■ BOLIVIA

Economic model limits change

Public investment has increased but not significantly so in the social and production sectors. There is still no strategy for redirecting the new resources generated by increased tax pressure and higher priced gas and oil exports to these areas.

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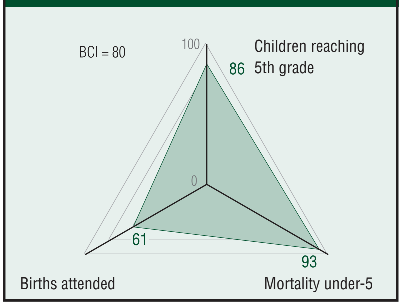
The higher prices of export goods[1] have resulted in increased Gross Domestic Product (GDP) growth from 1.68% in 2001 to 4.06% in 2005. This reflects the Bolivian economy's high level of dependence on the economic performance of industrialized countries.[2]

During the last two years this favourable external context has had a positive effect on the level of internal tax collection and revenue from royalties and taxes on hydrocarbons but has not remedied the fiscal deficit. Although the latter was 1.9% in the middle of the 1990s, in 2002 it reached 9%, the highest in Latin America, due to public expenditure pressures, public income volatility and global economic fluctuations. After that peak the deficit was curtailed – falling to 2% by 2005 – through public expenditure control policies, extraordinary tax collection measures, foreign aid and most significantly new revenue from the Direct Tax on Hydrocarbons (DTH).[3]

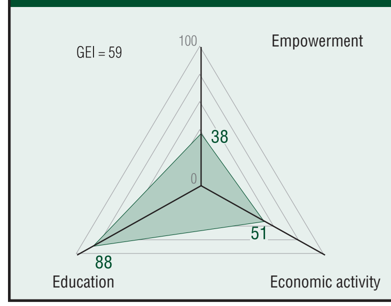
Nevertheless problems with the makeup of public expenditure and income remain unsolved. In 2005 more than 70% of public expenditure went on debt servicing, salaries and pensions. Several aspects of the economy are worrying: the limited growth of public investment in social and production sectors and the high level of dependence on both increased tax pressure (that emphasizes indirect taxes on individual's income) and the behaviour of gas and oil exports and prices.

In June 2006 the Government presented a new Development Plan aimed at reducing poverty by 9%, from 58.9% to 49.7%, extreme poverty from 35.3% to 27.2% and the Gini Coefficient from 0.59 to 0.58, all before 2011.The success of this plan could be threatened by a high dependency on public investment if the generation of employment, the main source of household income, is left to the market.

Basic Capabilities Index (BCI)



Gender Equity Index (GEI)



The fragility of public income

Faced with the need to loosen fiscal policy and strong pressure from social organizations to nationalize the hydrocarbon industry, in 2005 resources from this sector were used to reduce the deficit. Although the tax system structure was maintained, measures geared to more efficient collection were approved and additional taxes were created.

The population has not seen a return on its tax payments in the form of social expenditure on investment for essential services such as health care and education. From 1995 to 1997 health and education expenditure represented 10.24% of GDP while taxes paid by consumers amounted to 12.07% of GDP. In short, the population contributed more than it received in terms of essential public services.

As previously mentioned, in recent years there has been no, or insufficient, public surplus to sustain investment in production and social services.[4] Finally it has to be taken into account that just over 60% of the population live in poverty and that the current tax system is regressive. As a result taxes have a significant effect on most families' consumption.

For the last five years, as was the case in the 1990s, tax collection has been the main source of public income. During this period an average 45% of public income came from tax collection. With the present administration this has risen to 54%.

A second element that has not changed is a dependence on foreign resources. Foreign credits and donations make up almost 32% of total income. Finally, the Other Internal Income category has gradually diminished from 33% in 2000 to 14% in 2004, principally due to the privatization of refineries that reduced income from hydrocarbons sales.

This scenario stems from the economic reforms of the 1990s, especially the privatization of state companies that led to a reduced income from the sale of goods and services.[5] Between 1980 and 1986 such income made up 77% of the total current income while by the period 1997-2004 it had fallen to 18%.[6]

The structure of public income has not significantly changed due to the maintenance of a regressive tax system very susceptible to fluctuations in economic activity and to a continuing high dependence on bilateral and multilateral sources of finance.

The new government and finance

Available fiscal information for the first two months of 2006 shows an overall surplus of approximately BOB 1 billion (USD 128 million), which differs from the first two months of the last six years.[7] However considering the fragility and volatility of public income it is too early to get enthusiastic about this.

The principal elements behind this fiscal surplus in the first two months of the current administration are: a still favourable external context,[8] the orthodox

1 The export prices index registered an increase of 111.5 % between 2000 and 2005.

2 According to a report from the Economic Commission for Latin America and the Caribbean (ECLAC) in 2005 this economic performance will not be maintained.

3 In May 2005 Hydrocarbons Law 3058 was passed. Among other things, it provided for the creation of a direct tax on production, generating revenue for the State of USD 287 million in 2005.

4 In the last three years the average growth rates for investment expenditure in production and social services were -8.4% and -7% respectively (data based on information in USD).

5 Unidad de Análisis de Políticas Sociales y Económicas. *Evaluación de la economía 2000, 2001, 2002.* p. 30, 35, 38.

6 Arze Vargas, Carlos (n.d.). *Crisis fiscal: La insolvencia del estado neoliberal.* CEDLA. The figure of 18% was calculated with data from the Fiscal Programming Unit.

