8%). The following four importing countries in order of importance are Mexico, Switzerland, Canada (3% each) and Hong Kong/China (1%, as retained imports).

The world production of alpaca and llama fibers is close to 4,000 tons each. Bolivia and Peru are the largest producers. The world market for fine hair is almost US$1 billion. Europe and Asia are the main importers and also the main exporters of fine fibers different from cameloids (angora). The world garment market size is difficult to estimate because the world statistics include wool products, but the market potential (with the actual population of cameloids) in llama and alpaca fibers could be close to US$500 million. At present Bolivia has 1.5% of the world market. This amount is quite low considering potential production capabilities.

Present Situation

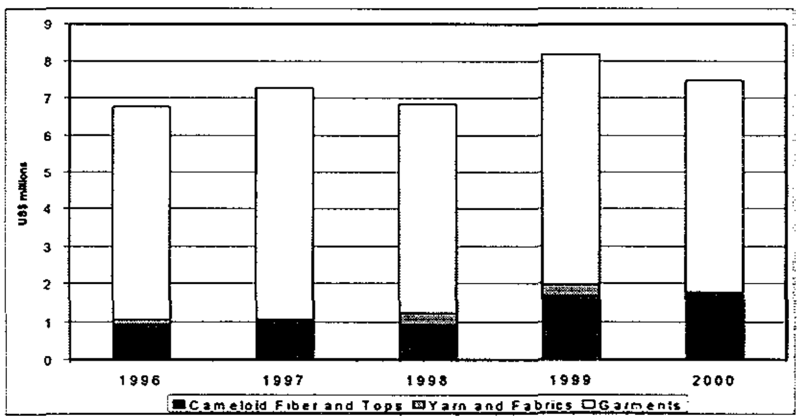
According to 1996-2000 export figures Bolivian exports of cotton products have been falling. The drop cotton in exports is explained by the reduction in cotton fiber exports (from US$30 million to US$10 million) and a slow increase in cotton garment exports (from US$16 million to US$19 million). Overall cotton sectoral exports fell from more than US$50 million (1997) to less than US$30 million (2000).

Graph 19: Cotton Exports in US$ millions, 1996-2000



Cameloid product exports (US $7 - $8 million) are explained by the stabilization of garment exports at around US$6 million. The sector consists of a number of medium sized exporters who account for much of this increase. In terms of products, there has been a steady increase in exports of fiber and tops, from US$1 million to almost US$2 million in five years, because of the important concentration of these export products in a single successful company and two cooperatives.

Graph 20: Cameloid Exports in US$ millions, 1996-2000



The sectorial situation is not easy. The Cotton sector are in a very complex situation. The sectorial debt is growing like informality, the liquidity is falling like the sectorial employment and the number of firms. The two major exporters of Cotton and Cameloid are tryng to compete trough vertical integration, trying to reproduce the complete cluster inside the company. This is a very risky option, but the structure of this businesses in Bolivia are pushing them to do it. The main risky factor is the need to increase the companie's investment in a very complex national economic situation.

Development Strategy

The vision of the sector's potential was prepared in CAMEX Strategic Workshop the last year. The vision esteems the future potential (10 years) in a billion US$ dollars (Cotton: US$900 million, Cameloid: US$120 million). The strategy proposed for Cotton sector consider to concentrate exports to USA in a full package contract, and growing up trough a relevant sectorial investment (domestic investment and FDI), motivated by obtain from USA Government, equal export conditions (tariffs) than sub-Saharan countries.

Constraints to Growth

This section summaries the main constraints to growth as outlined above.

- The installed capacity of the Bolivian textile and garment industry is very small in comparison with the potential market (world market) and overall production potential, if one was to consider a regional cluster with Peru. In order to fully realize the potential of the sectors is necessary to increase investment and certain critical conditions (such a in passage of ATPA for cotton exports to the USA) and cluster reorganization for cameloids must be mat.

- Bolivia's textile and garment sector does not have an Export Promotion Strategy.

- The country image in the international markets is poor.

- Transport costs are high of poor infrastructure and a weak transport sector. Air transportation is an option that needs to be studied, particularly if export volumes to USA increase as a result of a renewed and expanded ATPA.

- As in the wood sector the absence of a market strategy and export promotional program that considers many different aspects such as financing export.

TOURISM SECTOR

General Description

The Bolivian tourism sector generates more than 60.000 jobs, with a sectoral that represents 3.8% of the GDP and exports in 2000 of US$ 160 million.

There six major tourist cities in Bolivia, measure by the nights spent in turn by foreign tourists. These cities are La Paz (46%), Santa Cruz (33%), Cochabamba (9,4%), Sucre (4,7%), Potosí (4,7%) and Oruro (2,4%). There are many small and medium sized tourist operators in Bolivia, mainly working regionally. Table 14 shows the total firm numbers in this sector, as well as the total number of rooms available.

Attractions/Offer[18]

Bolivian tourism offers 3 different packages: Adventure and Special Interest trips, General Interest trips and Holiday trips. Adventure and Special Interest trips have the best potential for foreign visitors from developed country markets. Routes and destinations are organized by "departments," or provinces.

La Paz: Culture, Churches and Museums, Indigenous Markets, City of La Paz, Natural Beauty, Lake Titikaka, Copacabana, Cordillera Real, the North and South Valleys of the Yungas, Trekking Ancient Roads ("Caminos Pre-colombinos"), Los Kallawayas.

Potosi: Colonial splendor, Culture, Natural Beauty, City of Potosí, Casa de la Moneda (the colonial treasury), Churches and Convents, Handcrafts.

Santa Cruz: Amazing jungles, the Jesuit missions, the city of Santa Cruz de la Sierra, Noel Kempff Mercado National Park, Amboro National Park, Archeological Site of Samaipata, El Chaco Boliviano, Route of the Combatants of Che Guevara.

Chuquisaca: Sucre, International Festival of Culture, Natural Beauty, El Grito Libertario, la Casa de la Libertad, Churches and Convents, Museums, Handicrafts.

Cochabamba: Cochabamba, The Virgin de Urkupiña Festival, Cochabamba's surroundings, Archeological sites, Natural Beauty.

Oruro: Carnival, Culture, Museums, El Pueblo Chipaya, Paleontology, Natural Beauty, Snowy Sajama, Religious Cults.

Pando: "The Cradle of Nature," pristine, Culture, Cobija, Archeology.

Beni: Culture, Temples, Natural Beauty, Trinidad.

Tarija: Land of Tradition and Hope, Museums, Churches and Chapels, El Valle Tarijeño, Festivals.

There are nearly 700 hotels and other lodges in Bolivia, most of them in La Paz (20%), Santa Cruz (27%) and Cochabamba (17%). The use of Bolivian hotel capacity is on average 31% for rooms and 24% for beds. The different lodges categories in Bolivia (year 2000) are the following:

[18] This section is extracted from reports prepared by the Vice-ministry of Tourism

Table 14: Hotel Rooms by Category

Category	Firms	Rooms
Hotel	**163**	**6.204**
H5*	9	1,191
H4*	30	1,328
H3*	30	1,297
H2*	41	1,069
H1*	53	1,319
Apart Hotel	**18**	**389**
HOSTEL	**195**	**3,962**
R4*	14	254
R3*	25	537
R2*	40	877
R1*	116	2,294
Lodges	**290**	**4,899**
A	88	1,405
B	87	1,497
C	115	1,997
Lodging Houses	**25**	**341**
TOTAL	**691**	**15,795**

Domestic Market

The domestic Bolivian tourism market can be measured by the total number of nights spent in hotels by tourists. The total number of nights is 2.3 million and 57% of these are used by local tourist (Bolivian) and 43% by foreign visitors. The local tourism is concentrated on Santa Cruz (27.5%), La Paz (23.5%) and Cochabamba (17.4%). Seasonally July, and the period December to January are high season. The potential of the domestic market, is really important, but much depends on the strength of the local economy and the development of a local tourism culture.

International Market

Growth in the normally buoyant tourism sector ground to a halt in 2001 and international arrivals slipped by 1.3% due to the terrorist attacks of September 11 and the weakening economies of major tourism generating markets, according to preliminary results released by the World Tourism Organization (WTO).

International tourist arrivals totaled 689 million in 2001, compared to 697 million in 2000. Experts hailed 2000 as an exceptional year for tourism, with special millennium events boosting international arrivals by 7% and, in some cases, causing travelers to advance trips that would have been taken in 2001.

WTO estimates that during the first eight months of 2001, from January to August, arrivals worldwide grew by 3%-more than one point lower than the average annual gain of 4.3% in tourist arrivals over the past ten years.

But the last four months of 2001 suffered a drop of 11% in arrivals worldwide and substantial decreases in every region: Africa (-3.5%); Americas (-24%); East Asia/ Pacific (-10%); Europe (-6%); Middle East (-30%); and South Asia (-24%).

The only other year in recent times that has shown negative growth in world tourism was 1982, when international arrivals declined by 0.4%. The Gulf War year of 1991 recorded a small increase of 1.2% in international arrivals.

America's International arrivals dropped by 7%, reflecting a trend that began well before September 11 due to economic problems in Brazil, Argentina and Japan, as well as decreasing levels of consumer confidence in the United States. Inbound and outbound tourism to the United States suffered as a result of the attacks, arrivals for 2001 fell by almost 13% and countries dependent on US tourists also suffered, including Mexico (-5%), Jamaica (-4%), Bahamas (-4%), Dominican Republic (-5%) and Canada (0.1%). Economic instability plagued Southern Cone countries causing decreases in Brazil (-8%), Argentina (-9%) and Uruguay (-4%). "

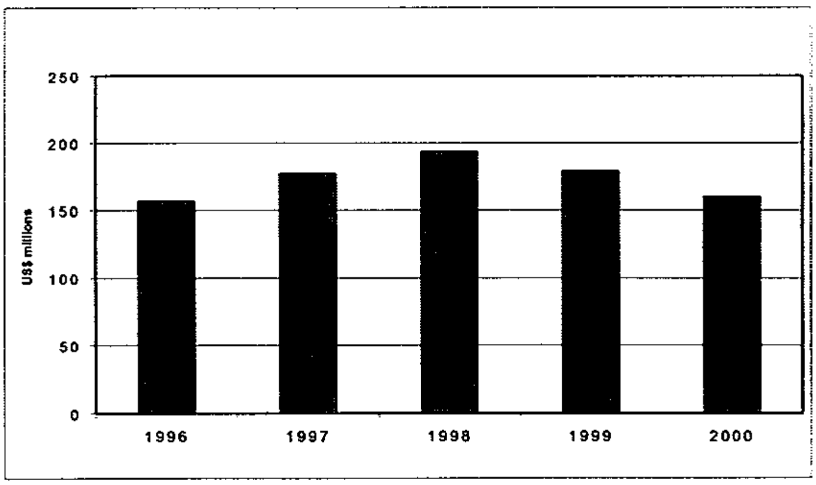
Bolivian Tourism Market

Data on the international Bolivian tourism market for the 2000 suggests that it accounted for around US$160 million and 300.000 visitors. This tourism is concentrated in La Paz (44.4%), Santa Cruz (28.3%), Cochabamba (8.2%), Potosi (7.5%), Sucre (5.3%) and Oruro (2.9%). Between July and August visitors tend to be from U.S.A. and Europe while in January, visitors tend to be mainly from Argentina, Peru, Brazil and Chile.

2001 data on the world market share of Bolivia in international tourism suggests that it accounts only for 0.037% of global tourism expenditure and 0.055% of international tourist arrivals. The total South American world market share, in the same period, was 2.09%. This information shows that Bolivian efforts on tourism market need to be much more coordinated with other South American countries in order to capitalize on regional attractions (such as an Andean route) etc.

Present Situation

Graph 21: Tourism Exports in US$ millions, 1996-2000



The outlook for the Bolivian tourism sector is not promising. Foreign tourists to Bolivia are typically loojing for value and are lost-conscions travelers. Bolivia offer a mix of value and attractive tourist destinations but the quality of services is diverse and social conflicts increase the risk for visitors.

Development Strategy

The vision of the sector's potential was prepared in CAMEX's Strategic Workshop last year. Future potential (10 years) is estimated at US$700 millions and 200,000 jobs. The strategy proposed for tourism sector is based reorganization of the cluster, more investment in infrastructure, a good investment climate, international promotion and other their. However it will be difficult to increase the flows of tourism without resolution of social conflict Tourism efforts need to focus attention on this matter, working with indigenous communities and his representatives.

Constraints to Growth

This section summarizes constraints to growth discussed above.

- The level of social conflict is a major deterrent.
- Lack of effective promotion, both of the destination and the products offered by specific businesses.
- The absence of a marketing strategy and an promotional program that considers many different factors, such as financing.
- The country's factors image in the main tourism markets is not well developed.
- Weak tourism administration at both the central and the community level.
- Lack of facilities, infrastructure and social services.
- Lack of investment in the tourism destinations and associated products (attractions, entertainment, shopping, etc.).
- Lack of qualified human resources with sector-specific skills.

