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BOLIVIA

Strengthening Competitiveness for Export Diversification and Inclusive Growth

Seynabou Sakho[a] and Oscar Calvo-Gonzalez[b]

What role should foreign trade play in Bolivia's development strategy given the country's natural resources endowment and landlockness? What are the constraints to higher competitiveness in Bolivia? What is the impact of preferential trade agreements on Bolivia's trade volumes, growth, employment, and poverty?

Bolivia's policy makers as well as its National Development Plan call for inclusive growth based *inter alia* on greater diversification of non-traditional exports (traditional exports being hydrocarbons and minerals).

In this context, a recent World Bank report[1] investigates how Bolivia can achieve greater diversification in the non-traditional sectors through higher competiveness. The report identifies the main constraints with an emphasis on transport and logistics, paramount for a landlocked country. The report analyses how Bolivia's opening to foreign trade since the mid 1980s has affected economic growth, employment and poverty. The analysis further assesses the role of Bolivia's current preferential trade agreements (with the US, the Andean Community, and Mercosur) on those key economic indicators.

Bolivia's trade liberalization effort, launched in the mid-1980s, has resulted in a relatively open trade regime. However, the results have been mixed. On the one hand, Bolivia now has one of the highest export-to-GDP ratios and export entrepreneurship index in the Latin American and Caribbean region and has achieved great success in making soya the major export crop in less than 10 years. At the same time, however, the country's share in world trade has stagnated and exports are increasingly dominated by gas and minerals.

Reinvigorating the non-traditional export sector is important for the government of Bolivia as it implements its National Development Plan. The plan's goal is to shift to greater value-added exports, coupled with more balanced trade relations and diversified export markets and products. In addition, the government currently faces several policy challenges regarding the renewal of preferential access to the U.S. market through the Andean Trade Promotion and Drug Eradication Act (ATPDEA), changes in its tariff policy toward the common external tariff of the Andean Community (CAN), possible free trade agreements (FTAs) between the United States and important regional partners (Peru and Colombia), and worsening global economic conditions.

As a resource rich country, the Bolivian government's emphasis on export diversification is well-placed but the optimal non-traditional export strategy should build on successes in the traditional sector. Diversification matters because a heavy reliance on a few products implies excessive vulnerability to price downturns. Bolivia's non-traditional sector is already exporting a wide range of diversified products but

1. BOLIVIA: Strengthening Competitiveness for Export Diversification and Inclusive Growth, World Bank, Report No. 43240-BO, June 30 2008

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the limited productive capacity implies short (rather than sustained) export episodes and a high attrition rate for new exporters. The current boom in natural resources can help to leverage the growth of non-traditional exports by providing resources to invest in human capital and knowledge technology, as well as infrastructure and transport that will have spill-over effects across different sectors of the economy.

MAIN FINDINGS

Preferential access to world markets is necessary but not sufficient for success in non-traditional exports; rather, success depends largely on increasing the competitiveness of exporting firms. Preferential agreements alone cannot provide the levels of growth and trade that facilitate long-term economic development. The simulations undertaken in this study suggest that the non-renewal of ATPDEA preferences is potentially the most costly. The report finds that non-renewal of the ATPDEA with the United States would reduce growth the most, by 0.6 percent. The ratification of the U.S.-Peru and U.S.-Colombia free trade agreements (FTAs) would reduce growth by 0.4 percent. Deeper integration with MERCOSUR would dampen growth by 0.09 and re-alignment of Bolivia's tariff scheme to the Andean Community (CAN) common external tariff would lower it by 0.01.

Preferential agreements remain critical because they can help spur new areas of export growth, thus helping towards the goal of diversification. The small estimated impact of preferential agreements does not reflect these agreements' full effect as second-round effects are not captured in the modeling. The scenarios analyzed are based on products currently traded and currents market conditions and do not consider products not yet traded. As a result, the scenarios downplay the impact of increased trade of new products that could take advantage of preferential market access. For example, the incipient trade in the service sector may well yield significant gains through preferential agreements, not only directly through the services sector but also indirectly by lowering the cost of services inputs into goods production and exports. Therefore, there are risks related to a loss of preferential access to the U.S. market and failing to pursue greater trade integration within the region. Bolivia could also be left out from the dynamics of trading blocks, which may reduce its potential to diversify its trade in new products and markets.

