WORLD BANK
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

en breve

May 2006 No. 89

A regular series of notes highlighting recent lessons emerging from the operational and analytical program of the World Bank's Latin America and Caribbean Region

BOLIVIA POVERTY ASSESSMENT: ESTABLISHING THE BASIS FOR PRO-POOR GROWTH

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Background - Poverty and Inequality in Bolivia

Bolivia faces high levels of persistent poverty and inequality. During 1993-1999, growth rates averaging 4.7 percent annually, surpassing other Andean countries, resulted in a decline in urban poverty from 52 to 46 percent. These gains were quickly reversed due to economic shocks in the late 1990s. By 2002, 65 percent of the population was living in poverty, and 40 percent in extreme poverty (See Table 1). In addition, income inequality increased significantly during 1997-2002, making Bolivia one of the countries in the region, along with Brazil and Chile, with the highest income inequality. The high income inequality reflects significant disparities in assets (e.g. – education and land), household size, and earnings gaps by gender, ethnicity, location, and employment type.

Bolivia's high poverty and inequality transcends rural-urban and regional boundaries. Although an overwhelming portion of the rural population lives in poverty, there are also large pockets of urban poverty. Poverty is concentrated in the valleys and the central highlands, especially in Potosí and Chuquisaca, followed by Beni, La Paz and Oruro. Santa Cruz and Cochabamba have lower poverty rates, but due to their large populations, they contain a large number of poor people. About 40 percent of the population in the department of Santa Cruz is poor, although the poverty rate is only 20 percent in the capital.

Table 1: Poverty Rates in Bolivia, 1993-2002

Income-based Estimates

		Poverty		Extreme Poverty	
		H	PG	H	PG
National	1997	63.6	33.7	36.5	18.9
	1999	63.5	36.0	40.7	22.2
	2002	65.2	36.7	41.3	22.3
Capital cities*	1993	52.0	22.2	23.7	8.4
	1997	50.7	21.0	21.3	7.5
	1999	46.4	18.8	20.7	7.02
	2002	51.0	22.1	23.5	8.8
Urban	1997	54.5	23.8	23.8	9.1
	1999	51.4	22.4	23.5	8.9
	2002	53.9	23.8	25.7	9.4
Rural	1997	78.0	49.4	59.0	34.4
	1999	84.0	59.4	69.9	45.1
	2002	83.5	57.6	67.0	43.3

Official Rates

		Poverty		Extreme Poverty	
		H	PG	H	PG
National	1999	62.0	30.7	35.8	15.0
	2000	65.5	33.7	39.2	17.2
	2001	64.4	31.8	37.3	19.6
	2002	64.6	31.2	36.8	14.4
Urban	1999	51.4	22.4	23.5	8.9
	2000	54.5	25.6	27.9	11.0
	2001	54.3	24.6	26.2	14.7
	2002	53.9	23.8	25.7	9.4
Rural	1999	80.1	44.8	56.7	25.4
	2000	84.5	47.7	58.7	28.0
	2001	81.1	43.6	55.6	27.8
	2002	82.2	43.4	54.8	22.6

Note: H: headcount (% of population), PG: poverty gap (% gap between average poor person's income and the poverty line). *Capital cities: Sucre, La Paz, Cobija, Cochabamba, Oruro, Potosi, Tarija, Santa Cruz, Trinidad and El Alto. Official rates are based on household per capita expenditures in rural areas and household per capita incomes for urban zones. Source: UDAPE, based on household surveys 1999-2002.

Social indicators related to Unsatisfied Basic Needs and the Millennium Development Goals (MDG) improved significantly during 1992-2001. For example, child and infant mortality rates declined by 30 percent, net enrollment in primary education is approaching 100 percent, and households without safe water and adequate sanitation fell from 50 percent to 30 percent. However, Bolivia still ranks among the worst in the region in malnutrition, maternal and infant mortality rates, and is off track to meet the MDG of universal completion of basic education.