LEGAL CONSTRAINTS

Forestry Sector

The most important constraint identified in the forestry cluster is the one related to the ownership structure of the land granted as part of the forest exploitation concession. Under the current law, concessionaires are granted a right to exploit wood contained within the exploitation area. Concessionaires do not acquire any property rights over the land itself. The structure set forth in the law responds, basically, to the rational that forestry resources belong to the State and therefore, what the State is granting the concessionaire is the right to exploit only those wood resources and not the land, which can be granted, separately, to others who do acquire ownership over the land, but do not acquire the right to exploit the wood resources on their land.

This structure is similar to the provisions contained in the Mining Code and in the Hydrocarbons Law. These two bodies of law grant concessionaires only the right to exploit minerals and the right to exploit hydrocarbons without the right to own the land or even the mineral deposits (in the case of the Mining Code) or the hydrocarbons located underground (in the case of the Hydrocarbons Law). In both cases, the concessionaire acquires title to the minerals and to the hydrocarbons only once such products have been extracted.

The principal argument wielded by the wood/forestry concessionaires is that the current structures deprives them from the possibility of obtaining finance to rationally exploit the wood because they have no real (*in rem*) property to grant as security for such loans.

We believe the first problem could be addressed, at least partially, by means of incorporating into the Forestry Law a concept currently existing in the Mining Code. This concept allows the concession itself to be treated as a real (*in rem*) right. As a result of such incorporation the concession rights could be mortgaged and granted as security. Since there is ample experience and precedent in the use of this concept - because of the Mining Code - forestry concessionaires should be satisfied as to the implementation and viability thereof.

The other arguments wielded were:

1. The concessionaires argue that the concessions being granted are not clearly delimited. This leads to overlaps in two and sometimes more concessions with the corresponding problems. We are of the opinion that this is not really a legal problem, but rather a technical one. However, in this matter, as on the matter of the property structure, there is the experience of the mining and hydrocarbons sectors where the problem of constant overlaps was endemic. In both cases the problem was solved through the overlaying over the Bolivian territory of a grid calculated based on UTM coordinates. Each little square of the grid has an alpha numerical denomination and all concessions are granted as full squares. Some work had to be done in order to adapt the existing concessions to the grid, but in the end, everybody was willing to sacrifice a little in exchange for the certainty that there would be no more overlaps. This certainty arises from the fact that the grid is controlled via computer and the program does not allow two concessions over any given square.

2. There are constant invasions by clandestine producers who cut the trees illegally and let the concessionaire take the blame for the infraction to the rules. As in the previous cases, this problem was also typical of the mining sector. It was partially solved by means of the enactment, in the Mining Code, of a special procedure called the Administrative Recourse ("*Amparo Administrativo*"). By means of this special recourse, the concessionaire can request the Superintendent to take all necessary action to defend the concessions from invasion as well as from any other disturbance. We use the word "partially" because the government does not really have the means nor the political will to act as decisively as would be required in

order to really stop the problem, but those deficiencies are much beyond the scope of this work.

3. The current Forestry Law divides the concession area into several smaller sectors. In addition, the law requires that concessionaires exploit only one area at a time. In other words, the concessionaire must rotate the sectors. The rational behind this requirement is that it allows the forest to recover from exploitation. The problem with it is that the exploitation of wood responds to the market's requirements of certain types of woods. It is practically impossible to predict such requirements. What complicates the problem is the fact that different types of woods occur at random in forests and not necessarily in the sector that is at any given time under exploitation. Thus, concessionaires often find themselves with orders for a certain type of wood that is not concentrated in the sector under exploitation, but in another one within the concession area limits which is, for a certain period of time, legally impossible to exploit. The same logic applies to the fluctuation of prices for different types of wood, that fluctuate and thereby determine which wood should be exploited at any point in time. This problem can only be solved through a major conceptual change in the Forestry Law resulting in its re-drafting. The successful solution lies in the government's ability to reconcile the constraints imposed by market forces and the need to maintain the ecological balance in the exploitation areas.

Our research and investigation failed to provide satisfactory answers to the question of why the concessionaires do not avail themselves of the advantages granted by the Forestry Law for the reclaiming of abandoned and semi-deserted lands. We believe this is an area that merits further analysis and investigation.

Textiles

All our research and investigation reveals that the problems of the textile industry are those of industry at large in Bolivia. Namely, judicial insecurity, labour problems, tax uncertainty and fluctuations, uncertain property registration, etc. In light of this, we would like to refer you to our comments and suggestions on these matters contained in earlier sections of this work.

Tourism

A careful reading of the Tourism Law shows that its main defect is that it does not really respond to a clear and decisive policy on the part of the Bolivian government. The law repeats a series of principles and objectives of no major consequence and provides true incentives only through tax exemptions. Unfortunately the value of such incentives is greatly diminished because of the difficulty in implementing them.

Our recommended course of action would be to provide the government with the necessary tools and technical assistance to develop a true, long term, comprehensive tourism promotion policy together with the necessary legal instruments to implement it. Such legal instruments should include matters such the empowerment to local municipalities and prefectures to grant, under certain conditions, tax deferrals or tax holidays, to grant the use of municipal lands for terms longer than just the ten to thirty years currently allowed for leases and usufructs under the civil code, to grant additional incentives, all in favor of projects that promote tourism within their jurisdictions.

The Bolivian government should also include in its tourism promotion policy the conditions under which it would be prepared to enact special, site-specific, legislation to further promote tourism in certain areas.

CHAPTER VII

ANALYSIS OF DONOR INTERVENTIONS

This chapter analyses donor support to trade and business promotion activities. The first part of the chapter provides an overview of AID support to BOLINVEST and Fundación BOLINVEST. The second part discusses other donor interventions, particularly in the context of the government's Poverty Reduction Strategy. The third subsection briefly explores the proposed work of the USAID LAC / RSD and USAID / PERU initiatives to support LAC Sub-Regional trading blocs in the FTAA area.

AID SUPPORT TO BOLINVEST – CARANA / FUNDACION BOLINVEST.

BOLINVEST was organized in 1989 by CARANA Corporation, an AID contractor. BOLINVEST began as a relatively modest export program. Throughout its existence, it underwent several organizational changes, analyzed below, in an effort to improve its performance. The evolution of BOLINVEST provides a number of useful lessons for AID, relevant to future interventions in the area of export promotion.

Project Evolution

BOLINVEST's initial actions focused almost entirely on export promotion activities and technical assistance by providing specialized support to local business, particularly exporters and companies with potential to become exporters. BOLINVEST was always seen as a project with a definite life span, one that would end upon termination of the CARANA contract.

Phase I (1990-1991): Export Promotion Focus.

During this phase, BOLINVEST's main focus was on export promotion activities. BOLINVEST's organizational structure was simple consisting of: an Executive Director, an export development unit and a small administrative division with a highly centralized decision making process.

The first overseas office BOLINVEST established in Latin America was in Buenos Aires, Argentina, providing the program access to market information and ability to support marketing functions directly in the field. In early 1990, AID became interested in adding an investment promotion component to the project and began the process of exploring this possibility.

Phase II (1990 – 1991): Introduction of Investment Promotion Functions.

During 1990 most of the officials at AID that were involved with the project left and the new staff responsible for BOLINVEST had different ideas as to how the project should evolve. Most believed that the investment promotion function should remain within the existing contract and that a new entity should not be created. Eventually, AID agreed to implement an investment promotion pilot project within the existing CARANA contract.

To interest Bolivians in both the private and public sectors in the need for the creation of a vital investment promotion effort, several consultants from Costa Rica were brought to Bolivia. In turn, a high level delegation of Bolivians also visited Costa Rica to learn more about the Central American and Costa Rican experience in this field.

By mid 1990, AID had decided to fund the investment promotion pilot project, and soon after CARANA and AID jointly began to staff an investment promotion division within BOLINVEST. This division operated within BOLINVEST, but it was independent from the rest of the project.

Phase III (1991–1994): Dual Function Organization: Export and Investment Promotion.

During this phase the dual functions of export and investment promotion were effectively combined. By the end of 1991, the investment promotion division was fully staffed and had established offices in the United States (New York and Miami). Experienced consultants were brought in to provide technical assistance. During this period, the export promotion unit launched the PROATEC project, an initiative designed to provide technical assistance to small rural organizations.

By 1993, AID had begun to assess the possibility of establishing BOLINVEST as a permanent institution with a life beyond the CARANA contract. The particular circumstances at the time augured well for such a course of action as program results were positive, according to independent evaluations and audits. In addition, a working organizational structure was in place and achieving results. In May 1995, a new organizational structure was introduced. During this time, AID and CARANA decided to establish BOLINVEST as an independent entity that would seek funds from diverse sources and continue offering services beyond the life span of the second CARANA – AID contract.

RESULTS

Evaluation of BOLINVEST:

The main objectives of the Project were fulfilled. In export promotion, accomplishments were measured in terms of net exports of any firm that had been assisted by the BOLINVEST team. These amounts were computed only after the actual exporting phase of the operation took place and only if the trade was a direct consequence of BOLINVEST intervention. As of December 1997, BOLINVEST was involved in supporting some US$ 250 million in gross exports, surpassing the target of US$ 170 million for the project.

In investment promotion, achievements were measured by the amount of money the BOLINVEST- assisted entity had actually invested in Bolivia. These amounts were computed at 100% of the investment amount and were calculated from the start of the project through its conclusion. As of December 1997, the project reported US$ 89 million in direct foreign investment, against a target of US$ 74 million.

Also, the Project achieved important results in terms of permanent employment creation. Although it was not possible to reach the established goal of 13,000 permanent jobs, it is estimated that Bolinvest support generated a total of 11,500 jobs.

Phase IV (1995 – 2002): FUNDACION BOLINVEST from Export and Investment Promotion Provider of Technical Assistance to SME

This section analyzes the evolution of Fundacion Bolinvest from an export and investment promotion institution to provider of tech assistance to SME. Fundación BOLINVEST was created on June 23, 1995. The new institution was formally established as an authorized NGO on January 10, 1996 based upon the original BOLINVEST project. Its Board of Directors was composed of talented professionals and proven business leaders with extensive contacts in the public and private sectors. The initial term of the first Board of Directors was of two years.

In March 1996, Fundación BOLINVEST and USAID-Bolivia signed an extension of the export and investment promotion project, with a budget of $US 2.8 millions and an initial term of 18 months. The extension of such agreement was later modified, allowing for the project to continue until late 1999. Finally, on September 30, 1999, USAID-Bolivia and Fundación BOLINVEST officially ended the export and investment promotion project, after a total of ten years of operations.

Fundación BOLINVEST became an independent organization with its own legal status as a private, non – profit institution. Its main objective, as stated in its by-laws, is to contribute to the economic development of Bolivia by:

- Increasing the level of competitiveness of Bolivian enterprises, to enable them to efficiently compete in local and foreign markets.
- Increasing and diversifying Bolivia's non-traditional exports.
- Stimulating the creation of new employment opportunities at all levels, in line with the national government's policy for poverty alleviation.

Current beneficiaries of Fundación Bolinvest include, but are not limited to, small and medium-size companies and associations of producers. In the export sector, its clients include small and medium-size companies that have the potential to become exporters of their own products, producers associations such as those in Quinoa, NGO which direct their efforts to specific sectors of the international market.

Fundación Bolinvest Inter Anerican Development Bank –Multilateral Investment Fund Project.

In June of 1999 Fundación BOLINVEST and the Multilateral Investment Fund (MIF), of the Interamerican Development Bank (IDB) signed a non-reimbursable, technical cooperation agreement (ATN/ME-6242-BO) to support small and medium industrial enterprise initiatives, by providing them technical assistance in production, training and commercialization. The project had a total budget of $US 3.0 million of which FOMIN would contribute with $US 2.1 million and Fundación BOLINVEST with $US 0.9 million, The project had a fixed duration of 36 months (three years). The areas in which this activity would operate were: wood manufacturing, leather goods, food products and textiles.

By late September of 2001, during a routine revision of supporting documentation submitted by Fundación BOLINVEST to the financial department at the local IDB representation office in La Paz, it was observed that standardized accounting and reimbursement procedures were not being accurately followed by the Program management; the IDB categorized these events as inappropriate, which, in turn, prompted the resignation of Fundación BOLINVEST's Executive - Program Director, its Financial Manager and the Accountant.

In October of 2001, the IDB informed Fundación BOLINVEST that the firm Price Waterhouse Coopers was to carry out an auditing of the entire Program. The process did not reveled any mishandling or embezzlement of the funds provided by the IDB for the Program implementation, although it made specific recommendations with regard to accounting practices and procedures and to internal control for future handling of Program funds.

The Program ended on June 30, 2002. During its 36 months of operation, the Fundacion BOLINVESTT - IDB MIF project implemented a total of 132 projects in all four sectors listed above using only $US 1.9 million of the $ US 3.0 million originally budgeted.

LESSONS

Both the BOLINVEST and the Fundación BOLINVEST experiences offer a number of lessons, on export and investment promotion issues as well as institutional arrangements for supporting trade activities. First, the most important reason why such a large and important project as BOLINVEST ceased to be an influential player, was the lack of a well established trade and investment institutional system in which the project could operate, evolve and generate high impact activities. This institutional failure kept BOLINVEST from becoming a major influence source in the political decision-making process within the Bolivian government and the international donor environment. Further more, BOLINVEST adopted a policy of maintaining a low institutional profile and its isolation led over time to the creation of CEPROBOL within the government structure, supplanting BOLINVEST as a potential primary counterpart on export and investment promotion issues.

