# BOLIVIA'S ROCKY ROAD TO REFORMS

Latin America Report N°18 – 3 July 2006

International Crisis Group
WORKING TO PREVENT CONFLICT WORLDWIDE

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## EXECUTIVE SUMMARY AND RECOMMENDATIONS

The first-round victory of Evo Morales in the December 2005 presidential election profoundly altered Bolivia's politics and the way South America's poorest nation is seen abroad. His left-wing Movement Toward Socialism (MAS) party rolled over the traditional parties in a landslide that reflected the expectations and desires of a majority of Bolivians for far-reaching socio-economic change, institutional reform and full inclusion of the mostly rural and indigenous poor. If Morales is to succeed, however – and he must if Bolivia is to avoid serious instability and violence – the international community will need to show understanding and offer support as he grapples with explosive issues of nationalisation, constitutional reform, autonomy, drugs and development policy.

Morales immediately demonstrated he is following a drummer different from that of every Bolivian president of the past 25 years. He appointed representatives of social movements and left-wing intellectuals to key posts, nationalised the hydrocarbon sector on 1 May 2006 and arranged for the election of a constituent assembly and a referendum on regional autonomy on 2 July. In foreign policy, he closed ranks with Presidents Hugo Chávez of Venezuela and Fidel Castro of Cuba and distanced himself somewhat from the U.S. While his assumption of power in January and first months in office have been surprisingly peaceful, there are strong indications the journey to the far-reaching reforms he and his constituents want will be difficult.

The hurdles include deep-seated economic, institutional and social problems; less than full control of the legislature; the opposition of economically and politically powerful groups in Santa Cruz in the east and Tarija in the south; and the hybrid nature of the MAS – both rooted in and constrained by the social movements. The reduction of Bolivia's grinding poverty and the creation of a more effective, inclusive and just state depend also on the relations the new government is able to build with foreign investors, South American neighbours, the European Union (EU) and the U.S.

In general, the international community reacted positively to Morales's election, which it correctly saw as the expression of overdue political change, an important step towards at least short-term institutional stability and a chance to make headway against widespread social exclusion and poverty. Not even the thorny issue of legalising the cultivation of coca bushes, an important Morales campaign topic and a preoccupation of Washington, Brussels and other European capitals, seriously dampened the initial honeymoon.

This changed on May Day, when Morales issued a decree that foreign enterprises in the hydrocarbon sector would have to yield "control and direction" of their facilities to the state-owned Yacimientos Petroliferos Fiscales Bolivianos (YPFB) and sign new contracts stipulating higher returns to YPFB within 180 days or be barred from further operations in the country. This measure, which affected primarily Brazilian and European investments, was followed by announcements that the government would soon implement land reform and nationalise other key sectors of the economy, such as mining. Spanish business circles were most outspoken in their protest, while relations with Brazil and Argentina were strained and the volunteered efforts of Venezuela's Chávez to mediate only complicated matters.

The referendum on regional autonomy on 2 July 2006 and the election of the constituent assembly that same day are milestones in Bolivia's political history. If the twin processes are carried out effectively, they might enable the Morales administration's fairly radical policies to be managed successfully and in the end produce institutional stability and a stronger democracy. But given the divisions within the country of virtually every sort – from ethnic to class to region – they also could prove to be the battlefield on which Bolivia's stability and even its territorial integrity will be determined.

The international community – not least the EU because of its resources and relatively uncontroversial standing in the country – need to engage the Morales administration about how it can help Bolivia overcome widespread poverty and social exclusion in a reform process that protects everyone's interest in stability. Donors' technical and financial assistance can also help carry out the constituent assembly and regional autonomy processes. A third tier

of EU and U.S. cooperation with Bolivia should stimulate alternative development as part of an expanded and integrated rural governance/development strategy. Ultimately, reduction of rural poverty through licit activities is the best option for reducing the pressure on poor farmers to grow coca leaf.

## RECOMMENDATIONS

### To the Government of Bolivia:

1. Avoid risking economic isolation by ensuring respect for international law in relation to all contracts and foreign private investments, in all sectors of the economy.
2. Seek consensus on land reform and ensure that credit, technical aid and marketing support accompanies land distribution to the poor.
3. Design a comprehensive energy policy addressing guidelines for gas and liquid hydrocarbons exports, gas industrialisation, internal market policy, guarantees of legal stability for foreign firms and attraction of private investment, particularly ensuring that:
   (a) the new contracts under Law No.3058 and Decree No.28701 do not sacrifice long-run investment and maintenance needs merely to obtain maximum immediate revenues;
   (b) within the framework of hydrocarbon nationalisation, control is transferred to YPFB in a way that retains competent capacity to run the sector;
   (c) credible audits are carried out to guarantee transparency and ensure payment of just indemnities to transnational oil and gas companies for the lost operations and direction of their subsidiaries; and
   (d) contact is established with the Dutch government and the Hydrocarbon Chamber of Bolivia for a comprehensive natural gas training program for the ministry of hydrocarbons and YPFB.
4. Engage with the new Chilean government with a view to selling Bolivian gas directly to the Chilean market.
5. Organise the Constituent Assembly (CA) and referendum on regional autonomy (RRA) in a transparent way that promotes real dialogue and consensus; support the activities of the Presidential Representation for the Constituent Assembly (REPAC); and in order to guarantee the integrity of the process, President Evo Morales agree to step down as MAS leader during the CA deliberations.
6. Ensure that the alternation of gender rule is applied effectively in the CA electoral process.
7. Speed up the study on traditional use of coca leaf and abrogate the 17 June 2006 regulation that allows coca producers to sell unprocessed coca leaf directly in national markets not covered by retail traders.
8. Promote alternative development not only in the Chapare and the Yungas, but also in the new coca growing regions of Caranavi and Apolo, and continue to cooperate with the Organization of American States, Brazil, Argentina, the U.S. and others on law enforcement and interdiction of cocaine exports.
9. Implement thorough controls on the legal coca markets in Villa Fátima and Sacaba as well as the new Caranavi market.
10. Reestablish a broad donors group led by the EU that includes the Inter-American Development Bank, the World Bank, the UN, regional organisations and as many bilateral donors as possible.
11. Complete the technical dialogue with the U.S. to take advantage of Millennium Challenge Account (MCA) assistance as soon as possible.
12. Reinforce the integration of the Andean Community of Nations (CAN).

