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The 'Political Poverty Trap': Bolivia 1999-2007

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Abstract. We analyse the recent wave of political instability in Bolivia in the context of a 'poverty trap' model which suggests that elements in a country's political system, as well as its economic structure, may be instrumental in perpetuating a state of poverty. In Bolivia the costs of adjustment in the recent phase have been very severe, with well over a hundred killed between 1999 and 2007 as a direct consequence of demonstrations against aspects of the globalisation and adjustment process, and an appearance of a return to a state of chronic political instability; other countries affected by the global crisis have suffered less severely. Is this because they used the available instruments of adjustment more effectively, or for other reasons? In particular, how does poverty impact fit into the story: would a 'more effective' pattern of adjustment have been more pro-poor?

There is no doubt that some aspects of the Bolivian political economy do have to be taken as parametric and have, over many years, played a major part in increasing the vulnerability of the political system and in predisposing it, in recent years, towards instability. These include: the collapse of conventional party politics as an instrument for representing the interests of the poor; the decay of a number of key institutions including the courts, financial institutions and standards of fiscal governance; and the unique combination, within the satellite city of El Alto, of strategic location, unemployment rising much faster than conventional poverty indicators, and very high levels of politicisation and strategic communication between neighbourhood groups. All of these factors applied a process of hysteresis, or a vicious circle of downward pressure, to levels of trust in government (not only amongst the Quechua/Aymara majority, but also among the urban middle class) by the centre-right coalitions of the 1990s, and the persistence of this dynamic seriously limited the government's room for economic policy manoeuvre as it tried to extract itself from recession in 1999-2004.

However, we also argue, there is clear evidence, in the Bolivian case, of some incorrect decisions (from the point of view of minimising social cost and political instability) having been taken, not because they were politically inescapable but simply because the necessary strategic vision was lacking. Our major examples, from the climactic year of 2003, relate to fiscal policy and policy towards the privatisation and pricing of oil and gas exports; but several other areas where the breadth of government vision during the crisis was not sufficiently wide include pensions policy, agricultural policy and international policy options, including capital controls and exchange rate management. A component of these errors, especially in the case of fiscal and privatisation policy, consists in not seeing how politically damaging a policy which overtly threatened to increase unemployment and inequality was likely to be. We argue that the aid donors were complicit in allowing those mistakes to happen: in not helping the Bolivian government to broaden its strategic field of vision.

In international perspective, it appears that Bolivia was hampered in its efforts to escape the political poverty trap by its low levels of institutional capacity, its high and deteriorating levels of inequality and unemployment, and the apparent indifference of government to measures which might have relieved these ills (such as increases in the social efficiency wage, and protection against instability on the external capital account). There seems little doubt that the overall regressive stance of policy, coupled with communication and institutional failures, played a part in locking Bolivia into a worse crisis than other afflicted countries; but policy was not uniformly regressive, and part of the problem appears to be that the Bolivian government was watching the wrong indicators of what might make it politically vulnerable.

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1. Introduction: political violence and varieties of stabilisation experience

On 12 and 13 October, 2003, over sixty people² were killed in a confrontation between civilian protesters and the armed forces in the city of El Alto, Bolivia. The incident marked the climax of a series of disturbances which have continued through to the present year, and which mark Bolivia as one of the gravest sufferers, in human terms, from the wave of capital-account crises which have buffeted the developing world since their onset in East Asia in 1997. The variety of experiences of adjustment-related conflict across the developing world since 1997 is illustrated in Table 1.

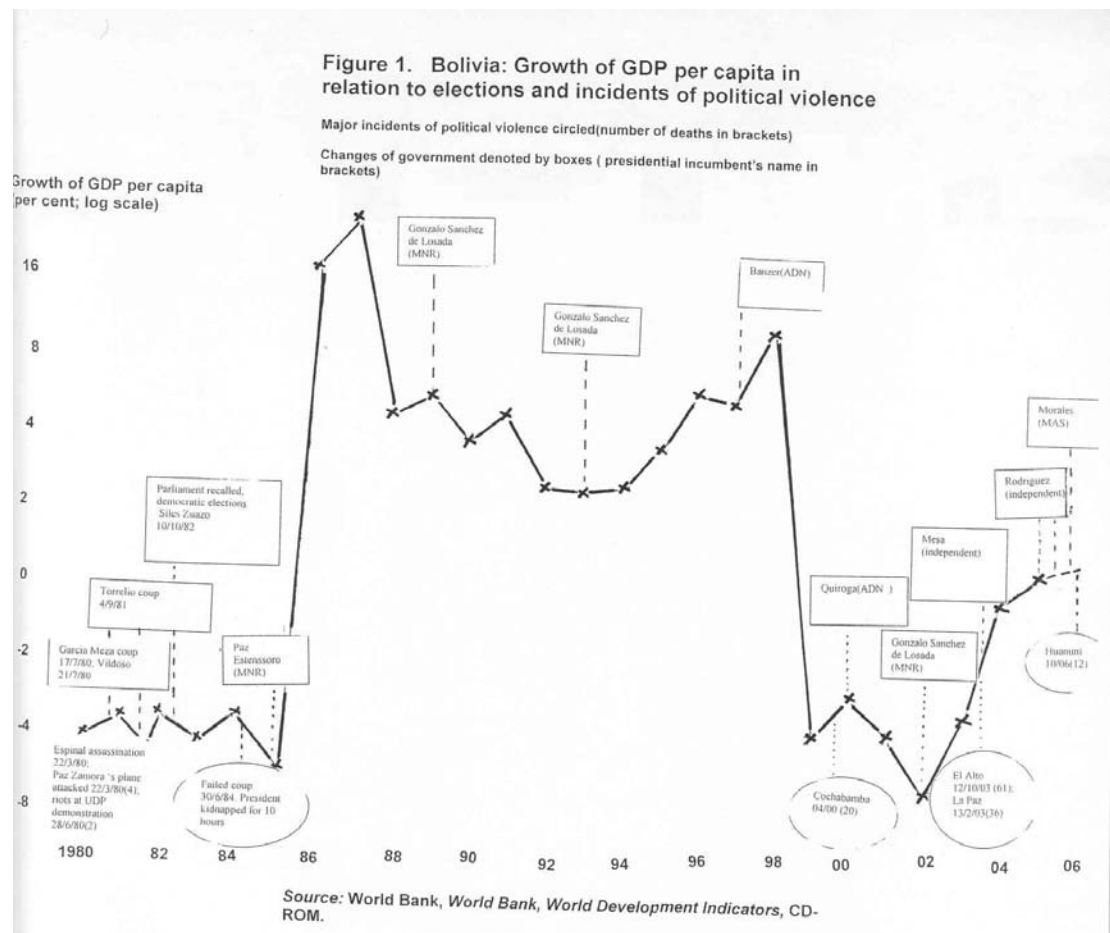
Table 1. Countries affected by global crisis(1997-2005): political responses and their consequences

Country	Year of entering crisis	Duration of crisis (years of negative growth in per capita GDP following onset of crisis)	Estimated deaths in political violence directly associated with economic crisis
Thailand	1997	1	0
South Korea	1997	2	2
Indonesia*	1997	2	30
Malaysia*	1998	1	0
Russia*	1998	3	25
Turkey	1998	2	20
Brazil	1999	1	no data
Argentina*	2000	3	12
Bolivia*	2000	6	140

Sources and definitions. Onset of crisis is defined as first year of negative per capita GDP growth, and duration of crisis is defined as number of years of negative per capita GDP growth after onset; source is World Bank, *World Development Indicators* CD-ROM. Estimated deaths from political violence associated with crisis (street demonstrations, riots, roadblocks, and crisis-related industrial violence) are provisional estimates derived from contemporary newspaper accounts under ESRC project RES-156-25-00016, *The political economy of pro-poor adjustment*. For more detail of computation see Mosley(2006), appendix 2.

It is clear from the table that the interaction between the social costs of crisis and the political consequences was in some cases (eg South Korea, Malaysia and Thailand) short-term and self-correcting, but in other cases (eg Indonesia, Turkey and Bolivia) much more long-term and self-reinforcing. In this paper we seek to understand why these differences in response-pattern occur, with particular reference to the case of Bolivia, where the recent crisis has restored an ancestral pattern of instability (**Figure 1**) following an apparently successful escape from the vicious circle during the 1990s. Our concern is both to explain the particularities of why recovery has proved so elusive in Bolivia, and also in more general terms to illustrate what the lessons may be for institutions and governments which may have responsibility for dealing with crises of this type in the future.

² Some accounts record more than 80 deaths in this incident alone, for example Suarez (2003)



One approach to crisis recovery strategies, often attributed to the International Monetary Fund, explains the effectiveness of reform strategies in terms of technical criteria, e.g. the speed with which particular economic policy instruments (expenditure cuts, tax increases, devaluation, and so on) are able to stabilise the currency. It can be argued, however, that what is in principle technically effective may not be in practice politically feasible or sustainable, that the political violence and policy instability portrayed in Table 1 are in part the consequence of this, and that as a result what is optimal in a technical sense may not be optimal if the likely political consequences of economic policy are taken into consideration. In particular, it may be necessary to orient adjustment policies more towards poor people than is necessary according to criteria of technical effectiveness, in order to obviate the risks of rebellion by poor people who are damaged by adjustment. This idea has been explored, and rejected, by the very comprehensive OECD studies of social and political consequences of adjustment (Bourguignon et al. 1992; Haggard et al. 1995). Their conclusion, reached on the basis of empirical data from the 1980s and early 1990s, is that, although criteria of political feasibility are important in determining the right adjustment policy, 'a focus on social equity is not necessarily relevant to understanding the politics of adjustment, because the politically most active groups are not usually the poorest'³ (Haggard et al. 1995:120). Their implication is that a more pro-poor policy might not necessarily have rescued

³ This rather harsh judgment is finessed on the following page, however, by the observation that 'the most intractable determinant of the likelihood that governments will adjust early is the underlying level of inequality in the society... Countries where inequality is high are more likely to reach fundamental deadlocks over adjustment.' (ibid., page 121)

Bolivia, or any of the other countries listed in Table 1, from the political consequences of fiscal austerity.

In this paper we explore, focusing on the Bolivian case, whether this is still true; and, more generally whether the adoption of more 'politically rational' reform strategies might be capable of achieving more sustainable processes of adjustment at lower social cost. Our analytical approach is to visualise developing countries as being vulnerable to being caught in a 'poverty trap' – an interactive process between poverty and its causes -, which if a crisis is wrongly handled may enmesh them in a long-term process of decline. 'Poverty trap' models have recently re-emerged in the development literature as explanations of the persistence of poverty in individuals and countries, but they typically do not contain political variables. What is attempted here is in general terms to explain the persistence of crisis in terms of the working of political institutions as well as economic factors, and in specific terms to ask whether and how more pro-poor patterns of policy might in specific cases such as Bolivia's be an effective instrument for escaping from such a crisis.

The original 'poverty trap' or vicious circle of poverty' literature, starting with Nurkse (1953), uses a causal mechanism in which, in its simplest form, low income causes low investment which perpetuates low income(left-hand part of Figure 2). More recent versions of the vicious circle, including Carter and May (1999), World Bank(2000) and Barrett and Carter(2006) have added additional mechanisms to this vicious circle, of an essentially economic nature⁴. Our own argument develops this approach by suggesting that what Bolivia has been caught in, since it became enmeshed in the global crisis, is a *political poverty trap*. As in a conventional poverty trap model, poverty remained high on account of low and unstable investment rates; but what kept investment rates low was in part, a collapse of trust in the political process to achieve democratic decision making and an erosion of the institutional structure, which in turn was aggravated by economic crisis. Policy choices (at both the macro and the micro level) provide a potential escape from this trap, and it will be a major objective to investigate the extent to which events in Bolivia were the consequence of a failure to take advantage of these opportunities.

⁴ These include linkages from poverty to health, participation in labour markets, risk management capacity and absence of group insurance mechanisms. For a discussion of recent poverty trap models see Barrett and Carter (2006) or Mosley et al. (2006).