This suggests that future AID support in these areas should be undertaken with the perspective of establishing a trade and investment system and in collaboration with a recognizable counterpart institution with donor credibility and government political support.

The Fundacion BOLINVEST experience is consistent with the experience of the BOLINVEST Project. Here too, the lack of coherent trade and investment promotion system neutralized most of the foundation's initial successes. In addition, Fundacion BOLINVEST's lack of financial sustainability and scarce human resources, transformed it into an institution that implemented projects according to priorities of its main financial supporter thus shifting its own focus and original mission. BOLINVEST's institutional sustainability has become its main challenge, as the ill-fated IDB – MIF project soon comes to its end.

OTHER DONOR SUPPORT TO TRADE AND BUSINESS ACTIVITIES

Most donor financial and technical support is allocated according to the priorities of the Bolivian Government Poverty Reduction Strategy PRS, which emphasizes social investment – heath, food security, education, sanitation -, microfinance, rural development, micro and small and medium – sized enterprises, rather than competitive international insertion in flows of capital and trade. In spite of the relatively low priority given to the trade and investment sector, a number of projects aiming the development of competitive international advantages are now being implemented in the areas of institutional strengthening and training, legal and regulatory improvement, and venture capital development. This section discusses the main donor interventions in those areas.

A. Institutional Strengthening and Training Programs.

The most important effort leading to the creation of a trade and investment system in Bolivia, is the establishment of the Sistema Boliviano de Productividad y Competitividad, with funding from multilateral agencies as the Inter American Development Bank, IDB, the Andean Development Corporation (CAF), the World Bank, and bilateral co-operation from the Department For International Development DFID of the British Government, the Dutch Co - Operation Agency, and the Swiss Government through the State Secretariat for Economic Affairs SECO.

The Sistema Boliviano de Productividad y Competitividad was organized by the Ministry of Economic Development and includes the participation of The Ministries of Foreign Trade and Investments as well as Agriculture. Its main's objective is generating an adequate level of institutional co-ordination between both, the public and the private sector for effective policy design aiming at strengthening Bolivian productive capabilities.

Additionally, the Inter American Development Bank's Multilateral Investment Fund (MIF) is currently supporting two main projects: a Mechanism Development Program for Exports and Investment Promotion. As a result, the Bolivian Investment and Export Promotion Center (CEPROBOL) was created, bringing about a strategic alliance between the private and public sector. In addition, the Ministry of Foreign Trade and Investments was strengthened and the Commercial Information and Business Opportunity System (SICON) was created. Under the strategic alliance between the public and private sector, the Export and Investment Office (Casa del Empresario) was established to provide all foreign trade services under one roof.

The European Union is implementing its ALINVEST Program which supports international investment and trade by establishing Eurocenters in selected Latin American countries. The Bolivian Eurocenter is located at the Chamber of Commerce (CAINCO) in Santa Cruz.

Swiss co-operation has supported a two- year Negotiation Skills Program, which has successfully trained 60 government employees providing them with proper negotiating skills. In addition, the Sistema de Ventanilla Única para Exportaciones (SIVEX) was established to increase operational efficiency and included developing an export manual, provision of specific operations training, analysis of World Trade Organization (WTO) regulations and the creation and implementation of a computer system for certificates of origin. An E-Commerce project with the purpose of promoting the use of B2B electronic commerce between Bolivian exporters and potential overseas buyers is also under current implementation. Finally, Swedish Cooperation is currently supporting the implementation of an Enterprise Statistic Information System.

B. Legal and Regulatory Improvements

Until 1993 the Swedish Cooperation focused on establishing strategic alliances in Bolivia in order to increase export capabilities, investments and trade. Subsequent analysis led them to conclude that Bolivia's business environment was not appropriate for this mechanism, as such, the strategy was changed to focus on building an institutional basis to deal with these constraints.

This new approach has been effective. Some of the achievements of this new approach are: a Stock Market Law (Ley de Mercado de Valores), which has provided enterprises the legal framework to obtain funding through the capital market, promoted the need for modifications of Bolivia's Commercial Code, as well as the establishment of new organizations related to the Capital Market and a Stock Exchange Training Program, which was aimed mainly at local journalists and key decision makers of large Bolivian corporations. In addition, current projects under implementation are: the amendment of the Commercial Code, and the standardization of corporate financial and accounting information (balance sheets) to European formats.

C. Venture Capital Development

With IDB's MIF funding the Venture Capital Project focuses on investing in shares of Bolivian enterprises considered with potential to become highly profitable. Investors in these funds are not allowed ownership of more than 50% of the stocks. This venture capital fund is administered by the Small Enterprises Assistance Fund SEAF and its purpose is to demonstrate the benefits and viability of investing in small and medium enterprises. Support to this fund has proven to be highly successful for small enterprises that otherwise would be financially unable to develop or grow; most of the selected enterprises are now profitable, have increased exports and are expected in the near future to enter the stock market.

In summary, most donor interventions reflect their own identified priorities, rather than a coherently organized support for the development of Bolivian competitive advantages in the areas of trade and business environment. Party, this results from the fact that until recently Bolivia lacked a well-organized system to address issues of production and competitiveness. The lack of such a system becomes strongly evident when assessing the impact of those interventions. Chapter VIII provides a model aiming at solving this situation.

CHAPTER VIII

RECOMMENDATIONS

This section outlines the recommendations emerging from the analysis presented in the previous seven chapters. For convenience, it is organized around the creation of an economic policy model, with an associated institutional structure, that the team of consultants believes to be important to set-up in Bolivia, as a way of channeling the efforts directed towards employment generation, economic growth and poverty alleviation. Initially, this chapter considers a summary of the main findings from the previous chapters. In the second section, the economic policy model is presented and explained and, in the third, the chapter describes the areas and work that are currently being financed by the international cooperation. The fourth section outlines possible areas of intervention for USAID- Bolivia based on lessons from the Chilean experience.

SUMMARY OF PREVIOUS FINDINGS

Bolivia lacks a growth strategy. In the past ten years, various policy initiatives have mainly been concerned with income redistribution rather than income generation. The result is mounting social demands against dwindling public resources. Hence, there is an enormous potential for social conflict, which in turn is may undermine democracy and all democratic institutions.

The strategy implicit in past policy initiatives has had the effect of concentrating almost all of the available external finance to the country in programs and projects directed at the social sector, particularly in education, health care, water and sanitation, development of rural areas and micro-finance. The considerable effort undertaken by Bolivia and the international cooperation to run these projects is, however, not sustainable in the long run, given that the country does not have the capacity to generate the resources required to finance them on its own.

In addition, emphasis on the social sectors and re-distributive strategies has had a negative effect on the productive sector, as it has detracted attention away from it and generated ambiguous policy directives and contradictory efforts that have reduced its competitive advantages and marginalized its productive capabilities. This situation may be clearly exemplified by the lack of meaningful commercial success in external markets and the ever-increasing competition Bolivian firms face in domestic markets from foreign competitors.

This situation has become critical. At present, it seems fair to suggest that the Bolivian productive sector lacks the critical mass of firms capable of sustaining cluster development, generate employment opportunities and, thus, economic growth. In the large majority of industries, productive activity is undertaken by very small firms - which employ less than ten workers and operate in the informal sector - that have little potential for productive efficiencies and have no access to technology, credit and new management tools. Support for these firms comes in the way of safety net policies aimed at keeping them alive, but without really helping them to grow and to compete in world markets.

Existing larger firms, with a labor force of fifty workers or more and which have the necessary attributes to compete in external markets have been abandoned by the public policies and governmental actions. There are three arguments that may be used to validate this claim.

First, there are no consistent policies directed at encouraging the growth of large Bolivian firms, if anything the opposite is the case. Second, Bolivia has failed in effectively developing support structures that exist in most countries in the world to promote exports and foreign direct investment, to the extent that firms that operate in export markets or have attracted foreign capital have done so largely by their own initiative and effort. Third, Bolivia is not a competitive milieu, imposing a number of additional operating costs to firms.

These additional costs come mainly, as it was pointed out in chapter four, from the lack of transport, services and other physical infrastructure, the difficulties and cost of access to credit, the prevalence of the informal economy, the regulatory constraints that increase the cost of labor, bureaucracy and corruption. Finally, it is also necessary to point out that the "neutral" management of the economy, which passed for responsible fiscal policy, has produced over the past fifteen years macroeconomic stability and an assortment of accompanying indicators to be proud of, but very little in the way of incentives for the growth of the productive sector and thus the real economy.

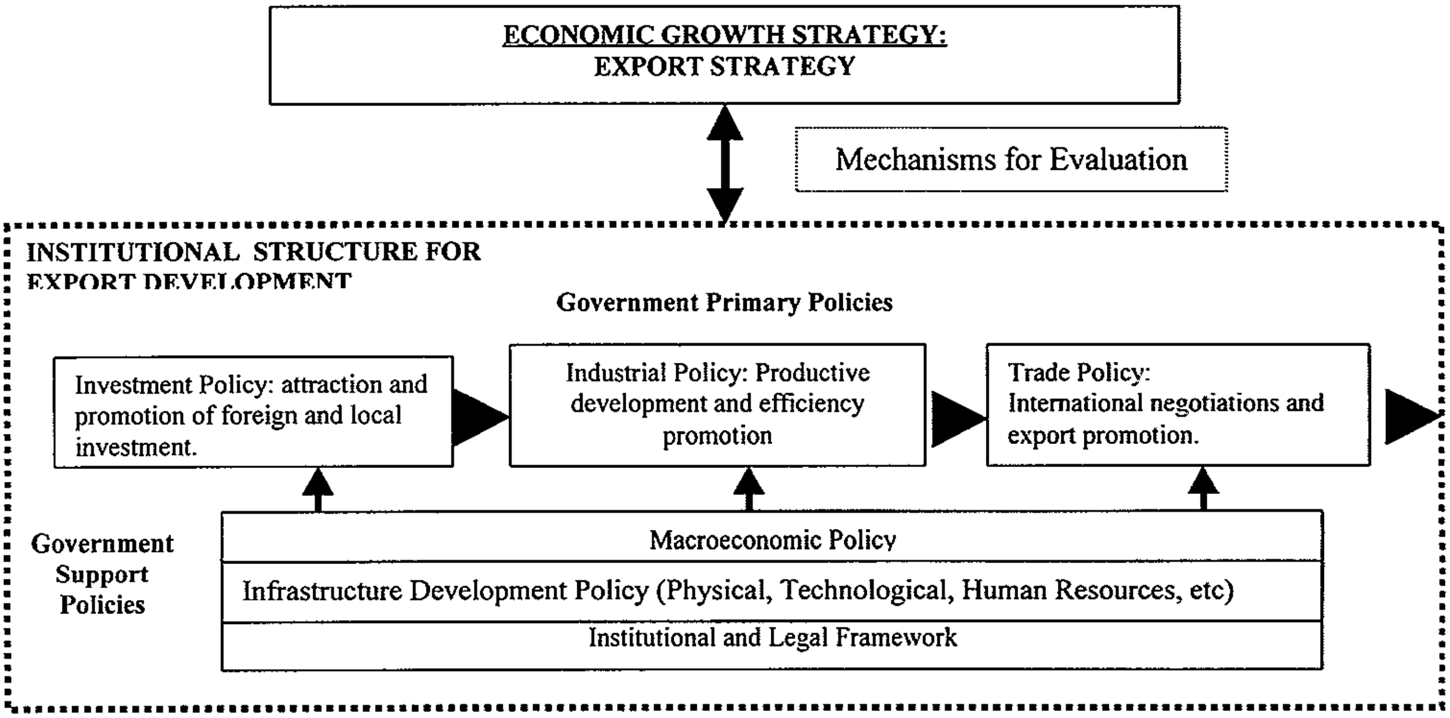
Another important element that has contributed to the reduction in the number of large formal firms in Bolivia has to do with the judicial insecurity that is widespread in the country. This team of consultants believes this to be one of the crucial elements that needs to be addressed if the country is to attract both foreign and domestic investment and to develop a market-relevant productive sector. The constant changes to the normative and regulatory framework, the weak enforcement of property rights, the lack of commercial trained lawyers and judges and judicial corruption introduce too big a risk factor for firms to properly plan for and undertake business opportunities existing in the country.

To address all these problems that have in the past hindered the development potential of the country and reduced the impact of the reform process undertaken over the past two decades, it is of the utmost importance that a coherent growth strategy be developed and an efficient institutional structure be put in place to implement new policy initiatives. In the next section, we utilize a public policy management model, developed by Phillip Kotler (et. al.) in his book The Marketing of Nations: A Strategic Approach to Building National Wealth (1998), to develop a growth strategy for Bolivia aimed at strengthening the productive sector, the growth of exports and the attraction of foreign direct investment.

PROPOSED PUBLIC POLICY RECOMMENDATIONS: MODEL AND ISSUES

The model suggested is based on three important elements and its structure is shown in the graph below:

- the generation of an economic growth strategy based on export promotion and the attraction of foreign direct investment,
- the development of a national export strategy capable of generating the income and social impacts that Bolivia requires,
- the organization of an institutional structure for the promotion and diversification of exports capable of generating a competitive and dynamic export portfolio.