The analysis suggests that policy should focus on increasing exporting firms' productivity and competitiveness to fully exploit preferential agreements. We find that Bolivian exporting firms are no more productive than their non-exporting counterparts, which contrasts with evidence from most countries. This finding, together with the fact that preferential access alone has a limited impact, suggests that increasing exporting firms' productivity is key to improving their performance. Long-standing investment and business environment factors--such as contract enforcement, regulatory uncertainty, and political instability--have undermined productivity and export performance. As a result, the manufacturing sector has only attracted limited FDI. In addition, exporting firms' productivity is further affected by competitiveness issues related to the neutrality of the incentives regime for exporters, the efficiency of backbone services such as transport and logistics, and the effectiveness of institutions for cross-border trade.

A neutral incentive regime is essential to the growth of non-traditional exports

Payment delays under the duty-drawback system are a problem for exporters. Duty drawbacks (called CEDEIMs) allow exporters to claim back duties paid on inputs for exported products, thus partly offsetting the cost of tariffs for exporting firms. Reimbursement requests under the CEDEIMs are accumulating, as the budgeted allocation for CEDEIMs is not keeping pace with exports levels. In addition, the program that automatically suspends taxes on imported inputs for exporters (called RITEX) has a very low take-up rate. In the absence of a smoothly operating duty relief mechanism, export manufacturers have to produce at a higher cost than if they had full and easy access to production inputs at world prices. This obviously handicaps their export performance.

The recent rise in import tariffs adds to the cost of imported inputs and worsens the anti-export bias. The increase in import tariffs is expected to reduce exports more than imports: exports by $35 million a year and imports by $24 million a year. Output and welfare are also expected to fall. These results stem from the fact that higher import duties are also taxes for exports. First, they mean higher costs of imported inputs, and higher costs of living may generate higher wage costs. Second, this strategy creates an anti-export bias and reduces incentives to export.

Rapidly rising inflation poses a threat to the competitiveness of Bolivian exporters. Inflation climbed to 12 percent at end-2007, up from 5 percent in 2006, increasing the price of Bolivian exports. The higher inflation is the result of such variables as the global rise in food prices, a slow supply response attributable to low private investment, increased aggregate demand fueled by remit-

tances and commodities revenues, and the destructive effect of the La Niña weather pattern. In response to the rise in inflation, the government issued export restrictions on staple food prices, shifting incentives to producing for the domestic, rather than the international market. The government also increased its open market operations and brought about a modest appreciation of the boliviano in real terms. Bolivia's currency, however, appreciated less than its neighbors; nominal and real appreciation will likely continue, further eroding competitiveness in the non-traditional sector.

Efficient backbone services are vital for reducing exporters' costs

For a landlocked country like Bolivia, efficient trade services are critical for export competitiveness. Telecom infrastructure is not well-developed, undermining the country's connectivity to international markets and the ability to take advantage of opportunities in dynamic services export sectors, such as call centers and outsourcing. The phyto-sanitary standards agency SENASAG does not function properly owing to a lack of capacity and resources; exports are delayed for months in some parts of the country because of slow certification procedures. The use of air freight remains limited because of a lack of air transport capacity. This hurts the capacity to develop exports using airfreight in some parts of the country, such as Cochabamba.

Trucking costs appear to be competitive by international standards but the predictability of trip time remains a challenge. The quality of transport logistics in Bolivia is slightly below the level to be expected for its income level. Transport costs of 5–8 U.S. cents per km are competitive, but the great distances to ports makes the overall costs high and places Bolivia at a competitive disadvantage. In addition, the predictability of truck trip time is important as most container ships operate out of Arica in Chile (Bolivia's main international port) once a week, hence seasonal damage or road blocks can be costly for exporters.

Institutional reforms implemented in Bolivia's Customs Administration (ANB) have improved trade control and trade facilitation, but smuggling and delays at border crossings persist. Import and export controls have improved and trade facilitation enhanced throughcomprehensive institutional reforms in the ANB. But control of smuggling remains weak and possibly affects a third of total imports, undermining the income of formal sector importers and producers. Similarly, econometric estimates suggest that Bolivian exporter are hurt by the costs associated with shipment delays at customs.

The government should be pro-active in addressing impediments to cross-border trade.

Export entrepreneurship is high, even though Bolivia tends to under-export relative to other countries. Accounting for its status as a landlocked country, Bolivia imports more than econometric models predict (by 3 percent) and exports less than predicted (by 11 percent). Not accounting for its being landlocked, Bolivia exports 43 percent less than predicted. But export entrepreneurship—as measured by the number of new products exported—is higher than one would expect given Bolivia's level of income. Bolivia has been able to export a diverse range of products, although only intermittently, in small quantities, and by only a few firms. These results suggest an unrealized potential for diversification through increasing volumes of some products that are already being exported - although in small amounts - rather than increasing the overall number of products that Bolivia currently exports.