### To the Political Parties, Citizen Associations, Social Movements and Trade Unions:

13. Engage in all REPAC activities; respect the results of the RRA and keep hardliners in the western highlands and eastern lowlands in check during the CA.

### To the European Union and its Member States:

14. Pursue timely implementation of the Action Plan for Bolivia, in particular:
   (a) urge the Bolivian authorities to present as soon as possible a revised Poverty Reduction Strategy Paper and offer them technical expertise and assistance; and
   (b) strengthen support and technical assistance to civil society, political parties and the media.
15. Train newly elected CA delegates on constitution and institution building, with priority for female delegates.

16. Work with the government to speed up the study on traditional use of coca leaf.

17. Take due account of Bolivia's new national development strategy while elaborating the Country Strategy Paper 2007-2013, and in particular:

    (a) engage the government in implementation of the national development strategy, giving priority to programs that fight poverty through creation of higher quality jobs and empower local communities as a means to strengthen social cohesion;

    (b) maintain existing health, education and basic sanitation programs, and additionally provide trade-related technical assistance that complements the national development strategy to diversify export based on the long-term development of small and mid-sized enterprises;

    (c) strengthen coordination between the EU, its member states and other donors within the framework of the Bolivian government's donor coordination mechanism; and

    (d) search for ways to carry on a dialogue with Cuba and Venezuela regarding cooperation with Bolivia.

**To the Organisation of American States:**

18. Collaborate with the EU observer mission during the CA and the RRA polls.

19. Cooperate with the EU to encourage early completion of the study on traditional use of coca leaf.

**To the Government of the United States:**

20. Extend the Andean Trade Promotion and Drug Eradication Act (ATPDEA) for three years.

21. Give significant support within a coordinated donor cooperation arrangement for rural governance, infrastructure investment and poverty reduction, and continue the dialogue with the government to finance, as soon as possible, the MCA compact in support of priority areas of development.

22. Maintain emphasis on the strategic objective of reducing cocaine trafficking by continuing to offer cooperation to the government on expanded alternative development, law enforcement, interdiction and demand reduction, avoiding, so far as possible, confrontation over eradication issues.

**To the Governments of Venezuela and Cuba:**

23. Engage in dialogue with other donors on maximising cooperation for Bolivia.

24. In the case of Venezuela, refrain from upsetting the financial sector, especially the well-established micro-credit sector, by introducing capital at undervalued interest rates, and refrain from intervening in Bolivian internal political affairs, especially those concerning the CA.

**To the Governments of Brazil and Argentina:**

25. Remain engaged and facilitate dialogue between Bolivian authorities and transnational oil and gas companies; help Bolivia with information exchange and law enforcement cooperation in its efforts to restrict cocaine production and trafficking; and keep Bolivia included in the energy infrastructure projects that are being planned in South America.

**Bogotá/Brussels, 3 July 2006**

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## I. INTRODUCTION

Six months after a clear first-round victory on 18 December 2005 in which Bolivians placed their hopes on the alternative for change embodied by his Movement Toward Socialism (MAS) party, President Evo Morales is beginning to define himself. A round-the-world trip in January 2006 helped boost his international image, and the inclusion of indigenous peoples in the highest levels of government is a clear departure from previous practices. Bringing leaders of social movements into the government has been the key to taming radical social protest.

Morales has, however, in some ways been more radical than expected. The nationalisation of oil and natural gas has transferred control of that sector to the state-owned firm Yacimientos Petroliferos Fiscales Bolivianos (YPFB), forcing trans-national companies to negotiate quickly or leave the country; in speeches tinged with nationalist pride, Morales has announced plans also to nationalise mining, forestry and other natural resource sectors in which foreign investors have important stakes; his personal friendships with Fidel Castro and Hugo Chávez have aligned Bolivia with Cuba and Venezuela not only on health and literacy cooperation but also in trade, oil and natural gas, mining and finance.

His administration has been more moderate on others issues, in particular building consensus among political parties and regions in the congress to pass two laws calling for the election of a constituent assembly (CA) and the holding of a referendum on regional autonomy (RRA). It has also strongly defended coca growers against forced eradication and campaigned for decriminalisation of coca leaf, while pledging to combat drug trafficking. Though he has expressed some strong criticism of the U.S., he has not expelled U.S. government agencies, and his adamant opposition to free-trade agreements has not prevented him from seeking an extension of the Andean Trade Promotion and Drug Eradication Act (ATPDEA) with the U.S.

Additional issues require urgent action. The CA and RRA, the continuity of alternative development programs, the eradication of "excess" coca crops and the stability foreign investors and business require all need to be addressed promptly. Demands by radical sectors close to the MAS for a complete overhaul of Bolivia's institutional framework and threats posed by autonomy movements in the richer provinces to the country's territorial unity and regional financial solidarity could endanger the CA. Tensions between landowners and landless peasants in the eastern lowlands could turn violent unless consensus is reached on the government's land reform project.

Relations with the U.S. could be strained further by Morales's decision to stop coca-crop eradication as well as by his ties with Castro and Chávez. YPFB now has big responsibilities in the hydrocarbon sector for which it may lack the necessary technical and managerial capacities. Foreign capital is essential if Bolivia is to develop, and Morales will need both to guarantee rule-of-law and mend relations with immediate neighbours, Brazil and Argentina, in order to re-establish investment flows. As Bolivia's principal source of aid, the European Union (EU) and its member states are needed to help the new government address all these issues and put the country on the path to political stability and economic growth.

## II. THE MORALES ADMINISTRATION

Morales received just under 54 per cent of the vote in his landslide victory.[1] His strongest opponents, former President Jorge ('Tuto') Quiroga (Poder Democrático Social, PODEMOS) and industrialist Samuel Doria (Unidad Nacional), obtained 29 and 8 per cent, respectively.[2] Adding to the surprise of the margin, MAS won a strong majority in the lower house and a plurality in the senate. The 84.5 per cent turnout was the highest in 25 years.[3]

Had Morales not gained an absolute majority in the first round, the congress would have been required to choose between the two candidates with the most votes.[4] That could easily have produced a political deadlock, with dire consequences for stability. Congressional selection of previous presidents has produced a weakened executive and the supremacy of the legislative branch. In contrast, the December 2005 election enhanced the executive's power.