The model above, with the interactions suggested between primary policies and support policies, does not exist in Bolivia and, thus, currently no support service infrastructure exists to promote the growth and diversification of exports in the country.

For this structure to be in place, the following primary policies have to be defined and implemented:

- **investment policy**, which includes the definition and generation of conditions for the attraction of foreign direct investment, the promotion of local economic groups and the country requirements for technology transfer, managed in conceptually the same way as a conglomerate company might manage i its various businesses and divisions),

- **trade policy**, which determines whether the nation is inward or outward looking in its commercial orientation. If the national strategy points to export development, then export promotion and international economic negotiations became important elements of trade policy.

On the other hand, the set of support policies required are as follows:

- **basic infrastructure policies**, including physical infrastructure, such as transportation and communications, human capital infrastructure, which is dependent upon the educational system and incentives for training and skills upgrading, and the bureaucratic infrastructure.
- **institutional and legal framework**, which comprises of elements such as property rights protection, industrial regulation and deregulation, privatization, industrial relations and social policies relating to such matters as women's and minorities rights, income redistribution, etc.
- **macroeconomic policies**, which are (ideally) a coordinated set of fiscal and monetary policies aimed at enhancing efficiency of resource allocation, improved income distribution and price stability.

ISSUES FOR THE DEFINITION OF INVESTMENT POLICY

Develop an aggressive policy to attract new investments and link this policy to a national industrial policy

Bolivia is a country with scarce financial resources and the implementation of a National Export Strategy needs to attract a relevant amount of funding. Hence, the National Investment Policy should be focused on the attraction of Foreign Direct Investment. This policy should be based on the provision of sustainable incentives to the investors, particularly related to the competitiveness of the industrial sectors being promoted. These sectors must be included in the strategic portfolio of the industrial policy or in the strategic projects of the national infrastructure policy.

The investment policy should focus on the attraction of new investors according to a traditional offer approach (what can the county offer the investors), but also according to a demand approach (what investors are looking for, and how Bolivia can address that demand), and taking into account the following evidence: "less risky countries increase their options to attract less risky investors". In other words, the quality of the investor's behavior is related to the quality of the country's environment and policy behavior.

The national investment policy should also consider the need to develop opportunities to encourage national savings and develop a wide range of national investors. This range could consist of by small investors, institutional investors and business investors, particularly relevant national economic groups, which should be a specific objective of the investment policy. Finally, investment policies must consider the need to develop a variety of new investment tools, which should include the creation of new insurance mechanisms for the reduction of economic and commercial risks.

Investment policy needs a clear and efficient institutional structure. The main components are: stable social and macroeconomic conditions, a reliable foreign investment law, an efficient and reliable Foreign Investment Committee Unit (country's operative counterpart for the investors) and a Foreign Investment Committee (normally a committee of ministers) responsible for policy coordination.

ISSUES FOR THE DEFINITION OF INDUSTRIAL POLICY

Analyze sector level constraints before defining policy interventions

The sector situation is not an average of the problems of the economy. The evidence presented in Chapter VI shows the need to understand the reality of specific sectors before policy interventions. The factors to be considered in this analysis are: a) the problems of certain sectors are not always clear, thus it is necessary to identify sources of good information based on quantitative parameters; b) it is necessary to create a powerful vision related to the future development of the sector and to have a clear strategy; c) the answers to the cluster's future development are not always in the hands of the domestic entrepreneurs, particularly when they do not have the relevant experience at international level. Finally, it is necessary to improve the structure used by the government to support cluster level development and also improve entrepreneurial associations who represent firm's interests.

Adjust Industrial Policy to the potential of particular clusters

The clusters analyzed in Chapter VI show an important potential linked to international market development. The amount of this export potential in ten years could be near to US$3 billion. The present situation of these same sectors is deeply risky, considering recent results and the sectoral constraints. We can see the beginning of a sectoral disintegration, with high firm mortality, mainly in the forest and cotton sectors. Large firms are trying to survive through vertical integration but this is risky especially when exports and liquidity are falling. The necessary response needs to be a cluster level response.

Industrial Policy should aim to link firms at different ends of the size spectrum

According to Prof. Patrizio Bianchi, Dean of the Faculty of Economics, University of Ferrara (Italia) and President of the Institute for Industrial Development Policy:

The development of small and medium enterprises (SME) requires that the following success factors be in place:

- integration in a productive and socially dynamic system at the local level,
- work on the quality of the products, processes and human resources,

- disseminate knowledge, information and competencies to be able to structure the local economy.

The first point suggests that SMES work to achieve sufficient economies of scale to enable them to compete with large firms in the global market. International experience shows that small individual companies cannot compete alone in a global scale, and therefore it is necessary to strengthen the productive system.

The second point implies that in global markets it is not possible to continue competing in terms of price, because very powerful agents are entering the market, as in the case of Asian and particularly Chinese industries, which enjoy economies of scale that are capable of displacing any country in competition. The case of the Italian industrial districts shows that the solution has been and continues to be to withdraw from this high level competition and move towards specialized markets, niche markets and markets of high income consumers.

The third point is that, knowledge is the factor that enables the generation of high value, high quality and innovative goods. Such specialization strengthens the position of the firm within the market. Knowledge creates a competitive advantage for a firm which is difficult to replace.

These are the three factors that enable the creation of a dynamic industrial structure which permits them to compete in the open market. This framework is essential because the majority of productive systems, especially in emerging countries, present a serious risk of division between a small group of modern firms and a large group of traditional firms, with no relationship between them, which can generate problems for the productive development of the country. This does not benefit national development, because it enhances contradictions and contrasts between distinct coalitions and corporative interests. For this reason a growth strategy requires a special effort to connect the modern and traditional sectors. There are three areas of action that require attention.

Firstly, there are actions which encourage the traditional sector to consolidate and strengthen competitiveness. An interesting example has been the Mise-au-Niveau in Tunisia, which has encouraged all its productive sector to work at a same standard of quality.

Secondly, it requires a special effort to increase the number of firms included in the international network of high technology. This is shown in the case of academic spin-offs of high technological content activities that permits society to transmit knowledge to the rest of the economy and to the national and local productive system, retargeting its medium and long term growth objectives, thus avoiding competition based only on price.

Finally, the action plan should be directed towards bringing together two types of firms in an integrated system of small national firms. In order to achieve this, the network of subcontracting between small and large firms or between small firms and the productive clusters in general needs to be strengthened. In this way the productive system needs to connect together all the economic agents in a single project of competitive development based on greater specialization and completarity of SMEs, integrated in networks that produce for the global markets.

One should note that these strategic actions correspond to the three basic factors previously mentioned as crucial for the development of SMEs and of localized productive systems: quality, knowledge and networking.

In this respect, it is of great importance to formulate policies and generate mechanisms that promote linkages between traditional and modern firms. These policies should at all costs avoid that the country develops at two different speeds and that income, wealth and welfare distribution becomes more inequitable.

This perspective enables to achieve adequate growth of SMEs based on economies of efficiency and agglomeration. The first are the result of specialization by the individual firm, operating in the context of collective complementarity. The second refers to the economies of scale and the potential of firms that derive from territorial and sectorial linkages in the form of networking (clusters). This is the basic focus that has been the industrial policy of the European Union over the last decades.

Develop an Institutional Structure for a National Export Industry

A national industry policy needs a clear and efficient institutional structure, focusing on exports. The main components are: stable social and macroeconomic conditions, a set of laws that promote the entrepreneurial initiative and human resources development, an efficient and powerful National Competitiveness Network, controlled by a National Competitiveness Center and responsible for new products development (mainly focused on exports) and development of the competitive capacity (firm strengthening). The proposal is to develop a CORFO (Chile) and Fundación-Chile style institution, and should include the agricultural experiences of the SIBTA. A powerful board in the National Competitiveness Center, would be responsible for the organization of the National Development Strategy Meetings necessary to develop and control the National Development Strategy Plan.

ISSUES FOR THE DEFINITION OF TRADE POLICY

Develop an aggressive national trade policy oriented to support the National Export Strategy and increase the efficiency of local markets

Trade policy must be a powerful tool oriented to promote and develop national exports. The policy should consider the following elements:

- Bolivia's export strategy must be oriented to a selected markets (targets), according to the competitiveness and vision of the clusters.

- The market goals and actions should be adjusted considering the export stage of the Bolivian products. The stage could be defined according to many different models like: internationalizations model, market share v/s growth, export learning curve, exports sales curve and others. Bolivia's image terms of the market's knowledge and perception should be considered.

- The main tools to be used by the foreign trade policy are export promotion and international negotiations.

The national foreign trade policy should consider the need to develop programs oriented to improve Bolivia's country image, focusing on target markets and considering increasing exports results but also foreign investment and tourism outcomes. Another one is the National Export Culture program, oriented to develop a national social compromise with exports.

The national foreign trade policy also needs a clear and efficient institutional structure. The main components are: stable social and macroeconomic conditions, a reliable foreign trade law, an efficient and reliable Export Promotion Agency (country's operative counterpart for the exporters), an International Economical Relations Committee (normally a committee of ministers and the export private sector) responsible for the policy coordination and finally an International Negotiations Unit (normally depended on of the Ministry of Foreign Affairs) who responds to the Committee directions.

The local trade development policy would be oriented to increase the efficiency of the local markets trough the following elements:

- providing transparency and legal security to investors
- promoting the development of local market channels in the country, including the supply infrastructure.

ISSUES FOR THE DEFINITION OF INFRASTRUCTURE POLICY

Build Transport Infrastructure on the basis of productive requirements

As Chapter 4 noted, the level of transport infrastructure development in Bolivia is abysmal. But more importantly infrastructure investment is not linked to productive sector requirements.

Infrastructure investments should take into account investments requirements based on current and potentially exportable goods. For instance, today Bolivia exports $ 50 millions worth of castaña (nuts) but often production languishes in the growing region due to transport constraints. Integrating investment and export production priorities requires a level of government coordination that does not exist today and will require a greater of institutional rearranging.

Develop Financial Infrastructure especially non-bank sources of financing for firms

Capital markets in Bolivia are underdeveloped. Only 2 Bolivia firms have to date raised significant amounts of money through the stock exchange. The secondary market in shares is non-existent. A technical assistance program to help firms meet listing requirements should be undertaken and an outreach program to educate firms of the advantages of using the stock exchange should be undertaken.

This implies that firms culture in Bolivia has to change and that firms have to maintain accounts in line with internationally accepted accounting norms, a practice that is not very common today.

In addition, existing venture capital funds should be modified or new ones created to fill the financing gaps firms currently face. Bolivian venture capital funds have tended to be highly risk-averse thus defeating the very purpose for which they were set up. Since most financial institutions which might support a venture capital fund are likely to find the Bolivian domestic market too small to be interesting, the option of an Andean venture capital fund should be explored.

Develop Human Resources Infrastructure and Steer the Education System to meet Productive Sector Requirements

Bolivia's educational reform program has focused on primary education. While undoubtedly important, this focus by itself is no sufficient to address the technical and vocational training needs of firms. The existing vocational institutes do not cater to firm needs. There needs to be a major overhauling of existing vocational and technical education (such as it is) to align it with the needs of business. Furthermore, tax incentives should be provided to firms to encourage in-house training and continuing education.

Develop a National Immigration Policy to Attract Certain Specialized Skills

Several countries have successfully pursued open immigration policies to attract needed skills to the country. Bolivia should consider a targeted immigration policy designed to attract badly needed skills such as wood sector engineers, industrial engineers, textile engineers, etc.

ISSUES FOR THE DEFINITION OF THE OVERALL INSTITUTIONAL FRAMEWORK

Build a basic institutional framework necessary to implement the primary policies (Investment – Industry – Markets).

It is necessary to build a technical institution charged with evaluating the National Export Development Structure in relation to the National Economic Development Strategy and to propose needed adjustments. Today, this role is being undertaken by the Unidad de Productividad y Competitividad of the SBPC. The coordination of government policy and operations related to policy is a task of the government structure at different levels and not a task of the Unit. Another option is to create a Ministry of Productivity and Competitiveness responsible for a National Development Strategy.

The institutional structure necessary is:

- **The Foreign Investment Committee Unit** : this organization would be charge of the Foreign Investment Promotion and Foreign Investment Development, should include the Investment Promotion Unit of the Ceprobol (Centro de Promoción Bolivia).

- **The National Competitiveness Center**: this institution has two principal mandates, New Products Development (mainly focus on exports) and Development of Competitive Capacity (Firm' strengthening). The proposal is to develop a CORFO (Chile) and Fundación-Chile style institution, and should include the agricultural experiences of the SIBTA.
- **The National Trade Promotion Agency:** this organization would be with charged the international markets development through exports. Market intelligence, promotional activities, and the development of a National Exports Culture, are some of its tasks. The Agency should be the new Centro Unico de Promoción, which include the Export Promotion resources of Ceprobol.
- **The International Negotiations Unit:** It is necessary to improve the international negotiations capabilities of the Bolivian Foreign Affairs Ministry. The proposal is to create an International Negotiations Committee, which would include resources of the Government and the private sector (mainly related to exports). The committee should have an operative unit, the Viceministerio de Relaciones Económicas. The committee should designate negotiation teams for different accords.