Increasing the effectiveness of trade-related institutions would enhance export competitiveness. The performance of the institutional framework for trade is mixed. While Bolivia implemented a successful customs reform, key export agencies remain plagued by institutional weakness and lack of resources. As a result, the export promotion agency (CEPROBOL) cannot fulfill its mandate. In some cases, the private sector has stepped in to provide export promotion services. The large number of products that are exported for only a short duration suggests that sustained government support through effective trade promotion institutions could reap substantial benefits.

POLICY IMPLICATIONS

The productivity and competitiveness of Bolivian firms should be the paramount focus for boosting export growth and increasing the impact of the export sector on job creation and poverty reduction. New trade developments have the potential to affect the preferential access of Bolivian exports to several markets. But preferential agreements and regional integration alone have limited implications for employment, poverty, and growth. In addition, preferential access can only be exploited once the goods are produced and ready to be exported.

(a) Trade policy and preferential access to markets

In the short term, the Government may seek to reverse the increase in Bolivian import duties; or, as a second best option, it may consider limiting the economic distortions implied by the tariff increase. Indeed, the tariff increase toward the common external tariff of the Andean Community creates an anti-export bias for domestic producers. The Government may consider exploring instruments that minimize those distortions.

Over the medium term, the Government may consider alternatives to the use of export bans for staple foods in order to contain price increases. Bans jeopardize the long term supply of food products to domestic markets, as producers have more incentives to shift their production to other products and the effectiveness of export bans is thus limited over time. Bans also encourage smuggling.

(b) Incentives regime

In the short term, a high-impact and relatively easy-to-implement policy is to pay duty drawbacks in a timely fashion, as delays burden firm finances and, hence, their production capability and competitiveness. Delays defeat the purpose of neutralizing the effects of tax policy for exporting firms. Customs control should be made more efficient to ensure that duty-drawback relief is legitimate and correctly executed.

In the short term, the authorities should continue to maintain a stable macroeconomic framework. Solid fiscal accounts, stable monetary policy, and controlled inflation are critical to maintaining economic confidence and making long-term plans needed to develop value-added exports.

A major priority over the medium term, with potentially substantial impact on FDI flows and exports, is to step up efforts to enhance the business environment. This would promote firm productivity and competitiveness and encourage investment in non-traditional exports, which would raise the volume of such exports. Political stability, anticorruption efforts, and reducing informality are key areas for further improvement.

(c) Backbone services

A priority for policymakers in the short term is to evaluate and revamp SENASAG-- the agency in charge of issuing phyto-sanitary certificates--to ensure that it fulfills its mandate in a sustainable manner. This mandate includes providing a sufficient budget to ensure adequate geographical reach and information systems consistent between destination market requirements and SENASAG services, appointing and training qualified personnel, and clearly defining the regulatory framework and delimiting the relationship and responsibilities of the SENASAG relative to other government agencies.

About the Authors
a. Country Economist, Economic Policy Sector, b. Economist, Economic Policy Sector, Latin America and Caribbean Region, World Bank

In the medium term, the Government could pursue further reforms in customs and border control management, continuing the focus on decreasing corruption and smuggling. Areas for further improvement include: setting up a risk-based selectivity process for inspections, relying on computerized databases; upgrading core software from ASYCUDA++ to the next level, or transition to other software; upgrading IT hardware and other equipment for border stations and expanding joint integrated border facilities with neighboring countries; setting up a system of border-crossing performance indicators; and improving coordination between customs and other border control agencies, especially SENASAG.

Another medium-term priority is to encourage the consolidation of air freight consignments and give truck trailers their own license plates. Air freight consolidation will facilitate export growth in producing regions without airports. Cochabamba in particular was identified as having the potential to channel exports by air freight via Santa Cruz to North American and European markets. The current law considers tractor and trailer as a single unit for purposes of registration. Allowing tractor units to have separate registration from trailers would enable them to keep moving—and earning revenue—while trailers wait to unload and reload.

(d) Increasing the effectiveness of institutions to promote cross-border trade

In the short term, a key policy priority offering high potential returns is to revamp the trade promotion office CEPROBOL by expanding its resources, stabilizing its institutional environment, and increasing the role of the private sector in CEPROBOL's operational support to exporters.

(e) Setting the foundations for exports diversification

Over the medium term, the government can boost export diversification by helping current and prospective exporters export higher volumes and for much longer periods using the revamped export promotion agency. ***Over the longer term, the authorities should develop a diversification strategy that leverages the country's natural resource endowment.*** Elements of the strategy may include investing in activities related to hydrocarbons or minerals such as in services, machinery, engineering product, or transport equipment; developing a trade regime that favors the emergence of new export activities; and promoting technological change in manufacture and services.

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