The clear message was that Bolivians want change. The country has had nearly two decades of democratic governments dominated by the traditional parties, including Acción Democrática Nacionalista (ADN), the Movimiento Nacionalista Revolucionario (MNR) and the Movimiento de la Izquierda Revolucionaria (MIR), in revolving coalitions described as "pact democracy".[5] Those parties were at their low point, identified with seventeen years of neo-liberal ideology that had failed to produce prosperity while dividing the country socially.

While all parties addressed such issues as nationalisation of natural resources, land reform, a CA and an RRA,[6] only MAS seemed convincing. Others, including PODEMOS, campaigned negatively, trying to raise fears of what a Morales victory would mean and polarising the electorate. Morales moderated his more radical rhetoric, helping him to make inroads among the urban middle class (especially in La Paz province, where MAS won with 66.63 per cent) and the 10 per cent of voters who were undecided to the end.[7]

The elections also demonstrated the new and crucial role of social movements as well as the political weight of indigenous groups.[8] Morales's support was massive in the western highlands, where social organisations are strong and most indigenous peoples live.[9] The large part of the population that had organised in social movements and civic groups to produce successive governmental crises that ousted the last two presidents were naturally attracted to MAS and Morales. A government official called the result a payback for the centuries-old social debt the indigenous peoples in Bolivia are owed.[10]

Only four of the eight parties that campaigned won seats in congress. MAS elected twelve senators out of 27 and 72 members of the lower house out of 130. This was up from eight senators and 27 members of the lower house in 2002. PODEMOS, with 28.94 per cent of the congressional votes, won thirteen senate and 43 lower house seats; Unidad Nacional, with 7.79 per cent , won one senate and eight lower house seats; and MNR, with 6.46 per cent, won one senate and seven lower house seats.[11] Movimiento

[1] For background, see Crisis Group Latin America Report Nº15, *Bolivia at the Crossroads: The December Elections*, 8 December 2005. In his first bid for the presidency in 2002, Morales won 20.7 per cent of the vote.

[2] The other candidates trailed far behind the first three. See http://www.cne.org.bo.

[3] In Bolivia, voting is obligatory, Art. 6, Law No.1984 (Electoral Code). In 1979, turnout was 90.5 per cent; during the last 25 years, the average turnout had been 73.6 per cent. Jorge Lazarte, *Entre los espectros del pasado y la incertidumbres del presente* (La Paz, 2005), p. 645.

[4] According to Article 4 of the Electoral Reform Law (No.1704) of 1996, a candidate must win an absolute majority of votes (50 per cent plus one), in order to be elected president in the first round; otherwise, the congress chooses the president from the two candidates with the most popular votes, Law No.1704 of 2 August 1996.

[5] The broad coalition governments that governed Bolivia from 1985 to 2003 drew together sufficient parties to obtain a majority in the congress, in the aftermath of each presidential election. Those multi-party agreements were known as "pact democracy". They implemented market-driven reforms and halted the runaway inflation of the late l980s, privatised state-owned energy, mining and some utility companies, and broadened political participation, particularly at the municipal level. Corruption, failure to generate visible reductions in income disparity or to end economic exclusion of the indigenous majority led to their rejection and the Morales victory. See Crisis Group Report, *Bolivia at the Crossroads*, op. cit., p. 6.

[6] See Sections III and IV below.

[7] Crisis Group interviews, La Paz and Santa Cruz, 25 April-12 May 2006.

[8] Crisis Group interview, Santa Cruz, 8 May 2006.

[9] MAS results in the departments included: La Paz, 66.63 per cent; Cochabamba, 64.84 per cent; Oruro, 62.18 per cent; Potosí, 57.80 per cent; and Chuquisaca, 54.17 per cent. National Electoral Court (CNE), available at http://www.cne.org.bo.

[10] Crisis Group interview, La Paz, 2 May 2006.

[11] The seats in the congress are distributed as follows: 27 members in the senate (three for each department). The candidates are chosen by each party and elected by a majority-minority mechanism: two seats for the party with the most votes, one for the party with the next highest total; 130 members of the lower house are elected by two different mechanisms: 68 are elected by a simple majority in single candidate voting districts (*uninominal*); the 62 others are elected in nine departmental party list voting districts (*plurinominal*) from lists headed by the

Indígena Pachakuti (MIP, 2.1 per cent), Nueva Fuerza Republicana (NFR, 0.68 per cent), Frente Patriótico Agropecuario de Bolivia (FREPAB, 0.3 per cent) and Unión Social de los Trabajadores de Bolivia (USTB, 0,257 per cent) failed to cross the 3 per cent threshold necessary to enter congress.[12]

Despite the MAS success, opposition parties still hold a majority in the senate, and Morales's party controls only one third of the provincial governments.[13] December 2005 was the first time prefects – the executives in the nine departments – were also elected.[14] The objective of this innovation was to give regional governments more autonomy and enhance democratic control over an additional layer of government.[15] Though MAS won the prefectures of Chuquisaca, Oruro and Potosi departments, PODEMOS took control of La Paz, Beni and Pando. Coalitions of regional civic groups opposed to MAS won in the traditional MAS stronghold of Cochabamba (Alianza Unidad Cochabambina, AUN), as well as in Santa Cruz (Autonomia para Bolivia, APB) and Tarija (Encuentro Regional: Camino al Cambio). Even a fragmented PODEMOS-Unidad Nacional-MNR opposition could eventually obstruct some MAS initiatives if it coalesces within congress, and its departmental prefects operate in a coordinated fashion.

The anticipated pro-independence surge in the eastern lowlands was not reflected in the vote for president, especially in Santa Cruz, where a Cochabamba native, Jorge Quiroga, received 42 per cent of the vote, far out-distancing the Unidad Nacional's Samuel Doria, a La Paz native whose running mate, Carlos Dabdoub, is from Santa Cruz and one of the most ardent exponents of the "Camba Nation" movement.[16] Dabdoub became the target of an aggressive campaign by the other parties, especially PODEMOS, which held Unidad Nacional to 12.5 per cent in Santa Cruz. Morales profited from this centre-right and right-wing brawl to build bridges to the urban middle and lower-middle classes of the eastern lowlands.[17] He received almost a third of the region's votes, including 33 per cent in Santa Cruz.