Support the Sistema Boliviano de Productividad y Competitividad

The SBPC represents the first concerted effort to bring together actors from the private and public sector and to put issues of productivity and competitiveness squarely on the table. [19] The work program of the SBPC which is being implemented with the support of several major multilateral and bilateral donors is concentrated in several areas some of which present interesting opportunities for AID support.

Support Institutional Administrative Simplification by Undertaking a Publication Program (Internet as Well as Paper) to Increase Transparency

Business in Bolivia face extremely high administrative costs. As discussed in Chapter 4, one of the most important explanatory factors for the high level of informality in Bolivia is the cost of opening a firm, the cost of opening a firm in Bolivia, at 3 times per capita income is one of the highest in the world. One the basis of various studies alluded to in Chapter 4 , part of the work being done in the Sistema Boliviano de Productividad and Competitividad is focused on a program of administrative simplification.

One of the key lessons that has emerged from administrative simplification programs worldwide is the need for a program that obliges public sector agencies to publish all administrative procedures. This increases transparency, reduces corruption, and forces public sector agencies to abide by their own rules. One such initiative in Peru entailed the publication of what is known as the Texto Unico de Procedimientos Administrativos. This initiative required all public sector agencies to identify, publish and abide by a set of listed administrative procedures. A prerequisite to such a program is a legal basis which obliges agencies to maintain a website that contains all administrative procedures, as well as to physically past all procedures in a prominent place in the agency. The legal basis for this

[19] As is known, two of the study team members' are also consultants to the SBPC.

was approved in April 2002[20]. This legal basis which will allow AID to piggyback on existing donor supported initiatives in this area.

The strategy for support in this area of administrative simplification would be to identify the 3 or 5 most important institutions from the point of view of a business user and undertake a pilot simplification and publication program with them before expanding this to other institutions (such as the Superintendencias, etc.)

As explained in Chapter 4, the municipality is one of the important actors in the firm registration process because they issue licenses and permits that allow businesses to operate. The International Finance Corporation of the World Bank through a technical assistance agreement with FUNDES is undertaking a pilot project to simplify firm registration requirements at the municipal level and this effort should be replicated at the very least in El Alto, Santa Cruz and Cochabamba.

Upgrade Internal Business Processes in Key Public Sector Agencies

As mentioned earlier, one of the key ways in which corruption can be reduced and transparency increased is to reduce the level of interactions between the public and the public sector. In many countries this has been accomplished by computerizing business processes and set up interactive systems that allow users to track the status of a particular administrative procedure via email. One such business process software will be installed in SITEL. Installation of such systems in the 5 major public sector agencies directly related to issues of productivity and competitiveness will speed up procedures, cut down on corruption and increase the efficiency of business operations

Undertake a Reform Program for SENASAG

This important institution, which is responsible for ensuring phtyosanitary quality of products imported and exported into Bolivia plays a critical role in the production chain of several Bolivian manufactures. According to several firms interviewed for the sector studies, the institution is in a state of disarray and its malfunctioning causes delays and loss of business opportunities. Although technical assistance has been provided by among others, its Chilean counterpart, much remains to be done. A major institutional overhaul is warranted which would include greater decentralization, capacity building and reduction of red tape.

Undertake a Reform Program for SENAPI

A process of institutional reform for the National Service for the Protection of Intellectual Property is slowly getting underway. A new director has been appointed. But much more needs to be done. AID should consider supporting the institutional process by undertaking a thorough study of institutional needs related to registration, capacity building, internal work processes and enforcement.

[20] Ley de Procedimientos Administrativos, approved April 25, 2002

ISSUES FOR THE DEFINITION OF THE LEGAL FRAMEWORK

Create Bankruptcy Courts

The proposed solution to the problem of the lack of business sophistication and knowledge on the part of Bolivian civil judges is the creation of a specialized bankruptcy court system. The rational behind this proposal is that civil law judges would have to be trained and taught to handle in a technically efficient manner bankruptcy processes. This would have to entail lessons and time. However, it is a well known fact that civil law judges are overwhelmed with cases of a very diverse and varied nature and therefore, it is not very likely that they will have the time nor the inclination to dedicate even more time to learn about business and accounting. In view of these facts, it is far more efficient (time wise as well as economically) to train a small group of lawyers (preferably younger in age) in the necessary skills (including judging skills), provide them with the necessary incentives and then have them compete with each other for a certain number of available posts.

Our proposed solution would, of course, require substantial modifications to the Commercial Code, to the Code of Civil Procedure and to the Law of Judicial Organization as well as create new demands on the judiciary's budget requirements (for infrastructure, training and salaries).

Of course, the solution would not be complete without a thorough change and modification to the Commercial Code which deals with bankruptcy procedure.

As was the case with civil law courts, the problem of corruption is beyond the scope of this work. On the matter of the inadequacy of the existing labor legislation, an entirely new law would be required to solve the problem, and that is likewise, a problem that exceeds the agreed scope of work.

Strengthen DDRR (Derechos Reales) and INRA

Our proposed solutions for the problems identified in DDRR, are:

(i) Technology, both computer as well as organizational can be bought. Therefore, the solution to this problem is to carry out a study that pinpoints the precise requirements and proposes the exact solutions.

(ii) The origin of this problem lies in the politically driven appointment of the member of the "Consejo de la Judicatura" and in its very poor relationship with the Judiciary (particularly the Supreme Court). Our proposed solution is to implement an efficient system of internal audit in DDRR coupled with new regulations, which should emerge from the study, recommended under (i) above. In addition, of course, it would be essential to change the members of the Consejo, but this is a political decision that is absolutely beyond our scope of work.

(iii) The problem of corruption in DDRR, which exists at the level of each office, can only be solved through the proper implementation of the measures described above, plus an increase in the remuneration of the personnel in charge of registration. This is because the current level of remuneration, compared to the value of the property being registered, is too low and therefore lends itself to corruption.

Our proposed solutions for the problems identified at INRA, are:

(i) Please see (i) in the previous point.

(ii) The problem of lack of means and funds must be solved through a combination of government funding and a large contribution on the part of international organizations. Unfortunately the tasks faced by INRA exceed by far too much any resources that could be provided solely by the Bolivian government

(iii) The problem of the very high degree of political meddling and interference is, unfortunately not solvable absent the required political decision and it will in all likelihood be increased rather than diminished when funding is provided. Thus, it is essential that the funding be accompanied with controls and restrictions, to the extent possible

(iv) Please see point (iii) above.

Provide Training and Education to Regulators

Unfortunately there is very little that can be done to solve this problem other than try to implement meetings between SIRESE Superintendents and personnel with other supervisory authorities throughout the world to exchange points of view and experiences. Having said that, we very strongly believe that proper training, specially to lawyers acting as counsel to SIRESE entities, in skills such as business environment and reasoning and even more important, on administrative law (there is no body of administrative law in Bolivia, even less doctrine and precious few jurisprudence) would really help diminish this risk. The training would have to include international administrative doctrine, administrative procedural law, international methods for the settlement of investment disputes, project finance (lawyers working for SIRESE consistently fail to understand why regulated entities ask to accommodate international financing entities' requirements) and basic market operations (in order to be able to apply anti trust measures properly and efficiently)..

Enact Anti-Trust Legislation and Provide Training Associated with Anti-Trust Issues

In this case, the proposed solution is, of course, the enactment of adequate and modern Anti-trust legislation. The methodology to do so is beyond the agreed scope of work.

In addition, we would recommend that lawyers and personnel working for the SIRESE superintendencies, as well as for other regulatory bodies, be provided with training in anti trust legislation, procedures, concepts and application, and that they be provided with the opportunity to see other anti trust agencies in the world in operation, particularly those of neighboring countries. This in addition to the necessary training we recommended for legal counsel in the previous point.

Enact Legislation Allowing Tax Stability Contracts

The broad issue of the required modification of the Tax Code and related legislation lies beyond the agreed scope of work so we will not address that problem. But we do have a concrete recommendation for the problem of the constant modifications of the tax rates and of the uncertainty in their interpretation and calculation. Some countries (the most notable example is Chile) have enacted legislation that allows investors to enter into Tax Stability Contracts with the State. Such contracts freeze the tax rate investors have to pay in a certain project in exchange, for example, of a higher rate. These contracts are also useful to set the terms and conditions under which taxes rates are interpreted and the way they are calculated. Of course, proper supporting legislation is essential for this type of contracts to provide the type of security investors need and in order for courts to have the necessary legal background to rule in case of controversy. The enactment of such legislation would be a big step towards providing investors with a favorable investment environment.

Enact Legislation Giving Precedence to International Treaties over Local Legislation

The perfect solution for this problem would be a constitutional amendment that clearly sets forth the principle of preferred application of treaties over local legislation. Of course, that principle would have to be eventually interpreted and applied by local courts of justice, thereby developing the required doctrinal and conceptual sustenance. Short of the Constitutional amendment, a law setting forth the principle could be of some help to local judges when asked to decide on the order of preference, but it should be made clear that such a law could be subject to constitutionality issues and questionings, which could conceivably succeed.

Train Trade Negotiators

Our recommendation on the problem of the lack of negotiation skills would be to grant a series of scholarships or grants for a selected number of Bolivian individuals to attend courses and later to practice negotiation skills in the best institutes and entities available. The selected individuals would have to be multilingual and pass a series of tests specially developed to determine their level of natural skill and ability.

In addition and in order to ensure that the trained individuals fulfill their expected role, it would be necessary to create and sustain a governmental body that centralizes all negotiations (at a certain level of complexity) of the Bolivian government. This entity would also have the right to seek (and mandatorily obtain) feedback from all government entities involved or affected by the negotiation as well as to interact with all private entities and individuals related to or affected by or interested in the negotiation. Finally, this entity would have to develop a training program for new negotiators, with its own funds and supported by foreign aid.

Set up a Business Law Training Program

Given the fact that any solution to this problem only works if a sufficient number of lawyers is trained, there is only one possible recommendation, namely to implement in one or more Bolivian universities the necessary programs to achieve that end. As stated in our analysis, there are none or too few Bolivian lawyers qualified to train, at the necessary level, the courses required for this solution to be successful. Thus, success of the program can only be assured if foreign, highly qualified teachers are invited. This, in turn, means that the cost of such a program could never be financed solely through student tuitions. It is very likely that teachers of the desired level, would only accept to teach the course if invited by entities that carry the necessary weight and prestige.

Finally, the course would have to be provided to students who have passed a certain number of tests and those who pass the test would have to be accepted regardless of their ability to pay, otherwise, the course would simply become a source of very, very few qualified lawyers that would, in all likelihood be invited to work for the few law firms capable of paying salaries high enough to justify the expense such lawyers incurred in to obtain the suggested diploma.

ISSUES FOR THE DEFINITION OF MACROECONOMIC POLICY

Macroeconomic policies for growth and exports

Since 1985, macroeconomic policies have been overly focused on maintaining financial/monetary stability. It is now advisable to start emphasizing fiscal, monetary and exchange policies oriented to increase private investment and economic growth. Furthermore, in times of economic crisis, such as that experienced presently, macroeconomic policies should be undertaken with a more active and counter-cyclical nature, focusing on export promotion.

Fiscal policy

In fiscal terms, in order to increase income, it is necessary to widen the tax base, so that all the economic actors pay taxes in a proportional manner. For this, it is necessary to create incentives so that the informal sector can enter the tax system. In addition the government should continue fighting against tax evasion and consolidate the institutional independence of the tax agency. Public expenditure and investment must become more efficient, especially in the less developed municipalities. In addition, public investment has to be complementary to private investment. Investments in infrastructure and projects to fight against poverty have to be part of a new concept that seeks a complementarity between economic policy and social policy.

Monetary policy

The high level of dollarization in the economy keeps the Central Bank from having a more active monetary policy. For this, it is necessary to look for mechanisms so that the economic actors use the local currency more frequently. The creation of accounting units, such as the recently-created units of housing promotion (Unidades de Fomento de

Vivienda, UFV) is one way the overuse of dollar-transactions in the national financial system.

Access to credit

Economic policy must also be oriented, first, to developing the capital market and, second, to facilitating credit. For this, prudential banking regulations should be flexible, without endangering the bank system. It is necessary to continue promoting competence in the banking system, supported by anti-trust laws enacted by the government. It is also necessary to create conditions so that the stock market.

The actions of non-governmental organizations and other financial institutions devoted to micro-credit should be well regulated as the development of small and micro sized firms depends on this sector.

Foreign exchange policy

Regarding foreign exchange policy, undoubtedly the local stock exchange is a very good instrument to be used as a rate of exchange. Meanwhile, devaluation has to be used quite cautiously to promote exports and mitigate external shocks. In this case, an important factor for investors is the predictability of the exchange rate. Sudden changes in the value of the national currency may cause uncertainty.

Reduce labor market rigidities

A flexible labor market constitutes a polemic public policy, yet it has to be implemented. However, in parallel to the labor market liberalization, it is also necessary to create a system of unemployment security to help mitigate the undesired effects of the labor market.

In order to reduce contracting and dismissal costs, temporary incentive system should be created to cover employers' expenses, thus enabling the enterprises to create new jobs at a lesser cost. This is a transitional measure that could increase national competitiveness.