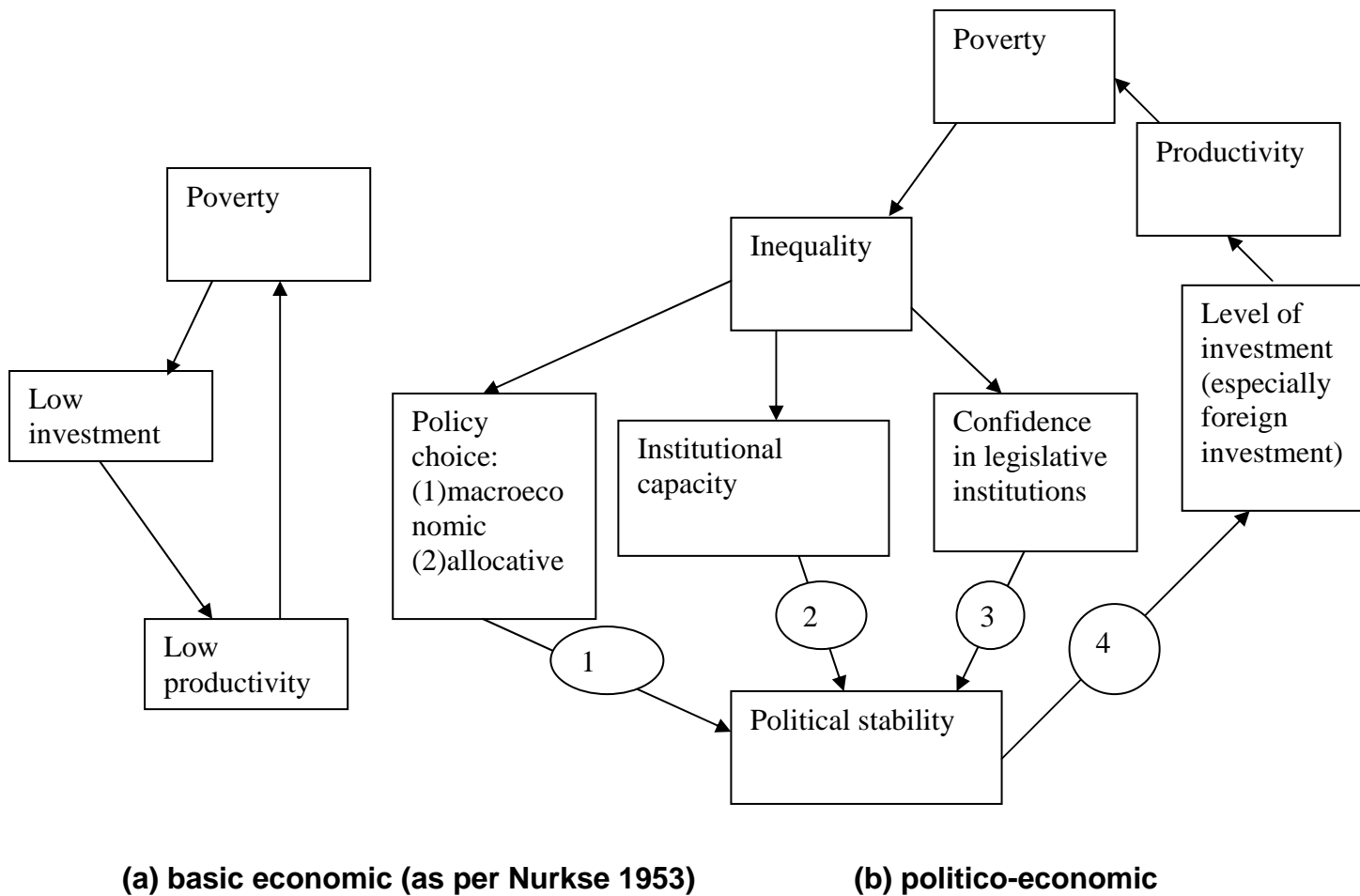


Figure 2. Varieties of poverty trap

The 'political poverty trap' approach specified in (b) forms the core of our general explanatory story. In the Bolivian case, two additional country-specific factors - relationships with aid donors, and the geographical concentration of wealth, poverty and political militancy - play an important part both in setting the initial conditions and in determining the course of the drama. These initial conditions are examined in the following section 2. In section 3, we test the poverty trap model pictured in Figure 2 against the available data for Bolivia. Section 4 takes a comparative perspective and asks whether the variables in the poverty trap model help to explain why Bolivia experienced a particularly severe political and economic crisis between 2000 and 2005 in comparison to other countries afflicted by the 'East Asian' crisis, and in particular whether other countries avoided the crisis by taking up options which were available to but neglected by Bolivia. Section 5 concludes.

2. The current crisis in its long-term setting

Bolivia's democratic state, established in 1825, has a notorious record of political instability, fragility and reversion to a totalitarian model. During the hundred

and sixty years from independence to the hyperinflation of 1985 there were around 150 changes of government (Mesa, Gisbert and Mesa 2003), and a number of episodes of military dictatorship. Between 1951 and 1985 a whole succession of governments sought to break the constraints to the country's persistently poor economic development performance by means of structuralist measures, including a thoroughgoing land reform in 1952, nationalisation of the mines in the same year and of the country's natural gas reserves in 1965, and widespread controls on the exchange rate and other 'key prices'. At the onset of the global structural adjustment process, in the early 1980s, the government initially resisted pressures for expenditure cuts and price decontrol, and the failure of these attempts led eventually to one of the great hyperinflations of modern times, reaching its peak at an annual rate of 24,000 per cent in August 1985.

As might have been expected, the scale of deflation and liberalisation required to achieve economic stabilisation was exceptionally painful, and in particular involved massive production and employment cuts in the country's former main export staples – the tin and silver mines⁵. But gradually, through this process, a measure of both political and economic stabilisation was achieved: inflation was brought under control, growth in the real economy was positive from 1987 until the onset of the global crisis in 2000, and most of the elected governments of this period, contrary to all Bolivian precedent, ran their full four-year term. Of these administrations, the most radical in its liberalising measures was that of Gonzalo Sanchez de Losada, a mining millionaire⁶, between 1993 and 1997, which initiated (under the so-called 'Law 21060') the privatisation of the main public utilities (oil and gas, telephones, electricity and water) under a regime known as 'capitalisation'. and drastically reduced controls on trade and capital movements. It was during this period that the Managing Director of the IMF expressed his hope that Bolivia would sustain its economic growth, and convert itself into an 'Andean jaguar', by analogy with the East Asian 'tiger economies'⁷.

The higher levels of economic growth and political stability produced by this liberalisation were however inherently vulnerable, on account of underlying structural factors. Firstly the shift, under structural adjustment, from a growth pattern based on exports of minerals to a pattern based on hydrocarbon (oil and natural gas) exports posed major problems for employment creation and poverty reduction, since mining is labour-intensive whereas the oil and natural gas sector is capital-intensive (Table 2); moreover, within both food and cash-crop agriculture, which is also labour-intensive, structural adjustment stimulated very little growth⁸, making the problem worse. Secondly, the gains from structural adjustment, essentially in the tradable oil and natural gas sectors, accrued mainly to individuals, mainly not of indigenous Aymara and Quechua ethnicity, in the richer east and south-east of the country, where the oil and gas deposits are located; and the losses from structural adjustment accrued mainly to workers, mainly of indigenous ethnicity, in the poorer west of the country. As a consequence, *inequality* (and especially inter-ethnic and inter-regional

⁵ Chavez(1992:6) estimates the number of tin miners put out of work at 23,000 out of a workforce of 30,000 or 70 per cent. and Morales(1991) at 80 per cent. Only about 2,000 tin miners are now (January 2007) at work.

⁶ It is relevant to the subsequent argument that Sanchez de Losada had been a major gainer in the privatisation process in Bolivian mining. He had bought the assets of the few mines which remained profitable after the 1985 hyperinflation, and had amalgamated them into a profitable private corporation known as CORPOSUR.

⁷ In a speech in La Paz in June 1996: Lazarte Rojas 2005, p.18.

⁸ The one very important exception to this generalisation is the coca industry, which grew fast during the period of structural adjustment and is very labour-intensive. De Franco and Godoy (1990) calculated by means of a computable general equilibrium model that a 10% increase in cocaine production raises Bolivian GDP by 2% and lowers Bolivian unemployment by 6%. Painter(1994) p.56.

inequality) grew through the period of stability from 1986 to 2000, and in a way that was openly increased by the government's acts of privatisation. *Poverty* has been measured in Bolivia over a much less lengthy period than inequality; but of the available measures of poverty, headcount poverty and poverty measured by access to health and education services appear to have diminished over the period prior to 1999, so that growth over this period can be characterised as (rather weakly) pro-poor (Klasen et al 2001; Landa and Jimenez 2005).

Table 2. Bolivia 1986-2004: growth of output and employment
Annual average growth rates

	Whole economy		Agriculture		Mining		Petroleum and gas	
	Average growth of output	Average growth of employment (private sector only)	Average growth of output	Average growth of employment ⁹	Average growth of output	Average growth of employment	Average growth of output	Average growth of employment
1995-98	4.7	-1.7	2.1	nd	0.0	-1.1	5.6	-0.6
1999-2004	2.1	1.0	2.9	2.7	-1.6	0.1	9.5	-0.3

Source: Instituto Nacional de Estadística, *Anuario Estadístico 2005*, tables 4.02.01.01 and 3.04.05.01.

The reformist governments of this period were by no means unaware of these long-term threats to economic and political stability, and attempted by various means to palliate them: the throughgoing decentralisation of political power and fiscal responsibility to the regions in 1994 (van Cott 2002); the fairly rapid growth of public sector employment (Table 2) supported by the pioneering *Fondo de Inversión Social* (Social Investment Fund), which channelled aid funds into the development of social infrastructure for low income groups; and the also fairly rapid growth of small private-sector and medium enterprises, supported by a number of innovative ventures in microfinance (Mosley 2001; Mosley and Marconi 2006), in which Bolivia has a reasonable claim to be a global market leader. (The last two of these are effectively joint ventures with the aid donors, on whom Bolivia is much more dependent than any other Latin American country¹⁰) These tendencies helped to improve the appearance of the social indicators, and even allowed some international financial agencies, as we saw, to feel a measure of euphoria about the transformations occurring in Bolivia. But the persisting inequality previously referred to, aggravated by persisting corruption in the public service, continued to undermine the political dividend delivered to the 'Andean jaguar' by economic growth. When the global recession hit, these areas of long-term weakness were to aggravate the short-term mechanisms of the political poverty trap, in a manner which we now examine.

3. The crisis of 2000-06, and alternative explanations of its 'persistence'

The 'East Asian crisis', having arrived in Latin America via Brazil at the beginning of 1999, hit Bolivia later still, in the second half of the year. The next five

⁹ Fruits, vegetables, grains, dairy and meat products.

¹⁰ Bolivia has a ratio of aid to GNP of nearly 3 per cent (World Bank, *World Development Report 2005*, table 21); no other Latin American country has a ratio of more than 1 per cent, and the average for the continent as a whole is 0.2 per cent.

years were all years of falling per capita GDP , there have been five new presidents in the last five years, and lethal political violence has occurred in every year except 2000, with a climax in 2003 (Table 3). For the moment at least, political stability has gone.

Table 3. Bolivia: evolution of the economy in relation to elections and political violence, 1997-2006

	1998	1999	2000	2001	2002	2003	2004	2005 <i>estimate</i>
Real economy								
<i>Growth</i> GNP per capita (in current US \$)	1070	1023	1016	949	883	870	874	890
Real GDP growth (%): absolute Per capita	5.2	0.4 -4.6	2.4 -0.7	0.0 -6.6	2.5 -7	2.6 -1.5	3.5 0.4	3.6 0.2
<i>Investment</i> Investment/GNP(%)	23.8	18.4	17.3	17.0	15.0	12.5		
Foreign investment/GNP(%)	11.9	12.9	10.7	8.7	8.3	4.5		
Savings/GNP(%)	16.0	12.5	11.8	12.7	13.4	9.5		
<i>Public finance</i> Budget deficit/GNP(%)						8.5		3.0
<i>Poverty indicators</i> Urban unemployment rate (INE)(%) Urban unemployment rate (CEDLA)%	5.3	6.1	6.8	7.3	7.4	8.0		8.2
Headcount poverty (INE)(%)		62.3	65.5	64.3	64.6	64.1	63.6	63.1
Gini coefficient of inequality(%)	62.7	62.2	64.4	61.5	63.2	62.4	61.4	60.1
Political changes and incidence of violence								
Changes of government				Vice-President Quiroga succeeds on death of Banzer		June: election won by Sanchez de Losada October: Sanchez de Losada resigns and flees from country after El Alto riots. His Vice-President, Carlos Mesa, takes over.		June: Carlos Mesa resigns following further riots in El Alto. Provisional govt appointed under Eduardo Rodrigues (chief justice) December general election: won by

								MAS under Evo Morales
Incidence of political violence: Deaths in policy- related violence			Feb- April: 4 (Cochabamba a 'water war' and other rural blockades) 18 Sept- 4Oct: 7	21-30 June: 2	January :12	February: 30 (La Paz) October: 59 (La Paz and mainly El Alto)		June: 1(Sucre)

Source: Instituto Nacional de Estadística (www.ine.gov.bo); Banco Santa Cruz/Muller y Asociados, *Estadísticas socio-económicas 2001, 2003, 2005*. Estimates of headcount poverty from UDAPE. 'Deaths in policy-related violence' and 'Days lost through strikes and demonstrations' are our own measure, which is elaborated in Mosley(2006b), Appendix 2.