7 Over the last six years January and February have registered an average deficit of BOB 320 million (USD 40.25 million).

8 According to ECLAC in 2005 South America's GDP grew by 4.9%, which is higher than the average growth of industrialized economies calculated by the IMF at 2.5%.

economic policies of previous governments, amongst them rate modifications for the Special Tax on Hydrocarbons and Derived Products (STHD); measures geared to improving tax collection (tax pressure); and fundamentally, the passing of the new Hydrocarbons Law as a result of social pressure.

As Table 1 shows, in 2006 there was an extraordinary growth in public income of almost 40%, mostly due to a 115% growth in the hydrocarbons sector. Comparing January-February 2005 with January-February 2006, the increase in revenue from taxes on hydrocarbons was BOB 860 million (USD 108.2 million), which represents 67.7% of the increase in total public income.

Approximately BOB 800 million (USD 100.6 million) was collected in DTH during the first two-month period of 2006, a figure that represents almost 90% of capital outlay (investments) during that period. When revenue from STHD and royalties is added to this figure it amounts to BOB 1.6 billion (USD 202.3 million), a sum almost twice that spent on investment and representing 36% of total income, 13% more than in 2005.

Regressive tax system

The 14.8% growth in tax revenue is the result of both old and new tax measures but all of them respect and have continuity with the logic of an income management policy oriented towards improving tax efficiency by combating evasion, avoidance and smuggling. It could be said that in general there has been no change or innovation in income policy.

In summary, public income growth in the first two months of 2006 reflects and reaffirms the income policy management logic developed by the State, an orientation that emphasizes greater tax pressure and efficiency while maintaining the regressive nature of the current tax system. In the face of this, changes proposed by the current Government are not apparent, leaving only good intentions but so far no concrete policy.

Still no defined strategy for public expenditure

During the first two months of 2006 public expenditure grew by just 2%, a figure influenced by, among other factors, the reduction of interest payments on internal debt (11%), lower pension expenditure (0.5%), increased expenditure on goods and services (50%) and a growth in capital outlay (25.9%).

Investment expenditure grew by 25.9% because municipalities and prefectures received DTH transfers.[9] Although DTH resources have made an increase in public investment possible, up to now there is no new strategic framework to redirect these new resources to strategic sectors. Such a reorientation would not only involve restructuring public expenditure but also an assessment and identification of public stakeholders or public sector bodies to which DTH resources would be allocated

TABLE 1

Income, expenditure and fiscal deficit (in million BOB)

	2002 JANUARY-FEBRUARY	2006 JANUARY-FEBRUARY	GROWTH (%) 2004 JANUARY-FEBRUARY	GROWTH (%) 2005 JANUARY-FEBRUARY	GROWTH (%) 2006 JANUARY-FEBRUARY	STRUCTURE (%) 2005 JANUARY-FEBRUARY	STRUCTURE (%) 2006 JANUARY-FEBRUARY
Total income	2,475.3	4,470.3	0.8	26.4	39.7	100	100
Current income	2,318.8	4,325.9	-0.02	27.0	41.5	96	97
Capital income	156.5	144.4	-13.3	15.5	1.0	4	3
Total outlay	2,747.6	3,452.3	2.9	11.1	2.0	100	100
Current outlay	2,276.5	2,560.7	-7.8	11.9	-4.3	79	74
Capital outlay	471.2	891.6	20.7	8.1	25.9	21	26
Current surplus/deficit	42.4	1,765.2	-109.1	2,151.0	363.4		
Total surplus/deficit	-272.4	1,018.0	-12.2	-64.2	-652.9		

Source: Calculated with data from the Fiscal Programming Unit.

The figures reflect two aspects:

- The growth in public investment expenditure due to increased hydrocarbons tax collection, which should not imply a deepening of the current regressive tax system.
- Reduced outlay resulting from measures taken within the Austerity and Rationality in Public Expenditure Framework established during Carlos Mesa's government (2003-2004)[10] that are being maintained by the present administration of President Evo Morales, which began this year (2006).[11]

In the first months of 2006 some significant matters have been dealt with very superficially by the present Government but will undoubtedly require greater attention in the medium term and perhaps will be part of the much anticipated management plan:

- External debt cancellation within the framework of the G8 initiative. Although the World Bank has ratified its cancellation and the IMF has already cancelled, it remains to be determined which are the appropriate public sector bodies for the administration of resources accruing from cancellation. This has led to an assessment of municipal governments' efficiency in administering resources liberated by cancellation under the Heavily Indebted Poor Countries initiative. It seems that the Government's attempts to include IDB debts within the framework of G8 cancellation have not produced positive results but it is waiting for an answer regarding this by September 2006.
- DTH resources. These have undoubtedly been fundamental to fiscal deficit reduction and the main enabling element for public expenditure increase. However in the medium term, discussion about the efficient use of these resources could lead to their redistribution, although this may cause conflict with municipal governments.

This detailed analysis of public finance during the first months of 2006 aims to show the trends in Bolivia's economy that the Morales Government inherited, and at the same time to make it clear that improvements have not been generated by public policy reforms but rather by the extraordinary behaviour of the prices for raw materials exported by Bolivia. In general, central aspects of economic policy continue unchanged, as demonstrated by the ongoing restrictive fiscal policy. ■

9 According to the 2006 Budget, DTH resources allocated to investment represent approximately 17% of the investment planned for that year.

10 Supreme Decrees 27327, 27407 and 27450.

11 Supreme Decrees 28609 and 28618.