Ensure diversification of exports

Exports of natural gas are likely to become the single largest export. As noted earlier, an abundance of foreign currency can have deleterious effects on the exchange rate in the short term and reduce competitiveness in non-traditional exports. In other words, Dutch disease must be prevented. In the medium and long term, proper use of the income from gas and well managed industrial and agricultural policies are critical for preventing an exaggerated growth of the hydrocarbons sector.

CURRENT DONOR SUPPORT FOR INVESTMENT, INDUSTRIAL AND TRADE POLICY

The following matrix represents the present situation with respect to donor support for some of the policies outlined above.

Donors	Investment Policy	Industrial Policy	Trade Policy
World Bank		-Sistema Boliviano de Productividad y Competitividad (SBPC)	
IADB (BID)	-CEPROBOL -Ministry of Foreign Trade and Investment (Institutional strengthening) -Venture Capital Project	-SBPC	-CEPROBOL -Ministry of Foreign Trade and Investment -SICON -Casa del Empresario
CAF		-SBPC (productive chains)	
DFID		-SBPC	
SECO		-SBPC	-Negotiation Skills Program -SIVEX -ITC E-Commerce and Sectoral Integral Develop. Capabilities -The stock market Law -The Commercial Code -The standardization of Corporate information
EU	-Eurocenter CAINCO		Eurocenter CAINCO
ITC			-ITC E-Commerce and Sectoral Integral Development Capabilities

The most important effort leading to the creation of a trade and investment system in Bolivia, has been the establishment of the Sistema Boliviano de Productividad y Competitividad, with funding from multilateral agencies as the Inter American Development Bank (IDB), the Andean Development Corporation (CAF) and the World Bank, and bilateral co-operation from the Department For International Development (DFID) of the British Government, the Dutch Cooperation Agency and the Swiss Government through the State Secretariat for Economic Affairs (SECO).

The Sistema Boliviano de Productividad y Competitividad was organized by the Ministry of Economic Development and includes the participation of The Ministries of

Foreign Trade and Investments as well as Agriculture. Its main objective is generating an adequate level of institutional co-ordination between both, the public and the private sector for effective policy design aiming at strengthening the Bolivian productive capabilities.

In addition, the Inter American Development Bank's Multilateral Investment Fund MIF is currently implementing two main projects: the Mechanism Development Program for Exports and Investment Promotion Program. As a result, the Bolivian Investment and Export Promotion Center (CEPROBOL) was created, bringing about a strategic alliance between the private and public sector. In addition, the Ministry of Foreign Trade and Investments was strengthened and the Commercial Information and Business Opportunity System (SICON) was created. Under the strategic alliance between the public and private sector, the Export and Investment Office (Casa del Empresario) was established to provide all foreign trade services under one roof.

The European Union is implementing its ALINVEST Program which supports international investment and trade by establishing Eurocenters in selected Latin American countries. The Bolivian Eurocenter is located at the Chamber of Commerce (CAINCO) in Santa Cruz.

Swiss cooperation has supported a two- year Negotiation Skills Program, which has successfully trained 60 government employees providing them with proper negotiating skills. In addition, the Sistema de Ventanilla Única para Exportaciones (SIVEX) was established to increase operation efficiency and included developing an export manual, provision specific operations training, analysis of World Trade Organization (WTO) regulations and the creation and implementation of a computer system for certificates of origin.

Throughout the International Trade Center (UNCTAD-WTO) of Geneva, the Swiss co-operation with the Ministry of Foreign Trade and Investment through CEPROBOL and the participation of export organizations as CADEX of Santa Cruz, established a US$ 2.4 million, four – year program, and an E-Commerce project with the purpose of promoting the use of B2B electronic commerce between Bolivian exporters and potential overseas buyers is also under current implementation.

With IDB's MIF funding the Venture Capital Project focuses on investing in shares of Bolivian enterprises considered with potential to become highly profitable. Investors in these funds are not allowed ownership of more than 50% of the stocks. This venture capital fund is administered by the Small Enterprises Assistance Fund SEAF and its purpose is to demonstrate the benefits and viability of investing in small and medium enterprises. Support to this fund has proven to be highly successful for small enterprises that otherwise would be financially unable to develop or growth; most of the selected enterprises are now profitable, have increased exports and are expected in the near future to enter the stock market.

Until 1993 the Swedish Cooperation focused on establishing strategic alliances in Bolivia in order to increase export capabilities, investments and trade. Subsequent analysis led them to conclude that Bolivia's business environment was not appropriate for this mechanism, as such; the strategy was changed to focus on building an institutional basis to deal with those constraints. This new approach has been effective. Some of the achievements of this new approach are: a Stock Market Law (Ley de Mercado de Valores), which provided enterprises the legal framework to obtain funding through the capital market, promoted the need for modifications of Bolivia's Commercial Code, as well as the establishment of new organizations related to the Capital Market and a Stock Exchange Training Program, which was aimed mainly to local journalists and key decision makers of large Bolivian corporations. In addition, the projects in implementation are: the amendment of the Commercial Code, and the standardization of corporate financial and accounting information (balance sheets) to European formats.

LESSONS FROM CHILE

The Chilean experience with developing an institutional structure to support exports provides two models we believe are useful for Bolivia. The first one is CORFO, mostly focusing on encouraging competitiveness (efficiency and productivity). The second is The Fundación Chile, the most important institution in Chile for product development.

The following are the profiles of both organizations:

CORFO

The Chilean Economic Development Agency (CORFO) was founded in 1939 and is responsible for promoting productive activities in Chile.

It promotes economic development in Chile by encouraging competitiveness and investment, contributing to the generation of more and better jobs and equal opportunity for productive modernization.

CORFO directs its activities in the following areas:

a) Innovation and technological development.

b) Modernization of companies that form alliances to compete.

c) Improvement of business management practices.

d) Financing and development of financial instruments that meet business needs.

e) Productive development in regions and emerging industries.

CORFO makes various financial instruments available to the business community, including long-term credits and co-financing. Co-financing partially covers the cost of business modernization efforts. CORFO requires companies to make a growing contribution over time to ensure that the initiatives that are supported are of real use to the beneficiaries.
To improve its efficiency, CORFO has established a Collaborative Network made up of Chilean and foreign institutions that contribute to business development efforts. Part of this network includes domestic private organizations whose participation allows a wider coverage of productive development, a more skilled administration of funding, and a more precise knowledge of business needs.

Fundación Chile

The Fundación Chile is a private, non-profit institution, created in 1976 by the Chilean Government and ITT Corporation of the United States. Its mission is to contribute to market innovation and technology transfer in goods and services in order to add economic value to Chilean products.

Fundación Chile mainly undertakes projects that involve technology transfer, institutional articulation and added value in productive sectors based on renewable natural resources. It also fosters the development of human resources. Most of its contributions have added new but proven technologies to the economy.

Now it is promoting the development of companies and clusters in the following sectors: Agribusiness; Aquaculture Fisheries Industries; Forestry Wood Products Industry; Ecotourism.

It also boosts human resources productivity with: New information and telecommunications technologies; the use of new technologies in education (Internet); innovation in educational management; certification of job skills, Continued and long-distance learning.

Its mission is to contribute to the innovation in markets for goods and services and to the transfer of technologies aimed at providing Chile with added economic value

Its vision is to become the country's leading technology institution, recognized nationally and internationally for the creation and dissemination of innovative businesses that significantly impact the institution's target sectors. In this way, Fundación will generate business development and productive job opportunities to improve the quality of life.

SUGGESTED AID INTERVENTIONS

Aid interventions should be geared towards developing the institutional structure for a national development strategy as outlined above. This would imply:

- Participation in and generation of a national growth strategy and a complementary national policy and institutional structure.

- Participation in the design and implementation of:
    - A national Industrial Strategy and related policies.
    - A set of laws to promote entrepreneurial initiative and human resource development.
    - A national Competitiveness Network, including a National Competitiveness Center. The proposal is to develop CORFO (Chile) and Fundación-Chile style institutions, which would include the agricultural experiences of SIBTA.

- National Development Strategy Meetings, to be implemented by the board of directors of the National Competitiveness Center.

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Bolivian Civil Code.

Bolivian Code of Civil Procedure.

Bolivian Commercial Code

Bolivian Constitution.

Bolivian Investment Law.

Bolivian Labour Law.

Bolivian Law of Judicial Organization.

Bolivian Sectorial Regulatory System Law (SIRESE)

Bolivian Tax Code.

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ANNEX 1

GLOBAL COMPETITIVENESS RANKINGS

Competitiveness Index (GCI)

Country	GCI 2001	GCI 2000
Finland	1	5
United States	2	1
Canada	3	6
Singapore	4	2
Australia	5	11
Norway	6	15
Taiwan	7	10
Netherlands	8	3
Sweden	9	12
New Zealand	10	19
Ireland	11	4
United Kingdom	12	8
Hon Kong SAR	13	7
Denmark	14	13
Switzerland	15	9
Iceland	16	23
Germany	17	14
Austria	18	17
Belgium	19	16
France	20	21
Japan	21	20
Spain	22	26
Korea	23	28
Israel	24	18
Portugal	25	22
Italy	26	29
Chile	27	27
Hungary	28	25
Estonia	29	-
Malaysia	30	24
Slovenia	31	-
Mauritius	32	35
Thailand	33	30
South Africa	34	32
Costa Rica	35	37
Greece	36	33
Czech Republic	37	31
Trinidad y Tobago	38	-

Current Competitiveness Index (CCI)

Country	CCI 2001	CCI 2000
Finland	1	1
United States	2	2
Netherlands	3	4
Germany	4	3
Switzerland	5	5
Sweden	6	7
United Kingdom	7	8
Denmark	8	6
Australia	9	10
Singapore	10	9
Canada	11	11
France	12	15
Austria	13	13
Belgium	14	12
Japan	15	14
Iceland	16	17
Israel	17	18
Hon Kong SAR	18	16
Norway	19	20
New Zealand	20	19
Taiwan	21	21
Ireland	22	22
Spain	23	23
Italy	24	24
South Africa	25	25
Hungary	26	32
Estonia	27	-
Korea	28	27
Chile	29	26
Brazil	30	31
Portugal	31	28
Slovenia	32	-
Turkey	33	29
Trinidad y Tobago	34	-
Czech Republic	35	34
India	36	37
Malaysia	37	30
Thailand	38	40

China	39	40
Slovak Republic	40	38
Poland	41	34
Mexico	42	42
Lithuania	43	-
Brazil	44	45
Jordan	45	46
Uruguay	46	-
Latvia	47	-
Philippines	48	36
Argentina	49	44
Domican Republic	50	-
Egypt	51	41
Jamaica	52	-
Panama	53	-
Turkey	54	39
Peru	55	47
Romania	56	-
India	57	48
El Salvador	58	49
Bulgaria	59	57
Vietnam	60	52
Sri Lanka	61	-
Venezuela	62	53
Russia	63	54
Indonesia	64	43
Colombia	65	51
Guatemala	66	-
Bolivia	67	50
Ecuador	68	58
Ukraine	69	56
Honduras	70	-
Bangladesh	71	-
Paraguay	72	-
Nicaragua	73	-
Nigeria	74	-
Zimbabwe	75	55

Slovak Republic	39	36
Jamaica	40	-
Poland	41	41
Latvia	42	-
Greece	43	33
Jordan	44	35
Egypt	45	39
Uruguay	46	-
China	47	44
Panama	48	-
Lithuania	49	-
Costa Rica	50	43
Mexico	51	42
Mauritius	52	38
Argentina	53	45
Philippines	54	46
Indonesia	55	47
Colombia	56	48
Sri Lanka	57	-
Russia	58	52
Domican Republic	59	-
Ukraine	60	56
Romania	61	-
Vietnam	62	53
Peru	63	49
El Salvador	64	51
Zimbabwe	65	50
Venezuela	66	54
Nigeria	67	-
Bulgaria	68	55
Guatemala	69	-
Paraguay	70	-
Nicaragua	71	-
Ecuador	72	57
Bangladesh	73	-
Honduras	74	-
Bolivia	75	58

Source: Global Competitiveness Report 2001

ANNEX 2

BOLIVIA: SOCIAL INDICATORS

Indicator	Base Year	Current Year	Reference Period
Population			
Total population (millions of inhabitants)	7.4	8.3	(1995-2000)
Overall fertility rate (no. of children per mother)	4.6	4.1	(1995-2000)
Life expectancy at birth (no. of years)	60.4	62.5	(1995-2000)
Mortality rate (per thousands)	9.6	8.6	
Poverty			
National (% of total population)	70.2	61.2	(1992-2000)
Urban area	51.5	49.5	(1992-2000)
Rural area	94.2	81.8	(1992-2000)
Employment			
Gross labor force participation (%)	40.9	44.4	(1995-1999)
Overall labor force participation rate (%)	55.1	55.9	(1995-2000)
Open unemployment rate (%)	3.6	7.6	(1995-2000)
Public expenditure			
Social expenditure (% of total public expenditure)	36.3	53.4	(1995-2000)
Social expenditure (% of GDP)	12.3	17.2	(1995-2000)
Health (% of GDP)	3.1	3.6	(1995-2000)
Health (% of total public expenditure)	9.2	11.2	(1995-2000)
Education (% of GDP)	5.2	6.3	(1995-2000)
Education (% of total public expenditure)	15.5	19.6	(1995-2000)
Basic sanitation (% of GDP)	0.7	1.1	(1995-2000)
Urbanization (% of GDP)	1.1	0.6	(1995-2000)
Rural development (% of GDP)	0.7	1.3	(1995-2000)
Pensions (% of GDP)	1.3	4.1	(1995-2000)
AFP's and FONVIS contributions (% of GDP)	0.1	0.3	(1995-2000)
Education			
Illiteracy rate (%)	20.0	14.8	(1992-1999)
Public school gross rate of coverage	72.4	77.0	(1996-2000)
Preschool	6.5	41.9	(1996-2000)
Primary	96.4	97.6	(1996-2000)
Secondary	40.4	51.7	(1996-2000)
Average years used to complete 5th grade	11.0	7.0	(1997-2000)
Students who completed 8th grade (%)			
Urban area	28.6	64.5	(1997-2000)
Rural area	8.2	29.2	(1997-2000)