A brief chronology of these episodes of violence can help to explain the interaction between short-term and long-term factors in causing the poverty trap to snap shut. In April 2000, blockades in protest at the government's economic policies were organised by the CSUTCB (*Confederación Sindical Unica de Trabajadores Campesinos de Bolivia* – the small peasant farmers' union) in various parts of western and central Bolivia, in protest against the increases (of up to 275%) in prices imposed by the water authority in Cochabamba, privatised under Law 21060. In the process of suppressing these blockades, four people were killed¹¹. In February 2003, a proposal was made to extend the income tax net downwards to include various categories of salaried employees not previously covered, in preparation for the arrival of an IMF mission which was expected to provide a \$3.9 PRGF (Poverty Reduction and Growth Facility) credit in return for credible reductions in Bolivia's fiscal deficit of 8.5 per cent of GDP¹². Before the proposal could be implemented, it was leaked to the press and, when a riot was started by students in the Plaza Murillo, the La Paz square where the presidential palace stands, the police, who were amongst the low-paid workers at risk of being brought into the income tax net under the new proposals, did not defend the palace, and stood aside. The army were then sent in to discipline the police, among whom about two-thirds of the 30 fatalities in the subsequent rioting took place¹³.

The climactic confrontation between the security forces and civil society took place in October 2003. It followed the announcement of a general strike in El Alto and La Paz by the COB (*Central Obrera Boliviana* – Bolivian Confederation of Trade Unions) in protest against a government plan to export Bolivian natural gas in an unprocessed state through Chile. The army, under government orders, broke a blockade of the Senkata petroleum depot, on the south side of El Alto, by force on 13 October, and this action escalated into a more general insurrection across the whole of El Alto in which, on 13 and 14 October, at least 59 people were killed¹⁴. On 14 October, the vice-president, Carlos Mesa, detached himself from the government in the light of the killings, and when, on 17 October, President Sanchez de Losada fled the country to escape what had become a lynch mob, Mesa was sworn in as interim president. His 21-month administration ended also with a general strike initiated in El Alto, in June 2005. The election of the country's first Aymara-Indian president, Evo

¹¹ These episodes are described in detail in *Pulso*, issues 37 through 39, 7-27 April 2000.

¹² Miguel Lora, *Pulso*, 7-13 February 2003, p.11.

¹³ Detailed coverage of these incidents is given in *Pulso*, issue 183, 7-13 February 2003, and in *La Prensa* for 12 February 2003.

¹⁴ For a very simplified geography of El Alto, see Figure 3 below. A detailed overview of the events of 'Black October' is given in the special issue of *La Prensa* for 23 December 2003. Some eyewitness accounts also exist in book form, for example Garcia, Prada and Tapia(2004)

Morales, has not ended the climate of instability: in sectarian rioting between groups of miners in Oruro in October 2006, a further fourteen persons were killed, and two more died in demonstrations in Cochabamba in January 2007¹⁵.

Why did these incidents of political violence occur? At the level of proximate causes, one account given in the wake of the February 2003 violence by the Governor of the Central Bank, Juan Antonio Morales, stressed the long-term factor of inequality (especially 'horizontal' inter-ethnic inequality), and the failure of the government's short-term measures to relieve it:

[The increases in] Bolivia's external debt and the external aid aimed at reducing poverty benefited mainly the middle class. Even if improvements were achieved in the Human Development Index and poverty fell, the distribution of income deteriorated, as it did across the whole of Latin America. The deterioration of income distribution in a poor and supremely politicised country is perhaps among the main causes of the tragedy of [last] February¹⁶.

However, several countries also suffering from high levels of inequality, including some in Latin America, did not suffer from the same high levels of overt social conflict (see further Table 8 below): so one thing that has to be explained is why a given plausible cause led to particularly grave effects in Bolivia. Secondly, it is useful to embed the Governor's explanation in a broader picture of cause and effect which takes into account not only the causes of violence, but its consequences in terms of lowered investment rates, and thence lower productive potential and incomes.

These are captured by the 'political vicious circle' model originally presented in Figure 1, which suggests that a circular causation between low incomes, political instability, investment collapse and low incomes will persist if the connections from economic decline to institutional debility and bypassing of formal political institutions (links 2 and 3 on Figure 1) are strong enough. In what follows we shall seek to argue that these linkages were particularly strong in Bolivia, and caused the political poverty trap to close, because of four factors:

- (1) '*deinstitutionalisation*' or '*political decapitalisation*': because of the decay of a range of institutions designed to promote justice and in particular to protect the interests of the weak, the deterioration of income distribution came to seem particularly hurtful to the excluded.
- (2) *The metamorphosis of party politics*: especially over the years of recession (2000-2005) the political parties acknowledged by the politically weak as protecting their interests moved away from parliamentary towards other channels of influence.
- (3) *The geographical focussing of discontent*: much of the anger felt by the poor was experienced in a location (El Alto) where it could be organised and deployed with reasonable probability that violent extra-parliamentary action could achieve long-term political change.
- (4) *Wasted opportunities for executing 'pro-poor' modes of policy reform*: even in face of the extreme vulnerability factors represented by (1) to (3), economic policy options for healing the underlying social conflict existed, had been successfully been tried out in other

¹⁵ See *Bolivia Rising* (<http://boliviarising.blogspot.com/2007/01/democracy-is-people-antonio-peredo.html>), 16 January 2007.

¹⁶ Juan Antonio Morales, 'Que le ha pasado a Bolivia?' (What has happened to Bolivia?), *Pulso*, 14-20 March 2003, page 7.

contexts, and might have been helpfully tried out in Bolivia. They were not used, and for this lack of vision the international financial institutions, on which Bolivia more than most crisis-afflicted countries was heavily dependent, bear some responsibility.

Political instability then drove away foreign capital, and the loss of investment perpetuated low income, completing the vicious circle. Having provided a rationale to support these hypotheses, we then, in Part 4, offer a test of them.

'Deinstitutionalisation'

In various ways, the visible impact of inequality was aggravated by institutional decay, or 'deinstitutionalisation' as the phenomenon is generally known in Bolivia. One major aspect of this is corruption, and specifically corruption arising from the process of 'capitalisation' (as the form of privatisation selected in Bolivia was known) of state assets, especially oil, gas and minerals. This inflicted an *allocational* problem, due to the fact that factors of production were often not being allocated on the basis of efficiency but on the basis of ability to lean on the government; a *fiscal* problem, one illustration of which is that in 2003, the privatised oil and gas companies were paying less than half the tax revenue they were paying before privatisation¹⁷; and a *distributional* problem, because the gains from corruption accrued mainly to the rich and not to the poor. It was largely the evidence of huge gains to the fat cats from the privatisation of the oil and gas sector at a time of austerity (and specifically income tax increases) for the mass of the population which caused the apparently rather extraneous and rarefied issue of petroleum exports via Chile to become a flashpoint in October 2003¹⁸.

A second element of institutional decay, intimately related with the decline in investment illustrated by Table 3, is based in the financial sector. The heavily microfinance-based¹⁹ recovery of the banking sector gradually became contaminated during the boom of the late 1990s, in particular by the entry into the market of consumer-credit houses seeking to lend to low-income groups without proper appraisal or security (Rhyne, 2002), which loaded many households and small businesses with a burden of debt they could not expect to sustain. When the recession hit, many clients defaulted on their loans (average six-month arrears rates in the microfinance sector rose from 2% to 12% between 1997 and 2001), and some of the more politically powerful of them leaned on the Banzer administration of 1999-2001, sometimes collectively as a debtors' cartel, to override their creditors and have their debts annulled. Some of the more loyal clients of the government were

¹⁷ Rolando Morales, *La Prensa*, 12 February 2003, p.6. 'The Confederacion de Empresarios Privados de Bolivia', Morales adds, 'indicated that the fall in the country's fiscal revenues [between end- 2001 and end-2002, which had caused a shortfall in revenues and required the IMF to be called in] was 7.3 per cent, and that the principal reason for that was a fall of 25.4 per cent over the same period in tax revenues due from the hydrocarbons (oil and gas) sector'.

¹⁸ In 2003, this was aggravated by two factors. First, many of the gains from growth, and from growth in the oil sector in particular, fell to the advantage of the already rich east and south-east of the country rather than the poor west (this has been felt particularly keenly during the period of rising oil and gas prices since the onset of the Iraq war in 2003). Second, President Gonzalo Sanchez de Losada, as the person who acquired many of the more profitable assets from a collapsing mining industry during the structural adjustment period, was himself an early epitome of the class who had made, and exported, a great deal of money out of Bolivia as a consequence of the privatisation process.

¹⁹ The microfinance institution BancoSol, born out of a non-governmental organisation initially capitalised by USAID, was for several years in the mid-nineties the most profitable bank in Bolivia.

successful in this, and in this way financial discipline was undermined²⁰. Because the banks were not getting their loans back, their lending, and the level of domestic investment, became increasingly constrained: the collapse of domestic investment visible in table 3 is intimately related to the collapse of discipline in the banks²¹. Whereas an initial shock to investment is a common feature of many recessions, whether or not this shock turns into collapse depends crucially on the behaviour of the banking sector, and it is significant that in Indonesia, another country badly hit by the 'East Asian' crisis, financial discipline was not relaxed by the main microfinance banks and small business investment rose through the recession, acting as a counter-cyclical factor (Patten and Rosengard, 2001; Marconi and Mosley, 2006). The ability of Bolivia's financial sector to exit from crisis may depend on whether the MAS government carries out its election pledge to cancel all overdue microfinance debt, which it so far has failed to do.

A third element of deinstitutionalisation was the erosion of civil rights. An important illustration of this process was the refusal of President Sanchez de Losada, in September 2003, to re-elect Ana Maria Romero de Campero as *Defensor del Pueblo* ('ombudsman' is only a loose translation). The office had been established in 1998, as one of the achievements of the Banzer years. A person who had spent five years upholding the law, and specifically civil rights law, was removed at a time of extreme pressure on those civil rights by the personal edict of the President –against, it turns out the advice of many of his senators and MPs²². The incident was a crucial one in triggering the violence of October 2003²³.

During the recession, indeed, the entire legal process in Bolivia became incapable of protecting civil or private property rights in a just or equitable manner. In the context of a system where, against sins of corruption and tax evasion plated with gold, the lance of justice could be seen to break hurtlessly, it was obvious, not only to the socially excluded, that existing institutions were not working. This was to be a major factor in bringing about political change.

The metamorphosis of party politics

It is well acknowledged that across the whole of Latin America political parties have for a number of reasons fallen short of orthodox democratic ideals (Foweraker, Landman and Harvey 2003: chapter 5). However, in Bolivia both the instability of the party system and the extent to which pro-poor parties have gone outside parliament to make their case exceed the Latin American norm. The MNR (*Movimiento Nacionalista Revolucionario*), the architect of the 1952 land reforms and nationalisation programmes, embodied a pro-poor rhetoric for a considerable period, but on its return to power in the emergency of the 1985 hyperinflation was forced to

²⁰ This generalisation is true as a general tendency but it is not remotely true for all financial institutions. Four microfinance institutions in particular (FIE, Caja los Andes, PROMUJER, and CRECER) resisted the trend towards increasing arrears during the recession, in part because their management stood up to government pressure to cancel arrears, in part because they were better designed to withstand shocks (for example by means of the 'internal account' of the last two institutions named, which acted as an insurance mechanism), and in part because of intense institutional loyalty amongst customers of all these institutions (Marconi and Mosley, 2006).

²¹ To the extent that microfinance reduces poverty, the fall in micro-lending described here also contributed directly to the increase in poverty of the years 1999-2004.

²² Interview, MNR senator, 21 September 2005.

²³ See *La Prensa*, 23 December 2003, and also the interview with Ana Maria Romero de Campero in *Pulso*, issue 218, 10-16 October 2003, in which she describes Bolivia as a 'democradura' (half democracy, half dictatorship).

put stabilisation before redistribution. Throughout the period of structural adjustment between 1986 and 1999, the main parties, all essentially pro-liberalisation, pro-international capital, pro-US parties of the centre-right (MIR, ADN/NFR, and MNR) were forced to engage in coalitions in order to govern, 'constantly changing position, like good lovers, each one sometimes on top and sometimes underneath'²⁴, as delightfully described by the columnist and former MP Cayetano Llobet. The horse-trading involved in making these coalitions compromised not only their ability to make rational decisions of fiscal policy²⁵, but even more their ability to represent in any credible way the interests of the socially excluded.