The transfer of presidential power was peaceful. Fears of trouble were put to rest when Quiroga quickly acknowledged defeat. A few days before the elections, the commander of the armed forces, Admiral Marco Justiniano, had encouraged the parties to respect the voters' decision, even if the top candidate received only a plurality in the first round,[18] and Doria committed his UN party to support the leading vote getter if the election went to the congress. Nevertheless, there was some anxiety about Morales both domestically and internationally, notably over his campaign pledges to end the "excess coca leaf" eradication programs[19] and nationalise especially the hydrocarbons sector.

President-elect Morales departed from the belligerent tone of the campaign against trans-national companies and initially adopted a more conciliatory stance. He embarked on a world tour one week after his election, visiting Latin America, Europe, China and South Africa. The moderate tone adopted during the trip, especially on trade and foreign investment, helped calm some of the apprehension among

presidential and vice presidential candidates; seats are distributed according to a proportional system, with a 3 per cent threshold.

[12] Parties that do not cross the 3 per cent threshold in the nine departments will lose their legal status as political entities and will no longer be entitled to receive public funding. However, they might still win a simple majority seat in a single candidate voting district. Lazarte, op. cit., pp. 137, 237.

[13] In the elections of prefects (governors of departments) the same day as the presidential elections, MAS won only three of nine: Oruro, Potosí and Chuquisaca.

[14] Crisis Group Report, *Bolivia at the Crossroads*, op. cit., p. 11.

[15] Critics argue that prefects' autonomy is highly limited as their competencies are minimal; discussions at the Round Table "Popular participation face to the constituent assembly and the referendum on regional autonomy", La Paz, 25 April 2006, made this point clearly. The prefects continue to operate within the restrictions of the Administrative Decentralisation Act No.1654 of 28 July 1995, which imposes restrictions on legal, financial and administrative aspects. But they have responsibilities in economic and productive areas such as intra-departmental road construction and maintenance; promotion of departmental tourism policies; support for infrastructure in agriculture and livestock rising and for regulatory activities in industrial and manufacturing sectors; and formulation and execution of public investment programs in electrification. They lack the capacity to coordinate departmental planning with national planning. *La Razón*, 7 November 2005; Crisis Group interview, La Paz, 4 May 2006.

[16] The "Camba Nation" is an attempt of some Santa Cruz elites to paint themselves as a distinct people with a particular mindset. See Crisis Group Latin America Report Nº 7, *Bolivia's Divisions: Too Deep to Heal?*, 6 July 2004, p. 15.

[17] Crisis Group interview, Santa Cruz, 10 May 2006.

[18] *Página/12*, 14 December 2005.

[19] Law No.1008 of 1988 establishes three categories of cultivation areas: 1) the "zone of traditional production" encompassing a number of provinces in the Yungas where 12,000 hectares are considered legal; 2) the "zone of excess and transitional production" encompassing the Chapare and other Yungas provinces where cultivation is illegal, but where crop eradication with alternative development is applied; and 3) the "zone of illicit production", which includes all other areas of cultivation and is subject to eradication without compensation. See Crisis Group Latin America Report Nº 12, *Coca, Drugs and Social Protest in Bolivia and Peru*, 3 March 2005, pp. 10-11. The statistics on coca cultivation in 2005 released by the U.S. White House Office of Drug Control showed an increase of 2,000 hectares to 26,500 in 2005 over 2004, in contrast the low mark of 14,600 hectares in 2000. http://www.whitehousedrugpolicy.gov/news/press06/041406.html.

investors and the political opposition. In Brazil and Spain, whose firms are two of the biggest investors in the natural gas sector, he declared that his nationalisation plan did not mean expropriation.

More importantly, for the first time in years Bolivians felt their country was in the international spotlight for a reason other than social and political instability.[20] Morales accomplished his twin objectives: from Cuba and Venezuela he got ideological support as well as health, education and fuel agreements; elsewhere, and especially in Europe, he addressed, although he did not entirely allay, concerns about some of his more radical policy intentions.[21]

On 21 January 2006, Morales received the "command" and "blessings" of the *curacas* – leaders of the indigenous peoples of the high plateaus – in a gathering in Tiwanaku.[22] This reflected his desire to invest the new government with a symbolic legitimacy beyond that from the formal inauguration and underlined his historic role as the first Bolivian president of Aymara descent.[23] The next day, Morales and his vice president, Alvaro García, were sworn into office in the legal ceremony in La Paz. Before the heads of state and government of Argentina, Brazil, Chile, Colombia, Panama, Paraguay, Peru and Venezuela, among others, he gave a speech with a mixed message: militant and conciliatory in turn, he said Bolivia was embarking on a "cultural and democratic revolution".[24]

In his choice of ministers, the new president departed from his predecessors' tendency to appoint technocrats, selecting instead left-wing intellectuals and activists from trade unions and the social and indigenous movements without previous government experience.[25] Besides Vice President García,[26] a left-wing intellectual who was a member of the Tupaj Katari Guerrilla Army (EGTK) in the late 1980s and early 1990s, Morales's most important choices have been activists such as David Choquehuanca of the Quechua/Aymara elite and a member of the Confederación Sindical Unica de Trabajadores (CSUTCB) union as foreign minister;[27] and Casimira Rodríguez, a former leader of the housemaids' union, as minister of justice. The implication of the latter appointment was that an expert on "social injustices" is better suited to address justice-related issues than a lawyer.[28]

A sociologist and indigenous activist, Félix Patzi, was appointed minister of education and culture. Abel Mamani, the new minister of water, led a prominent 2005 demonstration while head of the Federation of Neighbourhood Associations (FEJUVE) of El Alto, against the local water and sewage company. The appointment of active social leaders in key operational vice ministries and at director level also broke with the past by including leaders of *cocalero* (coca grower) and peasant associations, indigenous movements and unions.[29] These appointments

[20] Crisis Group interview, La Paz, 25 April 2006.

[21] Evo Morales was quoted by the press as saying he had learned that "being a good president is to do good business", *Página/12*, 5 February 2006; see Section V below.

[22] The archaeological site of Tiwanaku is an ancient ceremonial location near La Paz, founded by the Tiwanaku culture that ruled the Andean high plateaus before the Incas (from the first to the twelfth century).