Indicator	Base Year	Current Year	Reference Period

Primary school promotion rate	83.4	89.2	(1997-2000)
Primary school drop-out rate	8.2	6.1	(1996-2000)
Secondary school drop-out rate	11.6	9.9	(1995-2000)
Repetition rate	7.0	4.9	(1997-2000)
Public spending on primary school (millions of bolivianos)	249	1,122	(1990-1999)
(in % of GDP)	1.6	2.3	(1990-1999)
Human resources			
No. of teachers	80,662	84,180	(1997-2000)
No. of primary school teachers	61,451	64,301	(1997-2000)
Pupil/teacher ratio in primary school	24.6	26.1	(1997-2000)
Physical resources			
No. of public educational buildings	11,592	12,087	(1996-1999)
No. of public educational units	13,141	13,935	(1996-1999)
No. of students per educational unit	156.0	158.8	(1997-1999)
Health and disease prevention			
Immunization (% of children under 1 year)			
Polio	70.9	89.0	(1996-2000)
DPT (first dose)	82.9	98.1	(1996-2000)
DPT (third dose)	70.5	89.0	(1996-2000)
BCG	85.4	94.7	(1996-2000)
Prevalence of malnutrition in children under 5 years	9.5	8.1	(1996-2000)
Urban area	6.9	6.1	(1996-2000)
Rural area	10.9	9.3	(1996-2000)
Infant mortality rate (per thousand live births)	68.5	60.6	(1996-2000)
Births attended by health staff (% of total)	32.5	53.0	(1996-2001)
Pneumonia cases attended by health staff (% of total)	39.0	97.0	(1996-2001)
No. of hospital beds (per thousand inhabitants)	1.3	1.4	(1996-1999)
No. of health establishments (per 10,000 inhabitants)	2.8	3.3	(1996-2000)
Housing quality and access to services			
Electric energy availability (% of total)	55.0	70.0	(1992-2000)
Urban	87.0	95.9	(1992-2000)
Rural	16.0	24.9	(1992-2000)
Access to water through pipelines (% of total)	53.9	70.2	(1992-2000)
Urban	81.4	90.1	(1992-2000)
Rural	19.2	35.6	(1992-2000)
Income			
Gross national income, per capita (in US$)	740	975	(1990-2001)

Source: National Institute of Statistics, UPF, SNIS-Health Ministry and Education Ministry.

ANNEX 3

BOLIVIA: KEY ECONOMIC INDICATORS

Indicator	Actual 1996	1997	1998	1999	Estimate 2000	2001	Projected 2002	2003	2004
National Accounts (as % of GDP)									
Gross domestic product [a]	100	100	100	100	100	100	100	100	100
Agriculture	20	21	17	20	22	23	23	24	23
Industry	19	17	18	17	15	17	18	19	20
Services	61	61	65	63	63	60	59	57	57
Total consumption	88	89	89	92	89	90	89	88	88
Gross domestic fixed investment	16	20	24	18	18	17	20	20	20
Government investment	..	6	5	7	7	7	8	8	8
Private investment	..	14	19	11	11	10	12	12	12
Exports (GNFS)[b]	23	21	20	17	18	18	19	21	22
Imports (GNFS)	27	29	33	27	25	26	27	29	30
Gross national savings [c]	12	13	13	11	13	12	14	14	15
Memorandum items									
Gross domestic product (US$ million at current prices)	7375	7902	8419	8265	8281	7938	7774	7791	7941
GNP per capita (US$, Atlas method)	..	..	..	..	..	..	..	..	..
Real annual growth rates (%, calculated from 1990 prices)									
Gross domestic product at market prices	4.4	5.0	5.2	0.4	2.4	1.0	2.8	3.0	4.0
Balance of Payments (US$ millions)									
Exports (GNFS)[b]	1314	1413	1355	1310	1453	1441	1510	1614	1760
Merchandise FOB	1128	1166	1104	1051	1230	1210	1270	1364	1499
Imports (GNFS)[b]	1779	2062	2200	1989	2078	2031	2129	2261	2377
Merchandise FOB	1578	1851	1983	1755	1830	1767	1858	1981	2091
Resource balance	-465	-649	-845	-678	-624	-591	-619	-646	-617
Net current transfers	245	292	340	386	387	397	384	379	372
Current account balance	-389	-554	-667	-488	-463	-389	-414	-439	-404
Net private foreign direct investment	426	599	955	1014	693	647	675	789	769
Change in reserves [d]	-342	-103	-128	-42	23	0	143	-59	-94
Memorandum items									
Resource balance (% of GDP)	-6.3	-8.2	-10.0	-8.2	-7.5	-7.4	-8.0	-8.3	-7.8

Indicator	Actual				Estimate	Projected			
	1996	1997	1998	1999	2000	2001	2002	2003	2004
Public Finance (as % of GDP at Market Prices)[e]									
Current revenues	24.7	23.1	24.6	25.0	25.3	25.2	26.5	27.6	28.1
Current expenditures	18.6	20.1	22.9	22.2	22.5	24.5	24.5	24.1	24.2
Current account surplus (+) or deficit (-)	6.1	3.0	1.7	2.9	2.8	0.7	2.0	3.5	3.9
Capital expenditure	8.2	7.2	7.1	7.1	7.2	7.4	7.7	7.8	7.8
Overall NFPS balance surplus (+) or deficit (-)	-1.9	-3.3	-4.7	-3.5	-3.8	-6.7	-5.4	-4.3	-3.8
Monetary Indicators									
M2/GDP	..	..	..	..	44.3	44.4	44.2	43.5	42.4
Growth of M2 (%)	..	..	..	..	3.4	3.9	5.0	3.9	3.9
Price Indices(YR90 =100)									
Merchandise export price index	81.8	81.0	75.5	71.0	73.3	..	..	..	..
Merchandise import price index	121.1	120.0	118.4	117.2	118.8	..	..	..	..
Merchandise terms of trade index	67.5	67.5	63.7	60.6	61.8	..	..	..	..
Real exchange rate (US$/LCU)[f]	89.5	90.6	94.0	95.3	93.4	..	..	..	..
Consumer price index (% change)	7.9	6.7	4.4	3.1	3.4	1.0	2.5	3.5	3.7

a. GDP at market prices.
b. "GNFS" denotes "goods and nonfactor services."
c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.
e. Consolidated central government.

f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

ANNEX 4

BOLIVIA: FIFTEEN YEARS OF STRUCTURAL REFORMS

Year	Policy.	Objective	Achievement
1985	DS 21060: Stabilization and structural reform of the economy.	Macroeconomic stability and economic growth.	Low inflation rates and moderate economic growth.
1986	Standard imports tariff: Opening the economy.	Improve competitiveness.	Acquisition of new fixed assets and new inputs for export.
	Paris Club I agreements: Restructuring of bilateral external debt.	External debt relief.	More resources available for social sector.
	Tax Reform: Increase tax revenues.	Adequate functioning of government finances. Simplification of tax structure	Increase in tax revenues.
1987	Financial reform: regulation, supervision and support for the banking sector.	Improved functioning of financial system.	Increase in the public bank deposits.
	Liberalization of labor market.	Better functioning of labor market.	Decline in open unemployment rates.
1990	SAFCO Law: budgetary reform, administration and control of government resources.	Efficient use of public resources.	Greater degree of oversight.
	Investment Law: rules for domestic and foreign investment.	Investment increase.	Increased investment rates.
	Law on Hydrocarbons: legal framework for the development and exploration of the hydrocarbons fields.	Better use of resources. Expansion of country's energy base.	More investment in the sector, expansion of hydrocarbons reserves, and strengthening of a strategic sector for national development.
1991	Updating of the Mining Code: legal framework for investment in the sector.	Promote investment in the sector.	Increase in exploration activities. One of the largest silver deposits in the world was found (San Cristobal mine).
	Law of the Tax Code	Improve efficiency of taxation. Increase tax revenues.	Increased tax ratio.
	Free Zone Regime: promotion of manufacturing activities.	Development of manufacturing industry.	Increase in the rate of growth of industrial sector.
1992	Privatization Law: divestiture of public enterprises.	Improve and redistribute fiscal resources.	Greater resources available for the social sector.
1993	Exports Law: international trade liberalization.	Increase in exports.	Increase and diversification of exports.
	General Banking Law: regulation of the financial system.	Strengthen financial system.	A more reliable financial system.
1994	Capitalization Law: sell of shares of public enterprises.	Better distribution of fiscal resources, generate higher domestic savings.	Larger Foreign Direct Investment flows.
	Popular Participation Law: redistribution of income.	Greater social participation in the definition of public policies.	Better allocation of resources.
	Law on Education Reform: improve quality and coverage of education.	Better coverage and quality of public education.	Better coverage. Higher retention rates.
1995	Law on Administrative Decentralization: assign new functions to levels of the government.	Improved administration of the public sector.	Increased investment at municipal level.
	Central Bank Law	Improved monetary management	Increase independence of the Central Bank.
1996	Pension Law: savings and individual capitalization of contributions.	Strength social insurance system.	Increase savings for long-term social insurance.
	INRA Law: regularization of agricultural land tenure (*).	Improve living conditions of rural population. Guarantee the property rights in rural areas. Include population in eastern part of the country and participation of women	Progress in the regularization of first people's land.

Year	Policy.	Objective	Achievement
		in land ownership.	
1997	Reforms in health sector, implementation of SNMN	Improve mother/child services.	Better coverage of services.
	Judicial Reform: Public Defender's Office, Judicial Council, Constitutional Court, and Supreme Court.	Improve access to justice system. Active participation in civil society.	Greater equity in access to justice system.
1998	Initiation of health reform, implementation of SBS (*Seguro Básico de Salud*) and Epidemiological Shield.	Free new services for general population. Continued improvement in mother/child services. Control of main endemic diseases (Chagas disease, malaria, tuberculosis).	Increase in mother/child services. Increased prevention, diagnosis, and treatment activities for main endemic diseases.
	Law on Securities Market: support for securities market.	Strength financial system.	Greater participation of large enterprises in securities exchange.
	Law on Property and Popular Credit: increase microcredit.	Improve conditions for small enterprises. Democratization of credit.	
2000	Customs Law, Customs reform.	Improve collections and the institutional structure of National Customs.	Reduction of smuggling.
	Civil Service Law.	Improve institutional structure o public sector.	Anticipated impact: improved performance pf public sector.
2001	Institutionalization of National Roads Service Law.	Improve roads management and reduce corruption	Well-managed national road network.
	Institutionalization of Internal Revenue Service Law and New Tax Code.	Improve transparency, efficiency, and management of tax system under consolidated cash management system.	Increase domestic income tax collections.
	National Dialogue Law.	Institutionalization of the PRSP and decentralization reform deepening.	Improved provision of public services.

(*) Currently, in revision and consensus being sought between authorities and beneficiaries following social unrest of

ANNEX 5

OVERVIEW OF THE FTAA PROCESS

The effort to unite the economies of the Western Hemisphere into a single free trade agreement began at the Summit of the Americas, which was held in December, 1994 in Miami. The Heads of State and Government of the 34 democracies in the region agreed to construct a Free Trade Area of the Americas, or FTAA, in which barriers to trade and investment will be progressively eliminated, and to complete negotiations for the agreement by 2005. The leaders also committed to achieve substantial progress toward building the FTAA by 2000. Their decisions are contained in the Miami Summit's Declaration of Principles and Plan of Action.

Four ministerial meetings took place during the preparatory phase of the FTAA process: the first was in June 1995 in Denver, USA, the second in March 1996 in Cartagena, Colombia, the third in May 1997 in Belo Horizonte, Brazil and the fourth in March 1998 in San José, Costa Rica. At their meeting in San José, Ministers recommended to their Heads of State and Government the initiation of negotiations and set out the structure and general principles and objectives to guide the negotiations. On the basis of the San José Declaration, the FTAA negotiations were launched formally in April 1998, at the Second Summit of the Americas in Santiago, Chile. The leaders agreed that the FTAA negotiating process be transparent and take into account the differences in the levels of development and size of the economies in the Americas, in order to facilitate full participation by all countries.