As Table 4 illustrates, this merry-go-round has now been completely shattered during the five short years of the Bolivian recession. None of the three parties which shared power throughout the structural adjustment period fought the 2005 election as serious candidates, and the country is now governed by a party (the MAS, or *Movimiento al Socialismo*, led by Evo Morales) which until 2002 had only 3% of the seats in parliament²⁶. In the 2002 election, the MAS and the MIP (*Movimiento Indígena Pachacuti*, led by Felipe Quispe, also the leader of the CSUTCB), both of them parties led by Aymara Indians committed to social justice achieved via constitutional change, economic protectionism and 'regaining the country's natural resources for the people', broke through: by contrast with the former elite parties, these are both low-tech parties, able to achieve an electoral transformation in spite of lacking any national organisation, publicity machine or access to international consultants (Lazarte Rojas 2005: 358). The US Ambassador clumsily sought to influence the 2002 election by telling the electorate not to vote for the MAS, a tactic which spectacularly backfired²⁷. From the 2002 election onwards, all pretence of respecting the parliamentary rules of the game was abandoned by both government and opposition. Quispe, on behalf of the MIP, promised a return to the roadblock tactics of 2000²⁸; Morales sought to supplement or replace the parliamentary process with a meeting between the president and a broad front of civil society interests: 'workers, small farmers including coca growers, pensioners, financial services clients'²⁹; and President Sanchez de Losada himself not only confined his dialogue with Morales (still the leader of the coca growers' union) to the issue of coca eradication³⁰, but chose the month of January 2003, just as the chances of a peaceful solution to the crisis were beginning to look problematic, to launch a pre-emptive strike against the coca growers of the Chapare, in which thirteen people were killed. From this point on, peace had little chance.

²⁴ Llobet 1999, p.47.

²⁵ For example, the extravagant pensions reform of 2000? – see page 19 below.

²⁶ The first serious attempt by a political party contender to represent the interests of the socially excluded, in the 1990s, was CONDEPA (*Conciencia de Patria*, Conscience of the Nation). CONDEPA, led by a 'white' professional arguing for poverty reduction on grounds of compassion, certainly raised the consciousness of the middle class concerning the gravity of social exclusion in Bolivia, but fell victim to widespread accusations of corruption (Llobet 1998) and was not able to sustain or consolidate its rapid rise.

²⁷ On 26 June 2003 the US Ambassador, Manuel Rocha, stated: 'I would like to warn the Bolivian electorate that if it chooses candidates who are trying to make Bolivia once again an exporter of cocaine, that result would prejudice future aid flows from the United States' (in the column *Usted Elige*, in *La Prensa* for 27 June 2002, as reported by Lazarte Rojas (2005), p.373.

²⁸ See Pulso issue 399 (21-27 April 2000)

²⁹ As reported in *Pulso*, 10-16 January 2003, p.4.

³⁰ See Victor Orduna, *Pulso* issue 179 (10-16 January 2003) and Lazarte Rojas, p.451.

Table 4. Parties in Bolivian Parliament, 1997- 2005

1997 <i>'Governing coalition'</i>			<i>'Opposition parties'</i>		
<i>Party</i>	<i>Leader</i>	<i>% vote</i>	<i>Party</i>	<i>Leader</i>	<i>% vote</i>
AND-NFR	Hugo Banzer Suarez	22.2	CONDEPA	Remedios Loza Alvarado	17.1
Movimiento de la Izquierda Revolucionaria (MIR)	Jaime Paz Zamora	16.7	Eje Pachacuti	Ramiro Barrenechea	0.8
Movimiento Revolucionario Nacional (MNR)	Juan Carlos Duran	18.2	Movimiento al Socialismo (MAS)	Evo Morales	3.2
2002 <i>'Governing coalition'</i>			<i>'Opposition parties'</i>		
<i>Party</i>	<i>Leader</i>	<i>% vote</i>	<i>Party</i>	<i>Leader</i>	<i>% vote</i>
Movimiento Revolucionario Nacional (MNR)	Gonzalo Sanchez de Losada	22.4	Movimiento al Socialismo (MAS)	Evo Morales	20.9
Movimiento de la Izquierda Revolucionaria (MIR)	Paz Zamora	16.3	Movimiento Indigena Pachacuti (MIP)	Felipe Quispe 'Malku' [The Condor]	6.0
Nueva Fuerza Republicana (NFR)	Reyes Villa	20.9	Other parties		9 11
2005					
			MAS	Evo Morales	54
			PODEMOS	'Tutu' Quiroga	32
			UN	Samuel Doria Medina	10
			Other parties		4

Sources: Van Cott (2003), table 1, p.753; Lazarte Rojas (2005), appendix.

Thus in face of the widening schisms and deprivations aggravated by the global crisis, not only did many of the key institutions which might have healed it come apart at the seams, but the parliamentary process which might also have healed it was partly or wholly bypassed by all of the main contenders.

It was the merit of Evo Morales, at the same time as he was contributing to this process of bypassing parliament, to persuade not only his core Aymara constituency but much of the middle class (at any rate in the western *altiplano*) to

back his efforts *within* the parliamentary arena³¹. He began this process in 2003, we argue, by successfully playing a ‘trust game’ against Sanchez de Losada. He persuaded not only his core constituency, but large parts of the urban middle class, to detach themselves from their traditional loyalties to the elite coalitions, even though this meant backing a man described by all the government-supportive media as a *narcotraficante* (drug-dealer). This trust game is formally modelled in the Appendix to Mosley(2006).

Poverty, inequality and militancy

It is a cliché frequently repeated in every conversation about the Bolivian predicament³² that ‘poverty lies at the bottom of everything’. True enough, but what kind of poverty, or change in poverty, is particularly likely to cause conflict and stop stabilisation policy in its tracks? The new economics-of-conflict literature is fairly silent on this theme, empirically confirming that lower levels of (and growth in) income and food consumption are associated with higher levels of conflict (Auvinen and Nafziger 2002, Collier and Hoeffler 2004), but in general confining itself to analysis of civil war rather than the type of street conflict discussed here, and not differentiating between the many measures of poverty and inequality now available. The political science literature stresses that a sudden expected fall in a standard of livelihood to which one has become accustomed is the type of poverty impact most likely to arouse sudden collective anger, and hence conflict (Gurr 1970, Goodhand 2003) but has not, in general, involved itself in assessing the role of different poverties in determining levels of violence.

In relation to Bolivia we may begin by examining what the indicators say and where the conflict was located. The indicators are set out in Table 5. Headcount poverty, after probably falling during the boom of the 1990s (Landa 2003, 2005; Landa and Jimenez, 2005) rises sharply in 2000, and is then flat through the recession to date. Health, education and other social indicators improve continuously, including during the recession (Klasen et al. 2005). The INE (*Instituto Nacional de Estadística*) estimate of open unemployment, which is only a short series, notably rises sharply in 2003, the year of greatest conflict. Other unemployment series show much greater variations: the CEDLA (*Centro de Analisis del Desarrollo Agrario y Laboral*) urban unemployment series doubles between 2000

³¹ We carried out a survey in La Paz and El Alto in September 2005 (Mosley 2006) with the purpose of understanding the links between interpersonal and political trust. This survey interviewed 105 people drawn equally from the ranks of microbusiness operators, manual workers and professionals. The results suggest that the proportion of professionals intending to vote for Morales was more or less equivalent to the proportion of workers and microbusiness owners intending to vote for him:

	<i>Intentions, September</i>				<i>Outcome, December*</i>
	Microbusinesses	Workers	Professionals	All	
Quiroga	6.5	5.7	30.6	14.7	29
Doria Medina	6.5	17.1	5.6	9.8	17
Morales	32.3	48.6	36.1	39.2	44
Other		2.9	2.0	2.0	10
Would not say	22.6	25.7	24.5	24.5	

(ii) Voting intentions and outcomes, 2005

³² This idea is echoed by the Governor of the Central Bank (page 10 above) – who, however, argues that inequality, even more than poverty, was the factor which triggered the riots of 2003.

and 2003 (table 3), and there are indications that in the city of El Alto, the level of unemployment trebled over this period (Table 5 above; *La Prensa*, special edition 23.12.04; *Pulso*, issue 195, 8 May 2003). El Alto, between 1985 and 2003, had grown from a small, exposed, dusty shanty-town adjoining the La Paz international airport into the Soweto of Bolivia, a vast melting-pot for Aymara and Quechua people in many cases uprooted from their previous livelihoods in mining or in agriculture³³, on whom the economy of the entire western half of Bolivia depended.

Table 5. Indicators of poverty and ill-being, 1996-2005

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bolivia										
Headcount poverty		63.2		62.3	65.5	64.3	64.6	64.1	63.6	
Extreme poverty		36.5		40.7			41.3			
'Open unemployment': INE CEDLA ³⁴				4.3	4.8 6.0	5.2	5.4	6.0 13.5		
Departmental capitals*										
Headcount poverty		50.7		46.4	52.0	50.5	51.0			
Extreme poverty		21.3		20.7	25.7	22.3	23.9			
El Alto										
Headcount poverty						66.9				
Unemployment									22.0 ³⁵	
Santa Cruz										
Headcount poverty						19.1				

Source: Unidad de Analisis de Politica Economica (UDAPE); Jimenez and Landa 2004; Klasen et al. 2005; INE, *Anuario Estadístico 2004*, table 3.06.03.04, page 339; World Bank 2005, tables 1.1. 'Normal' headcount poverty line (at 2002 prices) is Bs 233/month (rural) Bs 321/month (urban), Bs 327/month (La Paz), Bs 272/month (El Alto). 'Extreme poverty line' is Bs 133/month (rural), Bs 170/month (urban), Bs 181/month (El Alto). CEDLA unemployment data are reproduced in PULSO (La Paz), issue 195, 2-8 May 2005.

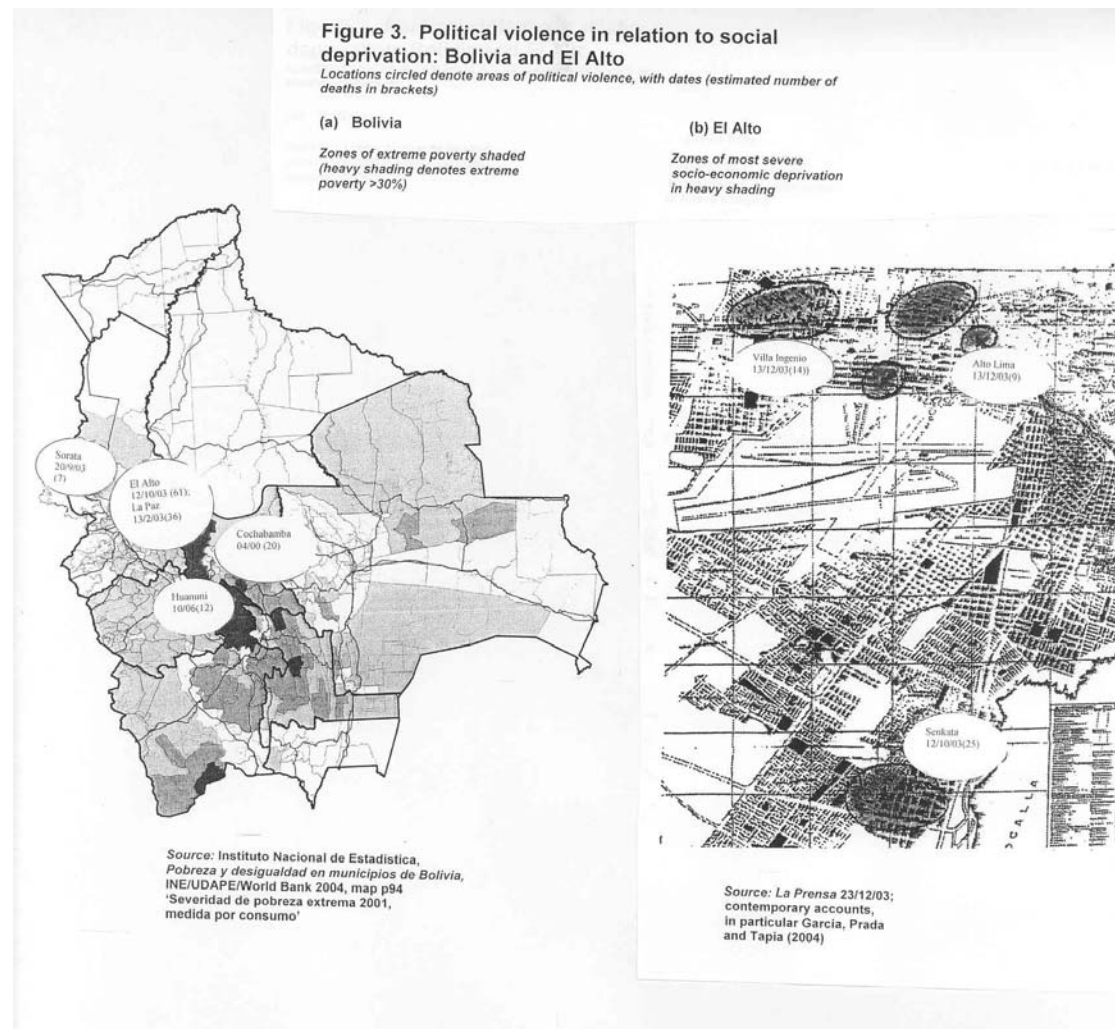
It is, therefore, *not* possible to say that the onset of renewed social conflict and political instability in Bolivia as a whole, in 2000, is correlated with a sharp rise in the conventional measure of poverty. Further, the escalation of that conflict, in 2003, is not correlated with any visible increase in most of the conventional measures of poverty in Bolivia as a whole. What occurred in 2003, rather, was that an increase in conflict confined to urban and peri-urban areas on the western side, in the *altiplano*, the main territory of the Aymara, was associated with an increase in *unemployment*

³³ El Alto indeed 'is unique in Latin America for being an almost wholly indigenous city', Lazar 2004, p.5.