[23] Some question Morales' pure indigenous origin and consider him a *mestizo*. Before his election, Bolivia had had many elected officials of indigenous descent: Víctor Hugo Cárdenas, of Aymara origin, was vice president during Gonzalo Sánchez de Lozada's first presidential term (1993-1997). A national survey revealed that 65 per cent of the mayors and city council members elected between 1999 and 2004 considered themselves of indigenous origin. José María Centellas, *Democracia en Cuarentena* (La Paz, 2006), p. 14; Xavier Albó and Víctor Quispe, *Quiénes son indígenas en los gobiernos municipales* (La Paz, 2004), pp. 140-144.

[24] He paid tribute to the struggles of Tupaj Katari, Ché Guevara and the *cocalero* activists, whom he described as liberation martyrs. He criticised discrimination against Bolivian indigenous peoples, comparing their situation with South Africa's apartheid era. He called for the unity and reconciliation of the country, while demanding renewal of politics, the end of the "colonial state", and a fight against corruption and the client practices of previous governments. He defended traditional coca leaf uses, while condemning cocaine trafficking. He thanked Fidel Castro and Hugo Chávez for their friendship while praising the presence of a U.S. State Department representative. He condemned neo-liberal policies and the privatisation of public services and insisted on his campaign promise of nationalising the hydrocarbons sector, though asking the international community for help in developing Bolivian riches. Evo Morales, 22 January 2006, available at http://www.presidencia.gov.bo/presidente/discursos_interven.asp.

[25] Crisis Group interviews, La Paz, 2-3 May 2006. Some vice ministers and other senior officials have technical credentials.

[26] This mathematician and self-made sociologist, after being sent to prison for subversion, became a university professor and political commentator/analyst on television before becoming Morales' vice presidential candidate. He is considered one of the main advocates of the indigenous ideology in Bolivia. Crisis Group interviews, 26 April 2006.

[27] Some of his early declarations spurred polemics and drew popular scorn, for example, a proposal to replace milk with coca leaves in children's diet. Crisis Group interview, La Paz, 2 May 2006.

[28] Crisis Group interview, La Paz, 2 May 2006.

[29] Vice Minister for Social Defence Felipe Cáceres, a former secretary general of the Cochabamba Tropic Federation, is in charge of coca issues. Vice Minister for Coca and Integral Development Félix Barra is a former *cocalero* leader from the Yungas and former vice minister of natural resources and environment. Vice Minister for Woman (gender issues) Maruja Machaca is a former executive secretary of the provincial federation of Sud Yungas-Chulumani. Vice Minister for

increased the government's grassroots legitimacy and helped appease hardliners in the MAS[30] but fell short regarding gender equality. Only four of sixteen ministers are women.[31] And while Morales has reportedly said his government represents excluded peoples, the vice ministry of gender issues has not been prominent thus far.[32]

The hybrid nature of the MAS – a political party with strong links to the social movements – could turn out to be a serious problem for Morales, not least in terms of its ability to govern. In the words of a MAS congressman, "the MAS is not a party in the classical sense of the word but a mosaic of ideologies and political tendencies".[33] It appears Morales was careful to include in his administration as many elements of this mosaic as possible. The cooption by the government of key social and indigenous movement figures has kept the strikes and road blocks of the past relatively at bay. Only isolated protest marches by health, transport and manual workers unions were recorded in the first months. But such a heterogeneous alliance of movements and political tendencies could produce constant policy disputes and conflicting public statements by officials that might call government credibility into question. The change of the entire high command less than a week after taking office allowed the government to exert a closer control over the military[34] but drew charges of politicising the armed forces.[35]

## III. NATIONALISATION

Nationalising the hydrocarbon sector and establishing a constituent assembly to rewrite the constitution were Morales's central campaign pledges,[36] and his supporters wanted him to move swiftly on them. Opinion polls revealed that 28 per cent of those who said they voted for Morales did so "because he will bring change to Bolivia"; 20 per cent "because he worries for our needs"; 17 per cent "because he is honest"; and 15 per cent "because he will change politics".[37] After his first month in office, Morales's approval rating in the four largest cities had increased from 65 per cent to 79 per cent.[38]

The administration's first measures were designed to demonstrate commitment to fighting corruption and promoting austerity and hard work. A decree cut the pay of congressmen and government and judicial officials by 50 per cent and the president's by 57 per cent,[39] with savings dedicated to health and education programs.[40] On 13 March, Morales submitted an anti-corruption bill to congress.[41] He levied corruption charges against members of congress and several state institutions and privatised companies but also against MAS and government officials.[42] The campaign had to be put on hold, however,

Communitarian Justice Valentín Ticona worked for the Ayllus' Federation of Bolivia. Vice Minister for Peasant Affairs and Rural Development Freddy Condo worked as counsellor of the Bolivian Colonisers Confederation. Minister of Economic Development Celinda Sosa, in charge of production and micro-enterprises, worked as secretary general of the Bartolina Sisa Peasant Women Federation. Minister of Mining and Metallurgy Walter Villarroel worked for the National Federation of Cooperative Miners (FENCOMIN) trade union. Minister for Employment Santiago Alex Galvez is a former executive secretary of the National Confederation of Industry Workers.

[30] Crisis Group interviews, El Alto, 5 May 2006.

[31] Such as the ministries of the interior (Alicia Muñoz), justice (Casimira Rodríguez), health and sports (Nila Heredia), and economic development, production and micro-enterprises (Celinda Sosa).

[32] Crisis Group, telephone interview, 21 June 2006

[33] Crisis Group interview, La Paz, 28 April 2006.

[34] In October 2005, presidential candidate Morales denounced the deactivation or destruction by the U.S. military of an undetermined quantity (press sources estimate between nineteen and 31) of Chinese-made surface-to-air missiles of the Bolivian armed forces after they were removed from the country. While these allegations were denied at first by the military command, the army's head, General Marcelo Antezana, admitted (and then denied) deactivation of the missiles out of concern for Morales' possible election. On 9 March 2006, former President Eduardo Rodríguez, former Defence Minister Gonzalo Méndez and former Commander-in-Chief of the Armed Forces Marco Antonio Justiniano were formally accused of high treason after an investigation by the attorney general's office. *La Razón*, 10 March 2006.

[35] Crisis Group interview, La Paz, 3 May 2006. However, military involvement in politics is not new in Bolivia. See Crisis Group Report, *Bolivia at the Crossroads*, op. cit., p. 11.