Bolivians' self-perceptions of their poverty and measures of income poverty are both largely determined by employment, education, access to assets and basic services, ethnicity and location. Bolivians tend to fall into income poverty—and also consider themselves poor—when they are younger, uneducated, unemployed or underemployed, indigenous, rural dwellers, and lacking basic services.

There are, however, some differences in income and self poverty perception surrounding ethnicity and location. Bolivian Quechuas tend to self-rate themselves poorer than suggested by income poverty profiles, while the converse is true for Aymaras. With equal access to basic services, rural residents perceive themselves as less poor than urban inhabitants, although they are more likely to be income-poor. Thus, exclusion and/or cultural factors (e.g., sense of empowerment or identity) as well as location-specific characteristics (e.g., inequality, social capital) may affect Bolivians' self-perceptions of their welfare.

> The main overall policy lesson of the 2005 *Bolivia Poverty Assessment* is that broad-based growth, sustained over the long-term, is a fundamental condition to reduce poverty and inequality. However, this needs to be supported by policies to improve labor productivity and job creation. This can be accomplished by: (i) removing obstacles to the modernization and growth of business, and their integration into the world economy; (ii) improving firm and labor regulations to facilitate business modernization and sustainability, and providing the framework and incentives for firms to participate and remain in the formal sector, especially for small and medium-sized enterprises; and, (iii) strengthening human capital and social protection for the poor to enhance their productivity and ability to market their labor.

Why is Poverty and Inequality in Bolivia so High?

There are three main reasons for the persistent high levels of poverty and inequality. First of all, the short-lived benefits of the peak years of the mid-1990s reflect weaknesses in the nature of the country's growth process. Growth during the 1990s was concentrated in natural resource-based (e.g., hydrocarbons) exports, which have a relatively low demand for unskilled labor. Negative shocks – such as the reversal of capital inflows, declining terms of trade, and the coca eradication program – limited growth, reversing earlier progress towards poverty reduction. Moreover, the high returns to capital compared to low returns to labor accentuated the already-high income inequality.

Second, the low productivity of firms, particularly in the informal, labor-intensive sector, has held back the growth of both employment and wages. Burdensome business and labor market regulations discourage innovation and smaller companies from fully participating in the formal economy, scaling up, and improving productivity.

Third, the poor have inadequate opportunities to improve their human capital, despite recent progress in access to basic education. This results in low labor productivity and restricted access to better-paying jobs. Moreover, faced with high opportunity costs and inadequate social protection, many of the poor leave school early and end up working in low-paying jobs.

Constraints to Employment Creation – The Demand of Labor

Bolivia's weak business environment hampers investment, productivity and job creation. Increased and improved physical capital (linked to the adoption of new technologies) contributed little to growth, and overall labor productivity (GDP per worker) rose barely 0.5 percent per year during the economic boom, reflecting limited gains in labor productivity even in the most productive sectors (e.g., petroleum, food and textiles).
Few small and medium enterprises (SMEs) grow larger. Small firms (10 or fewer employees) account for 83 percent of employment—largely unskilled—and 25 percent of output, while a few large firms (50 or more workers) generate two-thirds of output and only 9 percent of employment, largely skilled. For smaller firms, the high costs in time and money for registration and operating licenses, high collateral requirements to obtain credit, and skilled labor bottlenecks are the most binding factors. For larger firms, input costs, including credit and access to technology, and market size represent the most binding constraints. More specifically, Bolivian firms face the following constraints to enhance their productivity and growth (World Bank 2001):

A thin, localized market. Domestic trade is highly concentrated and there are a limited number of firms exporting (about 50 percent of large firms export, and only 20 percent of small-medium firms export).

Burdensome business regulations and weak institutions.

- Business registration is costly and subject to long delays, despite recent improvements.
- Property is difficult to register and enforcement of contracts or property rights is uncertain.
- Transactions and information costs are high, particularly with regards to credit, technology and information on foreign and domestic markets, accreditation, and contract disputes.

Limited access to credit. The costly and high collateral required for lending, especially for smaller firms (over twice the loan amount, and mostly through real estate guarantees), reflects thin credit markets, ineffective assets registries, and insecure and costly debt recovery.