³⁴ Centro de Estudios para el Desarrollo Laboral y Agrario, La Paz

³⁵ ProMujer estimate. Jan 2004

in those same regions – and in particular with an increase in unemployment in El Alto, the most politicised part of the country. Even within El Alto (Figure 3b) the epicentres of conflict were in Senkata, Villa Ingenio and Alto Lima - the parts of the city with worst access to water, sanitation, and other public services.



As the left-hand part of Figure 3 shows, El Alto, and indeed most of the places where political violence has occurred since 2000, is not amongst the localities of highest poverty in Bolivia³⁶, although the contrary is often asserted in the media³⁷. However, it has five characteristics which, we argue, predispose it towards high levels of conflict. First, worsening trends both in unemployment, as discussed, but also in other indicators of deprivation, notably water and sewerage³⁸. Second, very high levels of intra-personal inequality³⁹, including intra-ethnic equality; rising much faster than conventional poverty indicators. Third, recent withdrawal of some key services needed to support a livelihood; in particular, microfinance was cut back countrywide

³⁶ The highest poverty levels in Bolivia are in the *altiplano* south-east of La Paz, between Coroico and Potosí (see figure 3). According to INE, *Anuario Estadístico 2004*, table 3.06.03.04, the percentage of persons in poverty in El Alto according to the 2001 census was 66.9 per cent (compare 58.9 per cent for Bolivia as a whole, or 19.1 per cent for Santa Cruz)

³⁷ See for example *La Prensa*, 23 December 2003, p. 22.

by most agencies during the recession from 1999 onward (page 12 above; Marconi and Mosley 2006) and El Alto is the most microfinance-dependent region in Bolivia. Fourth, strategic location: to paralyse western Bolivia and La Paz in particular, all that is needed is to blockade El Alto. The country's main airport is in El Alto (which was its original *raison d'être*); the three main roads from La Paz to Peru, Argentina and the east of the country, and the pipelines by which natural gas is transferred from the production areas to La Paz and out of the country, all pass through there. Fifth and maybe most crucial, El Alto is emphatically the place in Bolivia where poverty is most politicised. The system of *juntas vecinales* (neighbourhood groups), linked by CoJuVe, the Confederation of Neighbourhood Groups⁴⁰, made communication easy, as did access to modern technology⁴¹: the uprising of October 2003 is one of the first revolutions to have been largely organised by mobile phone. It was also of great importance to communication that El Alto is made up mainly of recent migrants from all parts of Bolivia, and in particular of former miners and peasants. For the peasant confederation the CSUTCB, for the landless peasants' movement the *Movimiento Sin Tierra*, and for the trade union confederation the COB, El Alto was the main organisational focus, reinforcing and seeking to unify the efforts of the *juntas vecinales*⁴² and providing them with an idealistic, albeit not fully articulated, policy framework. This was autarchic and protectionist in nature, mixing atavistic notions of 'returning Bolivia's natural resources to their rightful owners' with ideas reminiscent of early development economics advocating industrialisation based on those resources as a strategy for escaping from Bolivia's poverty trap. Some of the rhetoric emerging from El Alto during the period of the blockade is more reminiscent of late nineteenth-century Russia than any place in the twenty-first century:

'Neighbourhood reunions and workshops took place in which... the possibility of making El Alto into a modern industrial city, [with a freeport, protected by its own tariff barrier] with employment for all, was debated. The conclusion of most of these discussions was that the only real opportunity of development for the country as a whole, and hence for El Alto, was to recapture for the state the asset represented by oil and natural gas and to add value to it by means of industrialisation.'⁴³

⁴⁰ The CoJuVe was partly financed by Evo Morales' MAS: interview, Katy Lopez, ProMujer El Alto, September 2005.

⁴¹ Interview, Fernando Romero, 16 September 2005.

⁴² The rebellions of 2003 and 2005 not only set workers against business owners, but also neighbourhoods against neighbourhoods, and women against men. (Mostly female) street-traders, receiving microfinance loans and needing to break the blockade to get their inputs and sell their produce, were in many cases the partners of (mostly male) workers required by the COB or the *junta vecinal* to be on the blockade. The *juntas vecinales* operated a licensing system, requiring traders to hold permits (*fichas*) if they were to continue to trade; many traders, during the blockade, were threatened with the withdrawal of these permits and even with the destruction of their kiosks unless they took part in the blockade (interviews, February 2004; see also Aliaga and Mosley 2006)

⁴³ Unsigned article, '*Pedagogia de la Sangre: Las Lecciones de Octubre* (What we learn from Bloodshed: The lessons of October 2003), *La Prensa* (La Paz), 23 December 2003, p. 20. During 2003 several articles were published in the Bolivian press illustrating how Bolivia's oil and natural gas resources could be converted into petrochemicals, plastics and other derivatives far more labour-intensive than existing oil and gas extraction activities, See for example *El Diario*, 5 February 2003, where it is claimed that value added from natural gas exports could be multiplied between a factor of between two and ten depending on whether the processing is 'simple' (electricity generation) or 'compound' (second and third generation petrochemical products). In particular, opportunities existed for selling gas-generated electricity to Brazil and Argentina from power stations located near the eastern and southern borders: an agreement of this with Argentina was signed to great acclaim in June 2006.

El Alto's high degree of political vision and organisation was thus, during this period, blended with its ability to serve as a conduit for most of the grievances of the poorest. This unique role greatly augmented the probability of those grievances turning into violence.

The choice of adjustment instrument and the role of aid donors

All of these three factors – the rise of radical ethnically-based political parties, deinstitutionalisation, and the politicisation of urban poverty in El Alto – form the frame determining the government's room for economic-policy manoeuvre. It is to the use that was made of that room for manoeuvre that we finally turn.

The context is that under the stress of recession, fiscal leakage through corruption⁴⁴ and a series of misconceived public-expenditure decisions, the Sanchez de Losada government found itself at the beginning of 2003 (Table 1) with an unsustainable public sector deficit of 8.5% of GDP, of which five percentage points were caused by a public-sector pensions reform expected to cost an extra 1.1 billion bolivianos (\$150 million) over the years 2000-2010 (*La Prensa*, 12/2/03; Julio Loayza, personal communication)., Needing to close this fiscal gap, it took two decisions both of which were the trigger for conflict, and which, we argue, caused the political poverty trap to finally snap shut. In February, it proposed an extension of the income-tax net to certain categories of the lower middle class, including the police (whose rebellion was suppressed in the February riots), and in September, as part of an overall plan for economic expansion, it proposed that exports of natural gas should be expanded by means of a new pipeline through Chile. In part because of the political turmoil which they caused, these decisions were economically and even fiscally counter-productive. Why were they taken?

⁴⁴ Recall the argument on page 16 above.

Table 6. Fiscal-policy decisions of 2003 resulting in violence, and the alternatives to them

	Income tax reforms, February 2003			Natural gas exports, September 2003		
	<i>Proposed measure</i>	<i>Short-term alternatives</i>	<i>Medium-term alternatives</i>	<i>Proposed measure</i>	<i>Short-term alternatives</i>	<i>Medium-term alternatives</i>
Description	Extension of income tax net to cover lower middle class	Tax changes of a more progressive type(eg airport taxes, hydrocarbon windfall taxes, closing of VAT loopholes on small and medium enterprise); expenditure cuts	Increases in pro-poor expenditure ratio and other increases in 'social efficiency wage'	Construction of natural gas pipeline through Chile, together with bulk export contracts	Negotiation of higher price for bulk gas exports	Plans for petrochemical-based industrialisation and employment
Apparent political impact	Rioting in La Paz, Feb 2003; 30 deaths	Would have entailed shift to a more equitable (and possibly less politically sensitive, see p. 9) tax base	Could have reduced poverty and increased growth (see table 7)	Rioting in El Alto, Oct 2003;; 60 or more deaths	Could have given the impression of an 'activist' government seeking to make a more effective international deal	Could have enhanced employment prospects, but only in the medium term
Impact on inequality	Negative: extension of tax net was purely to lower income groups			No direct impact, but drew attention to pre-existing inequalities	Probably neutral	Probably more labour-intensive than the oil and gas industry itself, and might have created jobs

The most obvious answer is a failure of vision: to foresee either that the measures proposed would force the government into conflict, or that alternatives existed which could have achieved the same fiscal saving at lower cost. We examine the two cases in sequence.

In the case of the February 2003 income tax increase, it seems clear that although the idea of closing the fiscal gap in this way originated with the IMF, the Fund left it

open for the government to propose other alternatives⁴⁵. Any politically aware government would have known, firstly, that a tax increase widely perceived as regressive⁴⁶ whose principal focus was the urban middle class was dangerous. (Once of the most important findings of the OECD study of social consequences of adjustment by Bourguignon and Morrisson (1992) was that, of all possible techniques for adjusting to a fiscal deficit, tax increases had the highest social costs). The analysis of Table 6 suggests that other tax bases existed which could have been immediately tapped in the short term both with less regressive, and with less harsh political, consequences. Secondly, it would have been both quicker and less regressive to seek to close the deficit by making cuts on the expenditure side (especially capital spending) than by increasing taxes of any kind. In the event not only was this not done, but public spending was *increased* through the crisis period, with four new ministries and nine new vice-ministries created between June 2002 and February 2003⁴⁷. In the longer term, the obvious way of lowering the political costs of adjustment would have been to redirect the pattern of public expenditure in a more pro-poor direction. Alternatively, by other means, it might have been possible to increase what we describe as the *social efficiency wage* – the bundle of public policies which have leverage in forestalling political instability, and which thereby raise the productivity of all public expenditure, by analogy with the efficiency-wage concept of standard labour economics, where an increase in the private wage increases the stability and productivity of labour (Mosley 2004, Mosley and Mussurov 2007)⁴⁸. But none of these options were taken. De-institutionalisation had helped to close the channels through which they could be communicated to the government.

The trigger for the second and more serious wave of political violence, in October 2003, - the government's announcement that it intended to build an oil and gas pipeline through Chile – is in a sense more surprising, because unlike the February tax increase it did not impinge directly on the entitlements of any social group. The context is however that the policy of capitalising (privatising) the hydrocarbons sector, and indeed all the state-owned industries⁴⁹, had left a legacy of bitterness for reasons already discussed: namely that it yielded a small return to Bolivia because of its ownership by international capital (made smaller still because many of the

⁴⁵ This is asserted by (inter al) Juan Antonio Morales, Governor of the Central Bank of Bolivia, PULSO, 14-21 March 2003, page 7. The IMF Resident Representative in La Paz confirmed that what the Fund had foreseen was 'not to extend the income tax net to politically sensitive groups such as the lower middle class...but simply to extend the net of income taxpayers beyond the 10% who were at that time paying income tax' Interview, Esteban Vesperoni, La Paz, 15 November 2006.

⁴⁶ In essence, the reform proposed that some income tax should be paid not just by the richest 20% of the population but also by the next four deciles (going from the richest 30% to the richest 60%). Schedules with different distributions of this extended tax burden were published in the press (e.g. Miguel Lora, 'Golpe a la classe media' (Blow to the middle classes) PULSO, issue 183(7-13 February 2003), page 11; *La Prensa*, 12 February 2003, page 4). Whether or not this would have been regressive (ie increased inequality and/or poverty) depends on the distribution of public expenditure, which some commentaries argue was in fact pro-poor between 2000 and 2005 (); what is important however was the proposed tax changes were *perceived* as hitting the middle-class and in particular the lower middle-class such as the rank and file police much harder than the rich, many of whom were not paying the tax they owed anyway. (Morales op.cit note 43; Julio Loayza, personal communication).

⁴⁷ *La Prensa*, 12 February 2003, p.6.

⁴⁸ For further discussion of the social efficiency wage concept see Mosley (2004, 2007)

⁴⁹ The Cochabamba 'water war' of April 2000, which initiated the current wave of political instability, can be analysed in the same way, namely as a protest against the augmentation of inequality by a privatised utility. In Cochabamba that April, the price of water was tripled and people saw themselves as having to choose between food and water (Mc Neish 2005).

corporations were not paying their taxes)⁵⁰, and in particular conferred few benefits on the poor western side of the country. The bitterness was increased because Gonzalo Sanchez de Losada had personally become a millionaire out of the privatisation of the country's mining industry; and because of an ancestral grievance, going back to 1879, against Chile⁵¹, through which the proposed pipeline was to go. In the still recessionary climate of mid-2003 the government urgently needed to increase export and fiscal revenues, and again failed to perceive how politically inflammatory was the route by which it was seeking to do this⁵². The riots of October 2003 can therefore be seen as a protest against inequality augmented by what the radical opposition described as *entreguismo* ('handoverism')⁵³; which again, by an argument similar to that used in the case of income tax above, did not represent the only alternative open to the government, but could have been accompanied by less regressive measures: windfall taxes on the privatised hydrocarbon industries, democratisation of decision-taking over the ownership of those industries, measures to add value to the production of unprocessed natural gas, and in the longer term, once again, measures to increase the social efficiency wage. The first two of these, indeed, were implemented by the Mesa regime of 2004-5, and the third and fourth were promised in the manifesto of the new Morales government (Government of Bolivia, 2006) and are now in process of being implemented, with results which are as yet uncertain.⁵⁴

It might have been hoped that the donors – or at any rate some or all of the 'gang of four' who deal with all the budgetary support and macro-policy advice given to Bolivia⁵⁵ - would warn the Sanchez de Losada government of the danger associated

⁵⁰ Recall page above.