[36] MAS platform, "Construir una Bolivia digna, soberana y productiva para vivir bien", cited in ibid, p. 14.

[37] *La Razón*, 15 January 2006.

[38] La Paz (82 per cent), El Alto (88 per cent), Cochabamba (83 per cent) and Santa Cruz (70 per cent). *La Razón*, 29 April 2006.

[39] Presidential Decree No.28609 reduced the president's salary to BOL$15,000 ($1,863), that of the vice president and ministers to BOL$14,000 ($1,740), vice ministers to BOL$13,000 ($1,615), directors general to BOL$13,500 ($1,677), and congressmen to BOL$10,500 ($1,304). Members of the Electoral Court, the Central Bank, superintendents, financial state institutions, armed forces and police are also subject to this reduction, as no official may earn more than the president. This measure is seen by some critics as demagogic, because, they say, it may make some officials more tempted by corruption. Figures denoted in dollars ($) in this report refer to U.S. dollars.

[40] According to Special Law No.3091 (6 July 2005), CA delegates should be elected no later than the first Sunday of July 2006.

[41] The bill, named after Marcelo Quiroga Santa Cruz, union leader assassinated in the 1980s, was still being discussed in congress in June 2006. *Bolpress*, 13 March 2006; *Los Tiempos*, 7 June 2006.

[42] These include dismantling a network collecting congressional salaries involving more than BOLS$1 million ($124,000) and elimination of certain congressional expenses (*gastos reservados*)

when a major natural disaster caused by landslides and floods hit in February and March.[43]

## A. HYDROCARBONS

Controversy surrounding hydrocarbon management had forced the ouster of two presidents[44] and fed instability for three years. Morales had tried to reassure Europeans during his travels by saying that while his government was committed to nationalising the hydrocarbon sector, it would not expropriate the assets of the trans-national oil and gas companies. A hardliner, Andrés Soliz,[45] was named minister of hydrocarbons and an expert, Jorge Alvarado,[46] was appointed president of the state-owned YPFB. Until late April, however, it was not clear whether Morales wanted to implement the May 2005 hydrocarbon law or substantially revise it. In March, he had announced that nationalisation would take place on 12 July 2006; a few days later, Soliz said it would happen in April;[47] and in April officials said a few more months were needed.[48] The delay caused analysts to wonder if the administration had finally realised the complexities involved in negotiating with the companies, especially Petrobras (Brazilian) and Repsol YPF (Spanish, with substantial Argentinian assets).[49]

The environment was tense, not least because the government's crusade against corruption had already touched the hydrocarbon sector. The attorney general's office cracked down on Petrolera Andina S.A. (Repsol YPF owned), accusing it of oil smuggling,[50] and opened criminal cases against eight former energy ministers for alleged wrongdoing in drawing up and signing contracts with foreign oil companies.[51]

Meanwhile, Spanish entrepreneurs complained that Bolivia was offering few investment guarantees.[52] Petrobras signed a memorandum of understanding on oil production, bio-fuels and development of natural gas internal markets,[53] but later cautioned against expropriation and suggested it might freeze investments.[54] Brazil, Argentina and Venezuela announced the "Great Gas Pipeline of the South" project, excluding Bolivia. Minister Soliz cautioned that a presidential decree regulating the nationalisation of hydrocarbons had to be followed by amendment of

that had been abused for political purposes by previous governments. The former director of the Roads National Service (SNC), José María Bakovic, was jailed on 12 February on charges of illegally suspending legal proceedings against contractors and paying $175,000 to a former SNC official who was suing for wrongful dismissal. The Bakovic imprisonment has been severely criticised by almost all Bolivian media as politically-motivated. The SNC is considered one of Bolivia's best managed institutions. Bakovic was quickly released but the government passed a bill to eliminate the SNC and create a new entity. Other actions included closing the Judiciary Technical Police (PTJ) and creating a new Special Force Against Crime (FELCC) on 20 April, after PTJ lieutenant Paolo Santos was involved in the murder of two Austrian tourists; charging Lloyd Aéreo Boliviano (LAB) Air Company boss Ernesto Asbún with corruption and the Andina S.A. oil company (a Repsol-YPF subsidiary) with smuggling; the arrest of the ambassador to Japan, Héctor Ticona, for embezzlement on 7 April; the dismissal of Vice Minister for Telecommunications Jorge Estrella Ayala, accused of extortion; the expulsion from the party and later resignation of a member of the lower house, Gustavo Torrico; and accusations of demanding salary kick-backs from his staff brought against MAS member of the lower house, Oscar Chirinos. *Bolpress*, 6, 8 February and 13, 21 March 2006; *La Razón*, 8 April 2006; *Bolpress*, 21 April 2006; *Agencia Boliviana de Noticias – ABI*, 18 April 2006; *La Razón*, 24 May 2006.

[43] The Inter American Development Bank (IADB) donated $200,000 for blankets, diapers, sleeping bags, mosquito nets, mattresses, medicines, potable water, food, and tools; in total sixteen countries, nine international organisations, seventeen NGOs and three private companies helped. *Los Tiempos*, 3 March 2006; *La Prensa*, 17 March 2006.

[44] Gonzalo Sánchez in 2003, in an episode commonly known in Bolivia as the "gas war", and Carlos Mesa in 2005, after the controversy generated by the new hydrocarbon law.

[45] Minister of Hydrocarbons Andres Soliz, a lawyer and journalist, has always been considered as a hardliner on nationalisation. Crisis Group interviews, La Paz and Santa Cruz, 26 April and 10 May 2006; he has called Hugo Chávez's "Petroamérica", the proposed project of energetic integration of Latin America, the popular movements' first line of defence against imperialism. "If Latin Americans unite to defend (natural) gas and oil, why not use our financial, water, agricultural or mining, resources? Why not advance together in science, health, education and technology, or in the field of military defence, in order to prevent the U.S. from imposing impunity treaties for their troops?". Andrés Soliz, "El triunfo de Petroamérica", 6 March 2006, available at http://www.argenpress.info

[46] Jorge Alvarado has a PhD in oil geology and has worked for YPFB as an engineer as well as a consultant and university professor in Venezuela and Bolivia. He is considered to have a wider vision of the hydrocarbons sector than most of the Morales cabinet. Crisis Group interview, Santa Cruz, 10 May 2006.

