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# Should the Bolivian Government Have Ended Fuel Subsidies?

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## *Q and A: Should the Bolivian Government Have Ended Fuel Subsidies?*

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On Dec. 26, Bolivian President Evo Morales issued a decree canceling heavy subsidies on gasoline and diesel fuel, citing the heavy preponderance of fuel smuggling across the border, and thus triggered a rise in fuel prices by more than 70 percent. The change was met with widespread protests, riots and a national transport strike. Morales reversed his decision on Dec. 31. Should Morales have ended fuel subsidies in Bolivia? What are the political ramifications for the move and its subsequent reversal? What else can the government do about widespread fuel smuggling? Is the government likely to cut subsidies in the future?

**A: Iván C. Rebolledo, managing partner of TerraNova Strategic Partners LLC and president of the Bolivian American Chamber of Commerce:**
"By all means, the government's announcement that it could no longer afford to subsidize fuel prices, which had been frozen for over six years, was the right thing to do. Bolivia's international capital reserves are beginning to dwindle in light of decreased foreign direct investment—especially in the hydrocarbons and mining sectors. It has been reported that more than $350 million of subsidies had illegally benefited those selling fuel to neighboring countries where the price was much higher. Without a doubt, this has been Morales' biggest political setback since his inauguration in 2006 and I believe it can continue to have serious consequences as further economic calamities might rear their ugly heads in the coming months. This cutback on fuel subsidies should have been done very gradually over the past few years and will certainly now need to be done in the not so distant future. The irony of this whole scenario is that those with the lowest incomes, who most likely voted for Morales, would have been the hardest hit with the ending of fuel subsidies. To combat the fallout from this scenario, Morales announced a 20 percent increase in salary—mostly geared to the police, armed forces and the health and education sectors. This action did little to appease the masses. In the end, he abrogated the original decree with the message that the will of the citizenship was obeyed."

**A: Jose Valera, partner at Mayer Brown LLP in Houston:**
"The government of Bolivia has budgeted $1 billion for the importation of gasoline and diesel in 2011. Due to the subsidy measures again in effect, the government will resell those products for $500 million in the domestic market and bear the cost of the other $500 million. This huge drain on the treasury is aggravated by the fact that large volumes of these products are smuggled out to neighboring countries with higher fuel prices, something the government says it can do little about. Bolivia has subsidized fuels at least since the early 1990s, but back then the

subsidy was paid to local producers who had economic incentives to explore for and produce oil and invest in refining and processing capacity. Now, five years after the industry's nationalization, the government is in the fuel business, has not increased refining capacity and has to subsidize foreign exporters. There has also been a marked decline in oil exploration and production due to the very low prices paid by the government to the few private sector producers that remain, as well as the lack of managerial, technical and financial capacity by state-owned YPFB to carry out such activities itself. The government now realizes that squeezing local producers is not good long-term policy. Since domestic demand for fuels is increasing, the policy choice is between incentivizing the private sector to produce and invest more or keep importing fuels from other countries. It was good politics for a while to squeeze the local producers, but the drain to the treasury has now become all too real. The second policy choice relates to the continuation of subsidies. Two things will happen: local producers will be paid more so that production and investment increase, and subsidies will be cut, albeit at smaller increments over a longer period of time."

**A:Maria Velez de Berliner, president of Latin Intelligence Corporation in Alexandria,Va.:**

"The elimination of subsidies was the right move to bring rationality to the gasoline and diesel market. But it was not an effective political move for Morales who lost the support of his core constituency. Morales learned that dividing and conquering the opposition in Media Luna was less costly than hitting the livelihood of those who put him in power, and who can take him down by the same tactics he used to unseat his predecessor. Despite the policy reversal, the transport sector will still raise prices by about 25 percent, causing continued strikes and road blockages that will adversely affect Bolivia's economy. Despite commitments by oil companies to invest $812 million in 2011, Bolivia will not soon return to being a net exporter of hydrocarbons. As it is, Brazil, its largest customer, is importing the minimum required to fulfill the 'take or pay' clause of its import contract with Bolivia. Given the gasoline and diesel price differentials among Bolivia (low) and Brazil, Chile, Peru and Argentina (all high), the incentive to smuggle will continue if smugglers do not have access to more profitable economic activity. But it is not only price. Smuggling is abetted by the weakness of Bolivia's institutions and its endemic corruption. So far, subsidies are the glue that holds Morales and his base together. Morales' hold on power will be precarious if his base and the industrial establishment in Media Luna, ironically, find common ground in opposing the future lifting of subsidies; the former for economic and the latter for political reasons."

**A: Bernardo Prado, director and editor of Hidrocarburos Bolivia:**

"The government overestimated its popularity and found no other alternative but to reinstate fuel subsidies. However, those six days with the decree in force were sufficient to open the Pandora's Box that this populist government struggled so hard to keep sealed. The political consequences of this misstep are just beginning to pass to the Morales administration, including the president's worst ever decline in popularity (he went from 54 percent to 30 percent), and a completely worn cabinet, to the point where union leaders and indigenous movements are calling for the Energy and Finance ministers' heads. The government mentioned smuggling as justification to cut the subsidies, but I'm not sure that is the main reason. The fact that Bolivia is paying about $27 per barrel of produced oil, a price well below international values, has discouraged foreign investment in exploration and production activities. At these prices, finding and producing oil in Bolivia is not a profitable business. There is where I think the problem lies; since President Morales decreed the nationalization of hydrocarbons in May 2006, the oil industry has entered a state of lethargy. Although it had some shining accomplishments, those were not bright enough to avoid being obscured by the nationalization process. Leaving behind the usual rough speech against foreign investors, President Morales seems to be finally aware that foreign oil companies need better economic conditions to invest and operate in Bolivia. But a better price alone does not solve the problem. No matter how many more dollars you end up receiving for a barrel of oil, without a consistent legal framework and a fair taxation regime, investments in Bolivia will continue to be a chimera. The Bolivian government is now facing the challenge to motivate investors, cut subsidies without affecting the people's pockets and prove the success of the nationalization process."

**A: Álvaro Ríos, partner-director of Gas Energy Latin America, director of DIInternational for Latin America and former minister of hydrocarbons of Bolivia:**

"The measure was intended to kill four birds in one shot, but it was too strong on the social and economic side, causing inflation and panic, which is why the government had to regress. First, by raising diesel and gasoline prices, the price at the wellhead for oil to be sold in the internal market could have risen from $27 per barrel to around $50 or $60 per barrel, thus encouraging investment. Second, the government's public spending has been increasing in past years and it was an easy way to collect $1 billion annually. Third, it was an easy way to cut fuel smuggling across the borders to neighboring counters, where prices are three to four times higher. Fourth, with increased oil production in five to seven years, the country could produce oil to feed its refineries and not have to import around 25,000 barrels per day with a cost of another $1 billion. It is quite a necessary measure, but too strong for the Bolivian economy and its social structure."

**A: Carlos Miranda, energy consultant in La Paz and former hydrocarbons superintendent of Bolivia:**

"Using heavy state subsidies, Bolivian fuel prices have lasted too long and have been far behind the market. Populist President Morales was not able to support the political cost of losing popularity by increasing prices to the consumer. Reversing the measures has put the government in the worst of all possible worlds. Subsidies are paid with uncommitted gas income. Facing increase in the demand and market prices, these funds are becoming insufficient. Figuring out how to cut subsidies without increasing prices to the consumer is the government's biggest challenge."

*The* Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at kuleta@thedialogue.org with comments.*