⁵¹ In the war of 1879 Chile deprived Bolivia of its coastal territories and acquired control over its access to the Pacific ports.

⁵²

⁵³ In our survey of September 2005 (see note 30) we asked respondents for their views concerning the causes of the fall of Gonzalo Sanchez de Losada. The replies were distributed as follows:

Answer given to the question 'What were the reasons for the fall of Gonzalo Sanchez de Losada?'	Microbusiness operators(n=23)	Manual workers(n=34)	Professionals(n=19)	Total
Wanted to sell gas to Chile	11	12	2	25
Use of violence	5	9	2	16
Corruption	3	4	6	13
Undemocratic, baronial style/didn't listen to people	3	1	4	8
Mismanagement of the economy		2	6	8
Took the side of the US/'not a true Bolivian'	1	4		5
Injustice, 'hatred of the poor'		2	3	5

Across the sample as a whole, therefore, the gas issue dominated even the use of violence as a cause of the President's downfall, even though it did not directly affect the well-being of any of them.

⁵⁴

⁵⁵ The IMF, the World Bank, the Inter-American Development Bank and the Corporacion Andina de Fomento.

with its chosen instrument of fiscal adjustment. They did not. Indeed, the president of one of them appeared on national television to defend the need for a downward extension of the income tax network on February 11, the night before first the police and then the whole of La Paz rioted against the injustice (Lazarte Rojas 2005:18). The World Bank's representative very uncharacteristically claimed that it did not see fiscal policy and other short-term policy issues as a Bank, much more a Fund, responsibility⁵⁶, and the Corporacion Andina de Fomento (CAF) argued that it saw its role at the time as to achieve implementation of expenditure projects on which money was unspent and development thereby delayed⁵⁷, not tax reform. The degree of coordination between the donors, and between them and the Sanchez de Losada government of whose decentralising, open-economy policies they greatly approved, was exemplary. This was the problem. The difficulty was not that the donors (as so often) were not singing from the same hymn-sheet, but that they were. Had but one of them warned the emperor that he was about to have his clothes forcibly removed, it is possible that some of the forces tending to close the poverty trap shut might at the last minute have been arrested⁵⁸.

Modelling of the political poverty trap

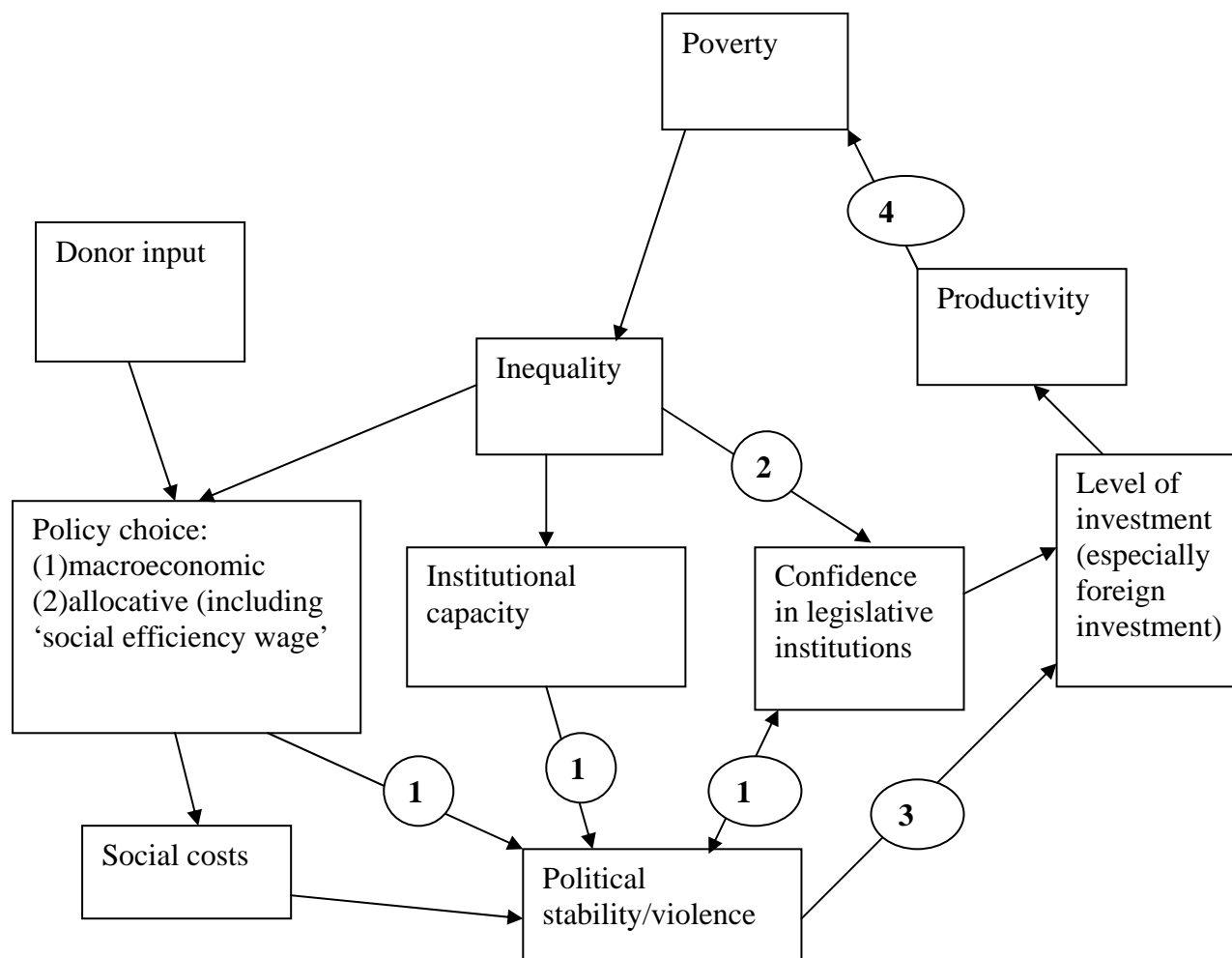
The argument is, then, that the four factors analysed – deinstitutionalisation, the changing modus operandi of the party system, the El Alto factor, and the government's abuse of its room for manoeuvre – converted an external shock into a political poverty trap. We now seek to gain more insight into this process by modelling it. A flow diagram of the model to be estimated is presented in Figure 4, which is transcribed directly from the right-hand part of Figure 1:

⁵⁶ Interview, Carlos Mollinedo, World Bank La Paz, 14 September 2005.

⁵⁷ Interview, Oscar Bonifaz Paz, CAF, La Paz, 22 September 2005.

⁵⁸ The CAF, somewhat locking the stable door after the horse has bolted, is currently disbursing a *Prestamo de Distension Social* (Loan for Reducing Social Tensions). The concept is laudable, and consists essentially of Emergency Social Fund-type expenditure focussed on areas of political tension such as those in Figure 3.

Figure 4. The ‘political poverty trap’: version to be estimated



The results of estimating this simultaneous-equation system are presented in table 7. The rationale behind the specification is as follows:

Political violence (relationship 1). Much analytical effort has recently been put in estimating predictive models of conflict in developing countries: but mainly with an emphasis on civil war. Within this literature, there is much debate between so-called ‘greed’ models (eg Collier and Hoeffler 1998, 2004), in which conflict arises from the rebellion of individuals on economically rational grounds against the established state, and ‘grievance’ models (for example Cramer 2002 and Fearon 2004) in which conflict typically arises from the expression of resentment against so-called ‘horizontal’ inequalities (for example, between ethnic, religious, or regional groups) in an extreme form.

Our own interpretation, in which political violence in Bolivia arose from inequality (both horizontal and vertical) aggravated by institutional decay, the organisation of El Alto and poor policy, clearly contains elements of both these explanations. The rapid rise of unemployment in El Alto in 2002-3, and the blockage of constitutional

channels of protest, clearly aggravated the desperation and hopelessness of many inhabitants and, in the language of the 'greed' approach, lowered the costs of protest, especially a protest whose costs, as in the case of this type of violence, fell well short of civil war. At the same time, the level of injustice and distrust of government felt by the Aymara/Quechua population (and increasingly the middle class), and the increasing level of political mobilisation of that population, particularly in El Alto, are causes of conflict more associated with 'grievance' type explanations. All of these variables feature in our estimating equation, with trust represented by the monthly index of 'confidence in government policy' collected by the opinion poll agency *Apoyo* and political mobilisation represented by the popularity ranking of parties committed to extra-parliamentary action (the MAS and MIP). One merit of our dataset, in principle, is that we have data on actual political violence, in the sense of deaths in conflict associated with stabilisation policies (roadblocks, demonstrations etc.) rather than the 'political instability' indicators typically used in research of this type (e.g. the ICRG and World Bank datasets), which rely on the subjective opinions of key informants reported to public opinion surveys. However, both the violence and the political popularity data are only available for a period of eleven years (44 quarters), from 1996 through 2006, and it is important to be aware of the interpretive limitations imposed by this constraint. For this reason, our 'political violence' story is presented in the context of other types of evidence, both qualitative and quantitative.

Confidence in government (relationship (2)). A long-established literature on political support functions in industrialised countries argues that confidence in government, and hence confidence in it, will be responsive to variations in the electoral cycle, and also to variations in perceived competence in economic management⁵⁹. In the literature on industrialised countries, measures of material well-being (e.g. the national rates of unemployment, of inflation and sometimes of personal consumption per capita) are typically used as measures of economic competence. In the context of Bolivia, as we have seen, not only measures of absolute material prosperity but also measures of process (notably the level of political violence) and measures of perceived social justice and inequality between different social and ethnic groups have been influential in determining levels of trust in the government. Hence, in our estimation of support for the government (linkage (2)) for Bolivia, we retain, from the standard literature on voting functions, 'time since last election', unemployment and change in personal consumption and add in our estimator of political violence (quarterly deaths in street riots and demonstrations) into the regression set.

Violence, investment and poverty (relationships (3) and (4)). The final links in this part of the poverty trap are those between political instability and investment. We surmise that political instability will depress both domestic and, especially, foreign investment (as in the analysis of Alesina and Perotti(1996), and that this lower investment, completing the 'vicious circle', will lead in subsequent periods to higher poverty.

Our poverty trap model is one of simultaneous causation, in which the causes of political violence are themselves endogenous to indicators of poverty and other causal variables within the model; hence a simultaneous-equation estimation technique, three-stage least squares(3SLS) is employed, in which the right-hand variables which are endogenous are replaced by appropriate exogenous, or instrumental, variables which are correlated with the endogenous right-hand side

⁵⁹ A large literature seeks to estimate 'popularity functions', using opinion-poll data on the government's popularity as a dependent variable. See Kramer(1970) Goodhart and Bhansali(1971) and Mosley(1978). We believe this is one of the first attempts to estimate them for a developing country.

variables. The estimates are presented in table 7, with the instrumental variables in italics.