[47] *La Razón*, 23 April 2006.

[48] *La Razón*, 26 April 2006.

[49] Crisis Group interview, La Paz, 26 April 2006. President Morales had said it was difficult to find the people needed to carry out the nationalisation. *La Razón*, 26 April 2006; Crisis Group interview, La Paz, 27 April 2006.

[50] In late February 2006, the attorney general's office issued an arrest warrant against Andina S.A. Representative Julio Gavito on charges of smuggling oil worth €7.54 million. Though the warrant was soon suspended, it was reissued and Andina's headquarters were searched by the police. Gavito resigned on 22 March, saying he needed to prepare his defence. Andina asserted its personnel were innocent and said it would try to bring the case to international courts.

[51] *The Washington Post*, 2 May 2006.

[52] *La Razón*, 21 March 2006.

[53] *La Razón*, 17 March 2006.

[54] *El Deber*, 29 March 2006.

the 2005 law. His vice minister was fired after Soliz accused him of holding secret meetings with the companies.[55] The presidency minister, Juan Quintana, said the foreign companies would in future be service providers, not business associates of Bolivia.[56]

On 1 May 2006 at noon, as Vice President García announced the nationalisation of hydrocarbons to a crowd in front of the presidential palace, President Morales was personally supervising in Cochabamba the takeover by YPFB and the military of one of the 56 oil and gas facilities. That same morning, he had issued Presidential Decree No.28071, placing Bolivia's oil and gas reserves under state control.

The decree requires the foreign companies to relinquish all hydrocarbon production, transport, refining, storage, distribution, commercial and industrial activities to the state-owned YPFB.[57] The Bolivian state is henceforth to control at least 51 per cent of the stock of companies which it had privatised during the 1990s and the two Petrobras refineries;[58] the state will collect 82 per cent of the revenue from the larger gas fields,[59] leaving 18 per cent for the foreign companies. The smaller fields remain subject to the 2005 law.[60] That law required the companies to sign contracts agreeing to the new arrangements within 180 days – by October 2005. No such contracts were signed, and the government set a second 180-day deadline in the 1 May 2006 decree, which it says must be met if a company wishes to continue to operate in Bolivia's hydrocarbon sector. The decree also provides that companies will be audited to determine the basis for those contracts and to ensure correct taxation.

Minister Soliz and the vice president had been speaking for some time of the "seven pillars" of nationalisation,[61] but secrecy surrounded the actual announcement.[62] A senior official admitted to Crisis Group that the government did this to ensure maximum impact on public opinion.[63] The decree was issued shortly after Morales's approval ratings had dropped, and the Episcopal conference of Bolivia had criticised government inaction. May Day seemed the most suitable moment to boost the government's standing. After the decree was issued, the government announced a minimum wage increase from BOL$440 ($55) to BOL$500 ($62) and the abrogation of the decree that regulated employment flexibility and was considered by MAS as the epitome of neo-liberalism.[64] The same week Presidency Minister Quintana reached agreement with the Santa Cruz Civic Committee for an end to a four-day strike,[65] and the vice president expelled two of MAS's most controversial leaders in Santa Cruz[66] and announced decrees on land reform.

[55] One analyst asserted to Crisis Group that the minister's decision was based on false allegations and likely ideological. Crisis Group interview, La Paz, 25 April 2006.
[56] *La Prensa*, 24 April 2006.
[57] YPFB was given 60 days to restructure itself as a corporate enterprise; and the hydrocarbons ministry will regulate activities until new rules are adopted, especially the audits of the foreign companies.
[58] The decree provides for the transfer to YPFB without cost of Bolivian citizens' stock that was part of the Collective Capitalisation Fund (FCC) of formerly state-owned Chaco S.A., Andina S.A. and Transredes S.A. The state will also take the majority stake (at least 50 per cent plus one) of Chaco S.A., Andina S.A., Transredes S.A., Petrobras Bolivia Refinación S.A. and Compañía Logística de Hidrocarburos de Bolivia S.A.
[59] In gas fields producing more than 100 million cubic feet (MCF) per day (the 2005 average), the government will collect 18 per cent for royalties and 32 per cent for the hydrocarbons tax (IDH), while 32 per cent will go to YPFB. At present, only two gas fields produce more than 100 MCF per day and are subject to the 82 per cent increase in royalties: San Alberto and San Antonio, both operated by Petrobras and owned by Andina S.A. (50 per cent), Petrobras (35 per cent), and Total (15 per cent). The 32 per cent participation of YPFB is expected to yield $300 million per year. San Alberto was an old field that gave 50 per cent to the state. However, the capitalisation law defined it as a new field, paying 18 per cent in royalties, because its reserves had not yet been proven. *La Razón*, 2 June 2006. Crisis Group interview, La Paz, 4 May 2006.
[60] For gas fields producing less than 100 million cubic feet per day (2005 average), Law No.3058 on distribution of revenues remains in force: the state receives 18 per cent in royalties and 32 per cent for the hydrocarbons tax, while the companies receive the remaining 50 per cent in revenue. The companies have complied with this formula but have not signed contracts to reflect it. Prior to the presidential election, this was the compromise that avoided arbitration.
[61] The seven pillars of hydrocarbon nationalisation are: i) takeover of effective control at the wellhead; ii) takeover of distribution and sale; iii) control of the majority shares of companies; iv) industrialisation of natural gas; v) massive distribution of natural gas for internal consumption; vi) punishment of companies that do not meet their obligations; and vii) guaranteed legal stability for foreign investments. Crisis Group interview, La Paz, 26 April 2006.
[62] In the interviews that Crisis Group held in La Paz the week before the measure was taken, people were not sure what the government's policy would be. Crisis Group interviews, La Paz, 25-28 April 2006
[63] Crisis Group interviews, La Paz, 2-3 May 2006.
[64] Decree No.21060.
[65] The Santa Cruz Civic Committee had called for a strike, demanding more resources for health and education as well as government guarantees that the contract of the Mutún mining project would be put up for public auction; *La Razón*, 4 May 2004.
[66] Adriana Gil and Vidal Quenta, who were accused of leading MAS militants in the take-over of Santa Cruz's institutions. Gil was also accused of joining the Puerto Suárez's protest against the central government in the EBX affair. See below.