High cost of logistics and risky input and output market conditions. Supply chains are weak due to expensive and slow transportation (on a unit basis, 20 times costlier than in Brazil), customs dispatching remains cumbersome and costly, the quality of domestic services and inputs is poor (e.g., unreliable supply of power), and as a result, inventories/stock on materials are high (36 to 50 days).

Restrictive labor regulations. Well intended but outdated labor legislation (dating back to 1943) prescribes generous conditions for workers compared to other countries in the region and elsewhere. This legislation—intending to protect workers—ends up increasing the total labor cost, making firms, particularly small ones, less competitive and discouraging equitable hiring in the formal market. As a result, it encourages informality, hindering productivity and employment creation.

More specifically:

- Uncapped severance payments lead to dismissal costs 2 to 3 times above most Andean neighbors and poor countries in the region.
- Non-wage benefits (e.g., pension, health) are about 50 percent of labor costs.
- Regulations restrict labor adjustments (including those due related to business cycle fluctuations, seasonal work, and overtime), and women's length of the work week and night work.

Faced with few incentives to comply with regulations to start and run a business, many firms particularly micro and small ones—remain outside the formal sector and lack access to formal institutions (e.g., credit and external markets).

Constraints to Human Capital Accumulation – The Supply of Labor

The combination of high opportunity costs and low returns to education discourage children from poor families to stay in school. The public education system, especially at the secondary level and in rural areas offers low quality education. Further, poor families face high opportunity costs and are often unable to afford keeping their children in school, instead needing them to help the family, either through income-generating activities or domestic and agricultural chores.

Returns to education are low—six out of ten graduates from high school are at risk of poverty because of these low returns. In rural areas, only a post-secondary education offers a significant boost to earnings. Education also does not carry equal returns for all workers. Workers from poor families tend to receive lower returns to education, likely due to limited learning outcomes, as a result of low quality schooling in poor areas, as well as health and nutrition deficiencies limiting early-childhood development, and limited access to the better paying jobs for their skills.

Bolivia's urban informal sector is large and heterogeneous. In 2002, more than 55 percent of the labor force was in the informal sector, either as self-employed (40 percent) or salaried workers (15 percent). An additional 10 percent of workers were unpaid, principally working in family businesses or as apprentices.

Informal employment largely reflects the low opportunity costs and non-income benefits of informality. For many Bolivians, it offers a competitive alternative to low-productivity formal sector jobs or no work at all. As well, self-employment may be more attractive to groups of the population, such as women seeking flexible work hours to balance their work and family obligations, or the indigenous who may face less discrimination as independent workers than as company employees. In fact, the self-employed perceive themselves as less poor than salaried workers with similar characteristics, an indication of the importance of non-monetary benefits of self-employment.

Due to the low productivity of workers in the informal sector, the informal salaried workers do appear to have a significant earnings disadvantage when compared to salaried formal sector workers with the same skills and job characteristics, particularly those at the bottom of the salary scale. In part this is possibly related to the lower access of informal firms to programs to promote worker training, technology adaptation, or other kinds of productivity-enhancing interventions.

While there has been some migration from less developed to more developed regions, small migration flows limit the potential of migration to be an escape valve for the rural poor. For the rural-to-urban migrants, earnings were improved by migrating, particularly for those at the bottom of the earnings scale. That is, despite a potential lack of contacts and urban know-how, migrants got competitive urban jobs for their skills. Thus, rural-urban migration likely helped to reduce poverty directly and possibly indirectly through remittances. However, individuals from the poorest locations and indigenous household heads are more prone to rural-to-rural migration. The young, more educated, women, and small families are more likely to migrate to urban areas. As a result, while urban and rural labor markets seem connected, the level of migration remains small reflecting high costs of migration and possibly non-pecuniary factors that affect settlement decisions.