Table 7: Regression analysis of ‘political poverty trap’ model

Regression coefficients on independent variables:

<i>Dependent variables</i> Independent variables	<i>Political violence</i> (linkage 1)		<i>Confidence in government</i> (linkage 2)		<i>Investment rate</i> (linkage 3)		<i>Gini coefficient of inequality</i> (linkage 4)	
	Pre- and Post-crisis 1996-2006	Crisis 2000-06	Pre- and Post-crisis 1996-2006	Crisis 2000-06	Pre- and Post-crisis 1996-2007	Crisis 2000-06	Pre- and Post-crisis 1996-2008	Crisis 2000-06
Constant	226.3** (3.54)	-403.5** (7.71)	71.3** (10.64)	524.3** (7.62)	107.0* (2.61)	11.7** (28.2)	60.5** (9.34)	53.3** (3.02)
<i>New government dummy</i>			-0.52* (1.86)					
<i>Unemployment (INE data), urban areas only</i>	-53.6* (2.42)		-5.31** (4.00)	-86.8** (6.94)				
<i>Unemployment (CEDLA data), urban areas only</i>		0.53 (0.50)					0.92** (3.69)	
Gini coefficient of inequality	4.62* (1.96)	6.43** (4.58)						
<i>Confidence in government</i>	-6.19** (3.65)	-0.11 (0.41)				0.045** (5.35)		
<i>Political militancy indicator</i>	1.42* (2.22)	0.15* (4.38)			-0.34** (3.09)			
Political violence indicator				-1.76** (4.89)	-0.82* (2.38)	-0.002 (0.38)		
Investment rate							-0.28** (2.49)	-1.83* (2.84)
<i>Pro-poor expenditure</i>							-0.33** (4.98)	-1.92* (1.38)
<i>Poverty (headcount index)</i>					-1.95** (2.80)		0.17* (1.67)	
Number of observations	44	28	44	28	44	28	44	28
R ²	0.91	0.95	0.59	0.86	0.68	0.79	0.55	0.81

Note: Three-stage least squares (3SLS) estimation; data are quarterly for the duration of the recession from first quarter 1999 to final quarter 2005 (hence n=40). Instrumental variables are in italics.
Definitions and sources: *Political violence indicator:* Deaths in policy-related conflict (street violence and demonstrations): index constructed from original sources, see Table 3 above. *Headcount poverty, Gini coefficient of inequality, INE unemployment rate total investment rate, foreign investment rate:* from Instituto Nacional de Estadística (INE), Estadísticas socio-económicas 2004. *CEDLA unemployment rate:* from Centro de Estudios para el Desarrollo Laboral y Agrario, La Paz. *Trust in government:* Apoyo Opinión y Mercado, *Informe de Opinión*, August 2005 issue plus updates. *Political militancy indicator:* proportion of seats held by parties involved in extra-parliamentary action (MAS and MIP)

The results of the regressions confirm as significant all the links hypothesised as make up the ‘political vicious circle’ model of Figure 3. *Political violence* (linkage 1) is associated with, amongst economic (‘greed’) variables, high levels of the Gini coefficient of *inequality* (reflecting the correctness of the instincts of the Governor of the Central Bank, page 10 above), but, as discussed in the text above, it responds insignificantly to conventional poverty measures (Figure 5): violence has increased, between the late 90s and early 2000s, whilst poverty has slightly fallen. Amongst the political ‘grievance’ variables in our model, violence is negatively associated with the

Apoyo index of trust in government and positively associated with a rise in the share of militant parties . As also illustrated on Figure 5, *trust in government* (linkage 2) rebounds at the beginning of each electoral period and responds negatively to levels of unemployment (as in industrial countries) but also responds negatively to political violence. Investment (and in particular inward investment from abroad; linkage 3) are responsive to the violence indicator and the political militancy indicator, declining particularly sharply during periods such as 2000 and 2003 when political instability is high and improving when calm is restored, in keeping with the cross-section findings of Alesina and Perotti (1996). Finally, and completing the political vicious circle, the Gini coefficient of inequality (linkage 4) responds negatively in response to declines in foreign investment and to increases in poverty and the social efficiency wage (*ppe*)⁶⁰. The results are robust to changes in specification, for example the experimental changes in estimating sample and control variables reported in the right-hand part of each column of table 7. When we move from data for the pre-and crisis period to the crisis period only, and when we amend the set of instrumental variables used to estimate the parameters of the poverty trap, the estimated impact of the core variables in the model does not significantly alter: the key linkages continue to be those from investment and the composition of public expenditure, to inequality, to political violence, to confidence in government, and back to investment.

⁶⁰ The ‘social efficiency wage’ is the set of public expenditures visualised as influencing political stability, and its definition is therefore sensitive both to the distribution of well-being and to the relative militancy of different social groups in each country. As a proxy for the social efficiency wage we here use ‘pro-poor expenditure’ (*ppe*), the ratio of expenditure likely to benefit low-income groups (primary health and education, rural water and sanitation, agricultural research and extension) as a proportion of total government expenditure. It is by no means clear how robust this definition of the social efficiency wage, which suggests that pro-poor expenditure will increase political stability, is across countries (Mosley and Mussurov, 2007). However, on the evidence of the right-hand column of table 7, it seems to work reasonably well in Bolivia.

Figure 5(a) Bolivia 1999-05: political violence, unemployment, and poverty

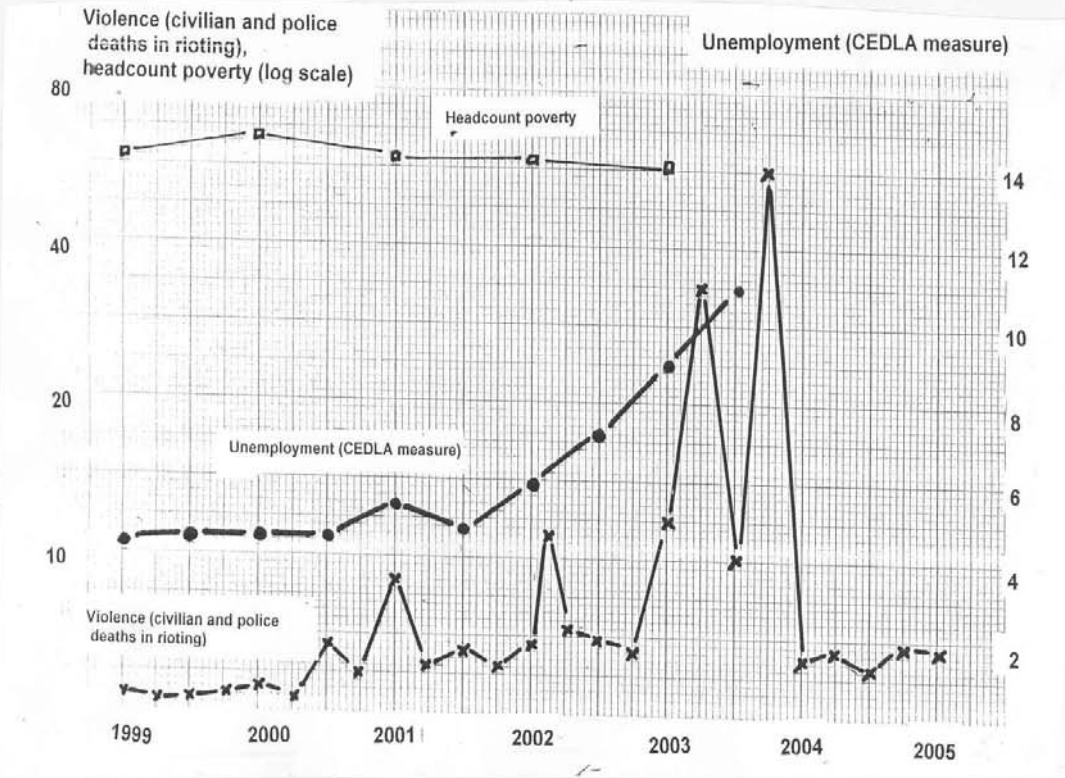
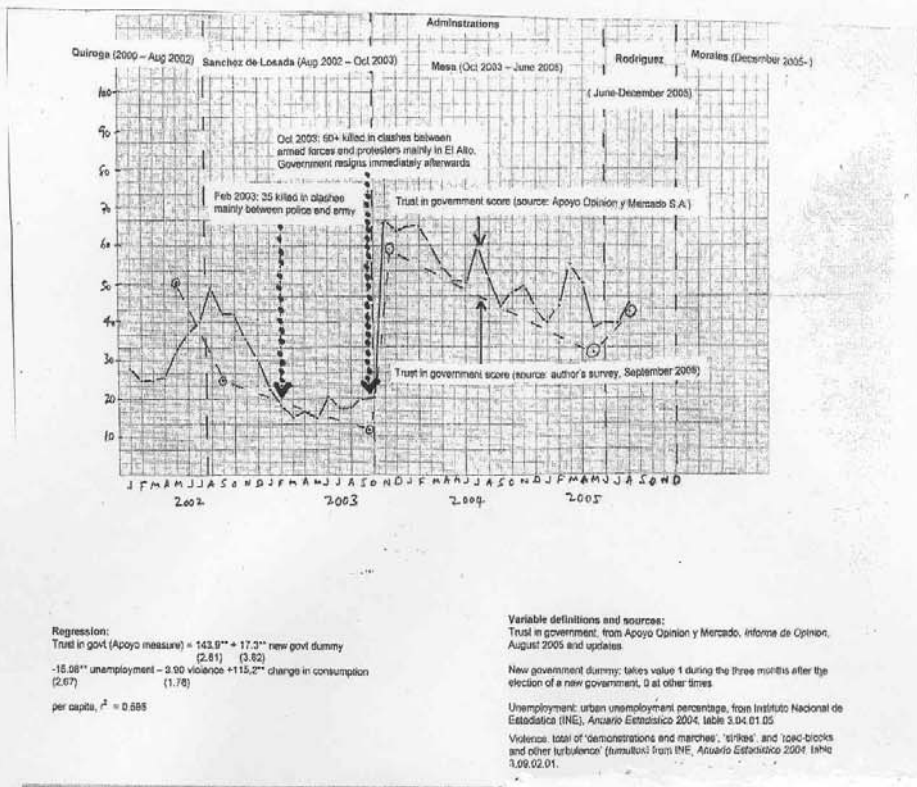


Figure 5 (b) Bolivia 2002-05: Trust in Government and possible determinants



4. International comparisons revisited

In order to better understand the question of how Bolivia came to be caught in a political poverty trap, we now take up again the comparison with other crisis-afflicted countries. In Table 8, we compare the values of the key policy and institutional variables which determined the likelihood of exit from crisis – institutional capacity, inequality, and a variety of indicators of the progressivity of economic policy – as between Bolivia and the other crisis-affected countries considered in Table 1, for the period 1995-2002, spanning the period from the build-up to the global crisis to the point when most of the crisis-afflicted countries were beginning to work out an exit strategy from it.

Table 8. Crisis countries: vulnerability indicators

Data given are for 1995-2002 (ie an average of pre-crisis and post-crisis years), unless otherwise stated.

	Initial conditions:		Policy choices: (as per table 7)			
	(1)Gini coefficient of inequality	(2)Institutional capacity:	(3)Internal/external adjustment measure	(4)Elements of the 'social efficiency wage'		(5)Capital controls((IMF score)
		World Bank 'voice and accountability' score, 2000/01	Percentage change in real exchange rate index(1995=100)	(a)Average value of PPE index 1995-2002	(b)Health and education spending (% GNP) 1995-2002	
Indonesia	32.3	-0.40	163.0	5.1	7.7	12.0
Malaysia	44.0	-0.13	56.7	12.5	6.1	12.0
Thailand	42.2	0.37	40.4	12.0	6.9	12.5
Turkey	39.2	-0.54	-23.3	24.2	13.6	9.6
Russia	40.5	-0.34	37.7	9.6	4.6	12.1
Brazil	58.7	0.52	134.2	9.0	8.5	13.1
Argentina	58.0	0.57	160.0	8.9	12.2	7.8
Bolivia	60.0	0.27	-10.3	10.6	7.9	3.6

Sources:

Gini coefficient of inequality: from World Bank, *World Development Indicators*, CD-ROM.

World Bank institutional capacity indicator: from World Bank website, www.worldbank.org/wbi/governance/govdata2002/(for a gloss, see also Kaufmann et al. (2003)).

Internal/external adjustment measure: ratio of changes in real exchange rate to tax rates;

original source for both is IMF, *International Financial Statistics*.

Pro-poor expenditure (PPE) index and ratio of health and education spending to GDP: IMF *Government Expenditure Statistics Yearbook* (for more detail of methods of calculation of the PPE index, see Mosley, Hudson and Verschoor (2004))

Capital controls(IMF score): original source is IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions*, various issues. (summary data are provided in Duasa and Mosley 2006, table A1, page 1224.)

In terms of factors predisposing towards political vulnerability, Bolivia had higher levels of the Gini coefficient of inequality⁶¹ than all countries except Brazil (column 1 of the table), compounded by severe horizontal inequalities both in income and in access to civil rights between ethnic groups: this, we recall, was the Central Bank Governor's diagnosis of the root cause of the riots of February 2003). In terms of policy options which may be considered as potential exit routes from the poverty trap, we consider three:

- (1) *The balance between external and internal crisis-recovery options.* As demonstrated by the original OECD study of adjustment (Bourguignon and Morrisson 1992) different adjustment instruments have different social costs. In particular, they argue, *external* measures of adjustment (and in particular exchange-rate devaluation) tend to have relatively lower social, and consequent political, costs because, providing the elasticity of response is sufficient, many poor people in export-related activities typically gain from devaluation, whereas internal measures of adjustment such as monetary deflation, expenditure cuts and tax increases lead to no gains for the poor at all (tax increases, as we saw in Bolivia, tend to be particularly inflammatory). We test this proposition by comparing the trend in the real exchange rate – which may be used as an index of external competitiveness – across the sample of countries in our Table 1.
- (2) *The government's willingness to insulate the economy against the volatility of capital movements,* in the shape of capital controls. As discussed above, a persistent element in the radical critique of the Sanchez de Losada government was that its liberal policies left Bolivia too exposed to the slings and arrows of fortune on international capital markets, and it is relevant to examine whether other crisis-affected countries sought to gain control over capital inflows and outflows.
- (3) *The functional allocation of public expenditure:* the extent to which public expenditure was concentrated on social groups likely to be politically militant, or 'social efficiency wage'. We consider two indicators of the social efficiency wage: the share of public expenditure spent on health and education and the 'pro-poor expenditure index'⁶², or share of expenditure spent on lower income groups.