The fifth Ministerial meeting – the first since negotiations were formally initiated —took place in Toronto in November 1999. At this meeting, Ministers instructed the Negotiating Groups to prepare a draft text of their respective chapters, to be presented at the sixth Ministerial meeting in Buenos Aires in April 2001. Groups responsible for market access issues were directed to discuss the modalities and procedures for negotiations in their respective areas. Ministers also approved several business facilitation measures, designed to facilitate commercial exchange in the Hemisphere, particularly in the area of customs procedures.

At the sixth Ministerial meeting, held in Buenos Aires, and at the Third Summit of the Americas held in Quebec City in April 2001, a number of key decisions were made regarding the FTAA negotiations. Ministers received from the Negotiating Groups a draft text of the FTAA Agreement, and, in an unprecedented move designed to increase the transparency of the process, recommended to their heads of State and Government to make this text publicly available. The draft FTAA agreement was made available to the public in all four official languages on July 3, 2001. Ministers also highlighted the need to foster dialogue with Civil Society, and the summaries of the second round of Civil Society submissions in response to the open invitation were agreed to be placed on the FTAA Website. Ministers reiterated the importance of the provision of technical assistance to smaller economies to facilitate their participation in the FTAA.

Deadlines were fixed for the conclusion and implementation of the FTAA Agreement. Negotiations are to be concluded no later than January 2005; entry into force will be sought as soon as possible thereafter, no later than December, 2005.

Deadlines were also set for the market access negotiations. Recommendations on the methods and modalities for tariff negotiations are to be completed by April 1, 2002, and tariff negotiations will be initiated no later than May 15, 2002. A second version of the draft FTAA Agreement is to be prepared during the third negotiating phase, which ends in October 2002 at the 7th Ministerial meeting, to be held in Ecuador.

Guiding Principles of the FTAA Negotiations

A number of agreed principles guide the negotiations. These include, among others:

- decisions will be taken by consensus;
- negotiations will be conducted in a transparent manner;
- the FTAA will be consistent with WTO rules and disciplines, and should improve upon these rules and disciplines wherever possible and appropriate;
- the FTAA will be a single undertaking ("nothing is agreed until all is agreed");
- the FTAA can coexist with bilateral and sub-regional agreements and countries may negotiate and accept the obligations of the FTAA individually or as members of a sub-regional integration group; and
- special attention will be given to the needs of the smaller economies.

Structure and Organization of the FTAA Negotiations

The FTAA negotiations are carried out under an agreed structure that is member-driven and ensures broad geographical participation. The Chairmanship of the entire process, the site of the negotiations themselves, as well as the Chairs and Vice Chairs of the various negotiating groups and other committees and groups, all rotate among participating countries.

Chairmanship of the Negotiations: rotates every eighteen months, or at the conclusion of each Ministerial meeting. The following countries have been designated to serve as Chair of the FTAA process for successive periods: Canada; Argentina; Ecuador; as well as Brazil and the United States (jointly).

The Ministers Responsible for Trade exercise the ultimate oversight and management of the negotiations. They meet generally every eighteen months and, since the negotiations were launched, do so in the country which is holding the FTAA Chairmanship.

The Vice Ministers Responsible for Trade, who as the Trade Negotiations Committee (TNC), have a central role in managing the FTAA negotiations. The TNC guides the work of the negotiating groups and other committees and groups and decides on the overall architecture of the agreement and institutional issues. The TNC is also responsible for ensuring the full participation of all the countries in the FTAA process, ensuring transparency in the negotiations, overseeing the administrative secretariat, and overseeing the identification and implementation of business facilitation measures. The Committee meets as required and no less than twice a year at rotating sites throughout the hemisphere.

Nine FTAA Negotiating Groups, which have specific mandates from Ministers and the TNC to negotiate text in their subject areas. They were established for market access; investment; services; government procurement; dispute settlement; agriculture; intellectual property rights; subsidies, antidumping and countervailing duties; and competition policy. The negotiating groups meet regularly throughout the year.

Three Committees and Groups address horizontal issues related to the negotiations.
A **Consultative Group on Smaller Economies** follows the progress in the negotiations with regard to the concerns and interests of the smaller economies and makes recommendations to the TNC. The Group has sought to determine the needs of smaller economies for trade-related technical assistance in their participation in the FTAA and to disseminate information about sources of such technical assistance. These databases have been made available through the FTAA homepage. In addition to these databases, the Tripartite Committee manages the Trade Education Database (TED), "an inventory of training opportunities available in FTAA-relevant areas of trade policy and negotiation for both government officials and the private sector in the region in order to facilitate access to technical assistance" as mandated by Ministers at the Toronto Ministerial meeting.

To further transparency in the negotiating process and to broaden public understanding and support for the FTAA, Ministers created the **Committee of Government Representatives on the Participation of Civil Society**. The purpose of this Committee is to facilitate the input of the business community, labor, environmental, academic groups, and others who wish to present their views on the issues under negotiation and on trade matters in a constructive manner. The FTAA is the first major trade negotiation where such a group has been established at the outset of the negotiations.

During the first phase of negotiations, the FTAA Committee of Government Representatives on the Participation of Civil Society issued its initial Open Invitation to Civil Society. This invitation called on interested parties to share their views on the FTAA process in a constructive manner. The submissions were studied by the Committee of Government Representatives on the Participation of Civil Society, who forwarded executive summaries of these positions to Ministers, and prepared a report outlining the range of views received in response to the open invitation. At the Toronto Ministerial, Ministers received this report and requested the Committee to "obtain ongoing input from Civil Society on trade matters relevant to the FTAA." A second Open Invitation was issued after the Toronto Ministerial, and the Committee was again asked to summarize the range of views and forward this to Ministers. The Committee's second report, including the executive summaries of the submissions received by Civil Society groups, was made publicly available on the FTAA Website after the Buenos Aires Ministerial meeting, at which Ministers urged "civil society to continue to make its contributions in a constructive manner on trade-related issues of relevance to the FTAA". The Open Invitation to Civil Society was extended permanently.

Another unique feature of the FTAA process is the **Joint Government-Private Sector Committee of Experts on Electronic Commerce** established to study how to broaden the benefits to be derived from the electronic marketplace in the hemisphere, and how to deal with this cross-cutting issue within the negotiations.

An ad hoc group of experts was established to report to the TNC on the implementation of the customs-related **business facilitation measures** agreed upon at Toronto. These measures, which do not require legislative approval but can be implemented administratively, are designed to facilitate commercial exchange within the Americas, and indeed benefit all traders. The transparency-related measures, initiatives to increase the flow of information about trade and trade-related issues among the countries of the Americas, are disseminated through the FTAA Homepage.

Technical and Analytical Support: The Tripartite Committee, which consists of the Inter-American Development Bank (IDB), the Organization of American States (OAS) and the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) provides analytical, technical and financial support to the process and maintains the official FTAA Website. The individual Tripartite institutions also provide technical assistance related to FTAA issues, particularly for the smaller economies of the Hemisphere.

Administrative Support: The FTAA Administrative Secretariat, located in the same site as the meetings of the negotiating groups, provides administrative and logistical support to the negotiations. It keeps the official archives of the negotiations, and provides translation and interpretation services. The Secretariat is funded by a combination of local resources and the Tripartite Committee institutions.

Venue of the Negotiations: has also been established on a rotating basis. Three countries have been designated as hosts of the negotiations, namely: the United States (Miami) from May 1998 to February 2001; Panama (Panama City) from March 2001 to February 2003; and Mexico (Mexico City) from March 2003 to December 2004.

ANNEX 6

COMMERCIAL DEFICIT WITH POTENTIAL FTAA COUNTRIES (EXPRESSED IN US$ 000s)

No.	COUNTRIES	1999			2000 (p)		
		EXPORT Value Official	IMPORT Value CIF	Commercial Deficit	EXPORT Value Official	IMPORT Value CIF	Commercial Deficit
1	ANTIGUA & BARBUDA	0	9	(9)	0	0	0
2	ARGENTINA	52324	187840	(135517)	28242	302709	(274467)
3	BAHAMAS	20	11	9	49	66	(17)
4	BARBADOS	71	0	71	29	7	22
5	BELIZE	0	7	(7)	0	0	0
6	BRAZIL	37079	207420	(170342)	157744	278764	(121020)
7	CANADA	6069	12728	(6660)	6187	14015	(7829)
8	CHILE	24274	97132	(72858)	25562	163077	(137516)
9	COLOMBIA	133280	32631	100649	195989	46966	149023
10	COSTA RICA	138	386	(248)	157	408	(251)
11	DOMINICAN	S/C	S/C	S/C	S/C	S/C	S/C
12	DOMINICAN REPUBLIC	437	9	428	1189	139	1050
13	ECUADOR	5534	5080	454	4680	8161	(3481)
14	EL SALVADOR	40	74	(34)	8	124	(117)
15	USA	222437	399844	(177407)	191918	430590	(238672)
16	MEXICO	4303	34414	(30111)	6230	45719	(39489)
17	GRENADA	S/C	S/C	S/C	S/C	S/C	S/C
18	GUATEMALA	5	96	(91)	18	119	(101)
19	GUYANA	S/C	S/C	S/C	S/C	S/C	S/C
20	HAITI	0	0	0	0	11	(11)
21	HONDURAS	25	40	(15)	73	10	63
22	JAMAICA	0	10	(10)	0	5	(5)
23	NICARAGUA	65	42	23	33	30	3
24	PANAMA	1020	5185	(4165)	1172	5115	(3943)
25	PARAGUAY	1819	2288	(469)	2103	26755	(24652)
26	PERU	69143	68468	675	57232	98763	(41531)
27	ST. KITTS & NEVIS	0	0	0	24	0	24
28	SANTA LUCIA	S/C	S/C	S/C	S/C	S/C	S/C
29	ST. VINCENT & THE GRENADINES	0	1	(1)	0	3	(3)
30	SURINAME	S/C	S/C	S/C	S/C	S/C	S/C
31	TRINIDAD & TOBAGO	0	501	(501)	16	256	(241)
32	URUGUAY (*)	74530	6266	68265	69197	3716	65480
33	VENEZUELA	17385	15659	1726	49871	14315	35556
TOTAL BOLIVIAN TRADE WITH FTAA COUNTRIES		**649998**	**1076141**	**(426143**	**797721**	**1439847**	**(642125)**
TOTAL BOLIVIAN TRADE WITH THE WORLD		**1040869**	**1854472**	**(813603)**	**1242944**	**1976611**	**(733666)**
CURRENT IMPORTANCE OF THE FTAA FOR BOLIVIA		**62.45**	**58.03**	**52.38**	**64.18**	**72.84**	**87.52**

Source: IBCE using data from INE / Viceministry of Exports (Ministry of foreign Trade and Investment).
(*) Includes exports in transit to third countries.
(p) Preliminary data
Note: Does not include re-exports or personal effects

ANNEX 7

ANALYSIS OF LAC/RSD AND USAID/PERU COLLABORATIVE INITIATIVE ON CONTINUED PARTICIPATION OF LAC SUBREGIONAL TRADING BLOCS IN THE FREE TRADE AREA OF THE AMERICAS

The proposal concentrates on two objectives: i) to strengthen CAN countries capacities to comply with existing World Trade Organization (WTO) and emerging FTAA-related rules of trade and ii) to strengthen the regional capacity of the General Secretariat of the CAN to assist countries in preparing for FTAA-related trade negotiations. Under the first objective, the proposal suggests, on the one hand, that USAID supports Andean countries with technical assistance to comply with rules of trade, which includes sanitary and phytosanitary measures, competition policy, government procurement and WTO Customs Valuation Agreement, and, on the other, that USAID provides training for trade negotiators.

The proposal presented by LAC/SRD was prepared in coordination with the Andean Community General Secretariat and is consistent with the views held by this multilateral institution with regards to the requirements that Andean countries have to successfully negotiate and participate in the FTAA process. From a Bolivian perspective, the proposal outlines and provides answers to three very important areas where the country experiences a shortfall, particularly the lack of technical assistance to comply with sanitary and phytosanitary measures imposed by third countries to Bolivian exports, valuation of imports under the WTO Customs Agreement and the shortage of qualified trade negotiators. In that respect, the objectives and proposed actions outlined in the document are extremely relevant to Bolivian needs.

However, as it was outlined in chapter three, the Andean countries - and particularly Bolivia – depend for its international trade negotiations usually on single government departments and, in some cases, on two or three officials that undertake the representation for the whole country in the negotiating table. Additionally, and this applies above all to Bolivia, these officials do not generally undertake a comprehensive process of consultation with the different actors affected by the negotiations, such as firms, exporters, importers, producers and consumers. Consequently, the results are usually perceived as poor and contrary to the interests of the private sector in the country.

It is for this reason, that in addition to the proposed activities prepared by the LAC/SRD we, the team of consultants, suggest that an important component of this program could be the establishment in each of the Andean countries – and with priority in Bolivia – of a permanent structure for formal consultations and exchange of information between the private and public sector, organized across different sectors and with groups of teams working in different areas, such as market access, technical barriers to trade, intellectual property rights, etc. This structure should encourage a broader participation of society in the integration processes pending of negotiation and the commercial agreements that the country has to sign in the future, particularly FTAA.

Finally, we believe that such a structure would allow for the generation of a more informed and better designed negotiating strategy, the optimization of the desired outcomes and should, also, legitimate the results obtained in the eyes of the population.