Selected Policy Options to Reduce Poverty and Inequality

Restoring sustained economic growth and facilitating the development of labor-intensive sectors are essential to reduce Bolivia's poverty and inequality. However, to have a significant impact on poverty reduction, this must be accompanied by policies that promote, among other things, broader social investment, increased productivity and job creation. Specific policy options are elaborated below:

Removing obstacles to firm modernization and growth and furthering their integration into the world economy by:

- Continuing ongoing efforts to simplify procedures and lowering the cost of business registration and operation.
- Implementing incentives (for example, limited, tax credits) to adopt new technologies, including in manufacturing, not just hardware and software, but also management techniques and worker training, and in agriculture small-scale rural technology and new crop varieties.
- Promoting expanded access to prudent financing for SMEs.
- Increasing participation in world markets, in particular through enacting free trade agreements that will deepen exports and promote investment and technology transfer.
- Encouraging the creation of producer/exporter associations to reduce the cost of information to take advantage of trade and other market opportunities.

Modernizing business and labor regulations, and facilitating formal sector participation, including:

- Reducing the cost of registration and business expansion for micro and SMEs. This could be accomplished by further rationalizing documentation requirements (e.g., outdated notarization practices) and government fees, and streamlining on-line business portals for registering and licensing in municipal government offices.
- Establishing pilot initiatives that provide small firms incentives to become formal, encouraging small firms and producers to bid for government contracts, extending partial credits of value added taxes for eligible firms, and offering business development services (access to market credit, judicial services, management and accounting practices) with special emphasis on supporting innovation initiatives and export production.
- Streamlining labor regulations that currently limit the ability of firms to expand and contract along with the economic cycles, and reducing the cost of mandated labor benefits.
- Simplifying, reducing the cost, and increasing the transparency of government bureaucracy procedures required to access technology, quality certification, accreditation, and dispute resolution.
- Strengthening institutions and coordinating relevant public agencies (e.g., Superintendency of Enterprises and the Labor Ministry) to reduce duplication and transactions costs.

Strengthening human capital and social protection for the poor to enhance their productivity and ability to market their labor by:

- Raising the quality of the education system, particularly for the poor.
- Filling coverage gaps in universal basic education, improving secondary education transitions and access to quality higher education for poor students, and addressing low quality and inequalities in education achievement at all levels with results-based management, especially in municipalities with weak education outcomes.
- Implementing a conditional cash transfer program that provides incentives for very poor families with children-at-risk to keep them in school and use preventive health and nutrition services.

Improving labor market equity and opportunities by:

- Reducing obstacles to employment by expanding preschool facilities and child care centers to facilitate women's and migrants' labor force participation.
- Training in high schools and colleges on relevant skills demanded in the labor market and encouragement of labor market intermediation services fit to market needs.
- Using the newly developed consumption poverty map to target interventions aimed at income generation of the poor.
- Strengthening pro-poor community investments and workfare programs.

Conclusions

Bolivia's growth prospects remain vulnerable to domestic instability and external circumstances. Because of the depth and breadth of poverty in Bolivia, and the skewed income distribution, high GDP per capita growth rates about 4 to 5 percent per year are necessary in the medium and longer term, if the country's poverty level is to be significantly reduced. The national MDG target of reducing the incidence of extreme poverty in half by 2015 could be achieved with growth rates in this range, along with other pro-poor policy interventions. Even higher per capita growth is needed to meet the MDG of reducing poverty in half. Economic simulations indicate that the country can improve its future growth potential through a comprehensive strategy of mutually-reinforcing reforms that includes macroeconomic stability.

Notes

This article is based on the *2005 Bolivia Poverty Assessment: Establishing the Basis for Pro-Poor Growth Report No. 28068-BO* developed by a Bank team led by Omar Arias, and with contributions from Bolivia's UDAPE- Unidad de Análisis de Políticas Sociales y Económicas and INE- Instituto Nacional de Estadística.

See alsoWorld Bank, 2001, *Bolivia Microeconomic Constraints and Opportunities for Higher Growth - Climate Investment Assessment, Report No. 24746-BO*, Washington, D.C.

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