The data of table 8, although fallible, suggest that Bolivia failed to make proper use of potential escape routes from the poverty trap which were utilised by other governments of crisis countries. It allowed its real exchange rate (column 3 of the table) to appreciate more than any other country in the sample except Turkey (other crisis-affected countries, notably in East Asia, intensified their policy of aggressive devaluations of the exchange rate, thereby making possible substantial gains for low-income groups working in labour-intensive export-competitive activities, notably manufacturing). Uniquely within the sample and indeed within the southern cone of Latin America as a whole, it did not ever (not even now during the socialist Morales regime) impose controls on either the inflow or the outflow of capital (column 6 of the table), which in Chile, Argentina and Malaysia were able to play an important role in protecting against the loss of jobs and in giving the electorate the impression that the government was in control of, rather than dominated by, international capital flows (Duasa and Mosley 2006, Woods 2006). Third, however, on some indicators and in particular *health and education*, Bolivia was on an improving trend even in relation to

⁶² Measured as the share of expenditure in the following categories: primary health and education, agricultural research and extension, and rural water and sanitation, as percentages of GDP. See appendix to Mosley, Hudson and Verschoor(2004).

other countries,⁶³ which may be one reason why the donors, much of whose aid was concentrated in these areas, were somewhat taken by surprise by the events of 2003. Thus some important elements of the 'social efficiency wage' had indeed been improved across Bolivia as a whole, and explicitly in areas of high ethnic majority concentration. What however had not been done was to satisfactorily improve the social efficiency wage in El Alto, the focus of discontent. One aggravating factor was that the measures which in Bolivia in the 1990s were very successful at counteracting this rising poverty, notably microfinance, were by contrast with other countries which were affected by the global crisis (and notably Indonesia) cut back between 1999 and 2002 (Marconi and Mosley, 2005)⁶⁴. A second, still more severe, was that support from international financial agencies, who had much to lose geopolitically and financially from any persistence of crisis in large economies such as Russia, Turkey, Argentina and Brazil, was much less forthcoming in the case of little Bolivia. The first group of economies were bailed out with as much as was necessary to prevent the economy falling into a downward spiral; this approach was, as was, as we have seen, not thought to be needed in Bolivia, where in addition there is no record that any of the donors thought it necessary to give any warnings about the consequences of any of the policies considered above⁶⁵.

5. Conclusion

Bolivia's return to economic and political instability since 2000 has been taken by many, particularly in Bolivia, as a historically foregone conclusion, with some commentators taking the argument back to 1879 (Molina 2005) and arguing that the country's predisposition to mass action and to rent-seeking is a 'fixed effect' which makes instability inevitable, and keeps the poverty trap closed.

Our argument here has been that this determinism is overdone. We have seen that the initial conditions within which Bolivia was operating during the structural adjustment process of the 1990s – in terms of high overall and specifically inter-ethnic inequalities, aggravated by the country-specific ethnic and geographical concentration of political militancy- did not constitute a good hand of cards with which to be confronting the renewed economic crisis of the early 2000s. We have also seen how the characteristic variables of our 'political poverty trap' - institutional decay and the decaying legitimacy of the elite-based party system – augmented the vulnerability of the Sanchez de Losada government as it confronted that crisis. Each of these factors have also been important in the persistence of other economic crises, notably Argentina, Turkey and Indonesia in the late 1990s and early 2000s. But a number of elements in this process of hysteresis have been Bolivia-specific, notably the politicisation of one highly unusual city and the government's *narrow field of vision* at the moment of extreme crisis in 2003: in terms of who it negotiated with, what measures it used to keep the fiscal deficit under control, what economic policy instruments it used to keep the medicine of stabilisation palatable, and what instruments of communication it used to expose the gains and defend the losses it was inflicting through all these policies. In all of this myopia it was, we have argued, encouraged by rather than forewarned by its high level of dependence on, and the poor advice it received from, aid donors. Thus Bolivia's escape from the poverty trap,

⁶³ Klasen et al. 2005, page 35 .

⁶⁴ This trend was not universal: some institutions, especially the village-banking NGOs, always resisted the recession. Now (September 2005) the trend is fairly universally upward, and the microfinance sector is growing at 25% per annum (interview, Fernando Romero, 16 September 2005)

⁶⁵ Contrast other countries where donors have been able to supply effective warnings (Indonesia?, also relevant Ethiopia and Tanzania. See Mosley and Suleiman 2005)

over the period we are examining, was admittedly hindered, but not precluded, by adverse initial conditions; what was really lacking was ingenuity and vision in the design of policy and institutions. We have illustrated this proposition mainly by relation to the cases of tax policy and petroleum sector policy during the climatic year of 2003, but many less political salient cases (pensions policy, public expenditure allocation, capital controls), only superficially analysed here, all helped to narrow the channel down which the government could hope to navigate. Five times between 2000 and 2005 that channel became blocked completely, producing each time a deterioration in the 'permanent' level of public trust in the government and a further twist in the vicious spiral of poverty. Since 1999, the level of per capita real GDP in Bolivia has declined by 15 per cent, even though the country is currently in the middle of an oil and gas boom, and 2006 is the first year of the decade in which an increase in per capita GDP has been registered.

What are the main options for escape from the poverty trap? As the model of Figure 3 illustrates, the crux remains to find means of influencing the key intermediate variables of investment and employment; and all that our model does is to throw emphasis on to political and institutional channels of influencing them. Some commentators, including the present Morales government in Bolivia, have seen the solution primarily in terms of a shift to new 'post-Washington consensus' policy instruments. 'This [sc. October 2003] was the moment', declared one MAS member of parliament to *La Prensa* on 23 December 2003, 'when the neo-liberal economic model in Latin America wore itself out'⁶⁶, and there is considerable awareness in the new government's policy manifesto that measures which increase perceived distributional fairness across a broad base can have powerful impacts on public trust and thence on investment, the structure of demand⁶⁷ and employment, for example hydrocarbon sector-based industrialisation (Government of Bolivia 2006, page 11, 17-18 and 27) and capital controls, especially if they are designed so as to avoid disincentive effects on efficiency, as in Malaysia and Chile (Duasa and Mosley, 2006). Other commentators, again including the Morales government (Bolivia 2006) have seen the solution in terms of reinstitutionalisation, in particular through an *Asemblea Constituyente*, and here as we have seen there are many parallels with the approach of the Kirchner government in Argentina. Finally, communication channels are important, as much for aid donors (who at the crucial moment, did not transmit the crucial and needed disaster warnings to the Sanchez de Losada government) as for Bolivian governments themselves - who at the crucial moment, in both 2003 and 2005, failed to perceive the erosion in middle-class trust and acted so as to further deplete rather than build up that trust. The structure of these channels, together with the breadth of the government's field of policy vision and the incentives provided by its institutions, appears from the Bolivian experience to have an important bearing on whether the process of recovery from crisis is self-reinforcing or self-defeating.

What hope is there that the 'neo-developmental' (*neodesarrollista*)⁶⁸ Morales government, which has been implementing an alternative strategy for escape from the poverty trap for the whole of 2006 to date, can finally reverse the spiral? We can seek the beginnings of an answer by referring back to the four political factors which, on our earlier analysis, kept the poverty trap closed. On two of

⁶⁶ On the economic impact of globalisation and liberalisation see Simmons and Elkins(2004) and on its diverse political impact in Latin America see Kurtz(2003)

⁶⁷ In its emphasis on the link between income distribution and the structure of demand the MAS manifesto recalls one of the key modern arguments in favour of a 'big push' – type programme of balanced industrial development (Murphy, Shleifer and Vishny, 1989)

⁶⁸ For a discussion of neo-developmentalism under the Kirchner administration in Argentina see Grugel and Riggiozzi(2007)

them the answer can be reasonably positive: the old party system, and apparently much of the corruption which went with it, has gone, and the 'El Alto factor', which brought Morales to power, has continued to work to his advantage within his presidency: the level of political violence has certainly declined since 2003, by any index, although the Sucre hunger strikes in August to try and force increases in public expenditure⁶⁹, and much more severely, the Huanuni miners' riot in October⁷⁰ were a major blow to the new government's hopes of pacifying the south-western region. However on the two other factors, deinstitutionalisation and the choice of economic policy, the verdict has to be more tentative. As might have been expected, the man who, out of office, once described capitalism as 'the worst enemy of humanity'⁷¹ has not acted in office so as to destroy it, and some of the ways in which this has been manifested (for example, his failure to implement a threatened moratorium on microfinance debt) have definitely been positive for institutional development, and the Central Bank has been allowed to continue to practise conservative management of the money supply⁷². But the main reinstitutionalisation project, the work of the proposed Constituent Assembly to reform the constitution, has scarcely begun, and no verdict on the impact of new institutional development on long-term poverty trends is yet possible. Similarly, the impact of the new economic policy environment brought in by Morales is not yet clear. The renationalisation of the private oil and gas sector on 1 May 2006 appears not to have provoked, at any rate by the time of writing, the flight of private capital⁷³ that was feared by right-wing observers, and in general an attempt is being made to use policy towards the hydrocarbons sector as a consensus-building instrument, both between social classes and between regions: 'Finally', declared the Minister for Hydrocarbons, Andres Soliz Rada on 26 June in the wake of a new deal to sell gas to Argentina at a higher price, 'there is an idea which can unite the dispersed social sectors'⁷⁴; but whether this strategy will work is not obvious. For their part the aid donors, in spite of receiving some hysterical advice immediately after Morales' accession⁷⁵, have not withdrawn their capital or returned to the kind of fiscal advice whose acceptance helped to destroy Sanchez de Losada; but the test will come when the oil price, which currently is functioning as a brake preventing the fiscal or the poverty situation from getting any worse, starts to fall again.

Our main argument, then, is that some elements within the cumulative processes which cause poverty to become self-reinforcing are political, and do not

⁶⁹ 'Mas problemas para Evo:protesta civica y huelga de hambre in Sucre', reprint from *El Mundo*, 1 September 2006, available on the internet at http://www.clarin.com/diario/2006/09/01/el_mundo/i-02301.htm

⁷⁰ This was a dispute between members of mining co-operatives and of a privatised mining company working on different levels of a tin mine in Huanuni, near Oruro, in which twelve miners were killed and more than 60 injured. The analysis of this incident in 'Vuelve la Inestabilidad a Bolivia', *Pulso* 368(6-12 October 2006), pp. 5 and 12-13, concludes that Bolivia has returned to 'pure ungovernability' and 'is [once again] gently advancing towards the abyss.'

⁷¹ Andrew Mueller, 'The cuddly crusader'[profile of Evo Morales], report in *Independent on Sunday*, 7 May 2006.

⁷² The prospectus for the Morales government's new economic policy (Bolivia 2006) emphasises that policy towards multinationals will consist of 'coexistence' (*convivencia*), not expropriation, and that collaboration with them is expected especially in import-substituting industrialisation based on the hydrocarbons sector (Bolivia 2006, pages 17 and 27)

⁷³ At the time of writing (September 2006), foreign corporations have some \$5.5 billion invested in Bolivia.

⁷⁴ 'Reversing neoliberalism:an interview with Bolivia's new Energy Minister' at worldpress.org/article_id=2372. In the deal in question, the export price of gas to Argentina was raised from \$3.25 per million British Thermal Units (BTU) to \$5 per BTU.

⁷⁵ See for example Michael Radu, 'The end of Bolivia?', December 21, 2005, at [www. fpri.org](http://www.fpri.org).

reside in individual behaviour or even in ill-functioning institutions. We have identified and estimated four elements in the political poverty trap, some of which may be seen as Bolivia-specific and some of which are more general. Although the bulk of this essay has been addressed to the specifics of the Bolivian case, our analysis also suggests that some of the requirements for effective adjustment in developing countries more broadly may have changed since the time of the OECD studies, precisely because the policy environment has become more liberalised and pro-poor and flows of capital more mobile. In particular the OECD's advice to ignore calls for 'poverty-conscious adjustment', on the grounds that it was not politically necessary, appears from this evidence to be now out of date; indeed on the Bolivian evidence what is needed is not only pro-poor adjustment, but adjustment to the right indicators of poverty and inequality- in particular what may be called 'politicised unemployment', as in El Alto. One aspect of poverty-conscious adjustment is poverty-conscious fiscal policy, as explicitly flouted by the Bolivian government of 2003. Another aspect is poverty-conscious institution-building, and there are lessons here from the comparative roles that microfinance was able to play in the Bolivian and Indonesian crises. In the light of changing global capital markets and policy priorities, the political requirements for a lasting escape from crisis have changed greatly from what was needed even a decade ago.

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