For the government, the nationalisation decree marks the recovery of sovereignty over natural resources.[67] But it neither expropriated assets nor forced foreign firms to leave the country. The 2005 hydrocarbons law provided for a major increase in royalties paid by foreign producers. In the July 2004 "gas referendum", 92 per cent backed nationalisation of oil and gas at the wellhead.[68] The 2005 law stipulated that gas at the wellhead was state property[69] and raised state revenues from 18 to 50 per cent.[70] In one sense the May decree is supplementary, in that it adds the punitive aspect missing from the 2005 law and requires new contractual arrangements within a set timeframe.[71]

Nevertheless, many view the decree as a much tougher measure than the 2005 law because it pressures the foreign companies to adjust to a new legal framework that is far from what they expected to achieve by negotiating with the government. If they decide to press for international arbitration, the government could find itself in a confrontation which could lead to its isolation and loss of foreign aid.

The decree has been conspicuously called "The Chaco Heroes' Law"[72] and described by the government as a victory of Bolivian sovereignty over transnational interests. In his speech on 1 May, Morales said "the looting by the foreign companies" had ended. Vice President García claimed the decree would boost Bolivia's royalties and revenues from $420 million annually to about $780 million.[73] The army deployment was a show of strength but meant primarily as a message for the MAS constituency, not the international community: from now on, Bolivians are in charge of their own property. The government insisted, however, that the army was moved into the oil and gas facilities to guarantee production, should disgruntled companies attempt to sabotage production. Soldiers also guarded entrances, searching employees and visitors to make sure no documents needed for the audits were removed.

Except for certain economic and political sectors in Santa Cruz and Tarija, Bolivians were pleased,[74] but the decree quickly triggered nervousness among foreign producers and markets. Bolivia has the second largest reserves of gas in South America after Venezuela,[75] and, a senior official said, it was confident about a negotiation on its own terms with the companies. First, it considered the tightness of the international oil and gas market gave it an advantage. Secondly, Bolivian gas is of great importance to Argentina and, especially, Brazil, and some foreign companies had already shown willingness to negotiate the new contracts quickly. Thirdly, in case of lawsuits or international arbitration, the government believed the audits would show that even a 90:10 per cent deal would be profitable for foreign companies.[76]

However, the companies have put substantial sums into Bolivia's natural gas sector, without which it would not have been developed. Between 1997, when partial privatisation of state-owned enterprises made the entry of the foreign companies possible, and 2005, when investments were drastically cut as the political situation worsened, they put in some $5 billion;[77] Petrobras invested over $1 billion between 1994 and 2005[78] and Repsol YPF, $1.08 billion between 1997 and 2005.[79] Such investments made possible expansion of proven natural gas reserves from 150 to 518 billion cubic metres, probable reserves from 93 to 394 billion cubic metres and possible reserves from 155 to 500 billion cubic metres.[80] The companies deny they have already recovered initial investments. The Margarita field, for instance, cost more than $300 million to develop; a return will take years.[81]

In an effort to calm apprehensions, Vice President García guaranteed gas supplies to Brazil and Argentina and insisted the 18 per cent revenue share for the foreign companies was in line with continental profit margins (between 15 and 19 per cent).[82] The companies are likely to sign new contracts. And though government sources repeated the 82:18 split is non-negotiable, they may yet

[67] Crisis Group interview, La Paz, 2 May 2006.
[68] See http://www.cne.org.bo.
[69] The former regulation stipulated that the gas was no longer Bolivia's property once it was pumped. The hydrocarbons law changed this, stipulating that the gas remained Bolivia's property at the wellhead. Art. 5, Law No.3058, 17 May 2005.
[70] The Hydrocarbons Law provides for a hydrocarbons tax (IDH) of 32 per cent of gas field revenues plus 18 per cent in royalties for the state. Arts. 52-57, Law No.3058, 17 May 2005.
[71] Crisis Group interview, 4 May 2006.
[72] This refers to the soldiers who died in the Chaco War (1932-1935), protecting, the government says, Bolivia's riches from Paraguayan greed; Alvaro García, speech at the Plaza Murillo, 1 May 2006.
[73] Alvaro García, speech, 1 May 2006.
[74] Crisis Group interview, Santa Cruz, 9 May 2006.
[75] 192 trillion cubic feet of proven and probable reserves in 2004, against a projected demand between 2006 and 2025 of nineteen trillion cubic feet. "The explosive nature of gas", *The Economist*, 11 February 2006, p. 51.
[76] Crisis Group interview, La Paz, 2 May 2006.
[77] "Now it's the people's gas", *The Economist*, 4 May 2006.
[78] See http://www.noticiaspetrobras.com.br/interna.asp?id_editoria=29&id_noticia=1407&palavra=
[79] Repsol-YPF argues that it has paid $822 million over the years and created more than 3,000 jobs. *La Jornada*, 3 March 2006.
[80] See http://www.worldenergy.org/wec-geis/publications/reports /ser/gas/gas.asp.
[81] *The New York Times*, 3 May 2006.
[82] *La Razón*, 3 May 2006.

be able to get a better deal for their largest fields. In that case, the government would ask for higher natural gas prices while the companies would ask for larger quantities of natural gas and more stability of contracts. Some observers believe that the decree was so popular and the timing so perfect that even a 70:30 deal would probably not spoil the government's domestic image.[83]

The transfer of shares stipulated by the nationalisation decree has made YPFB the third largest oil and gas company in Bolivia, after Repsol YPF and Petrobras, with $750 million in assets. It has participation in the domestic gas pipelines as well as the Bolivia-Brazil pipeline and administration of the maritime terminal in Arica, Chile. It will partner with Andina in exploiting gas fields in San Alberto, San Antonio, the Mamoré bloc and Boquerón, and will have shares in the Río Grande plant, Kanata, Bulo Bulo and Carrasco as well as control the production of liquefied petroleum gas (LPG), almost 10 per cent of the country's proven natural gas reserves and almost 10 per cent of heavy oils.[84] There are other developments that could enhance YPFB's position in the internal and external markets and open new possibilities to insert Bolivia into Mercosur's energy strategy.[85] The stage is set for more government control of domestic hydrocarbon prices, which could affect foreign operators' margins. In 2005, price controls on LPG caused several to complain that they were losing money.

With the privatisation of state-owned enterprises in the mid-1990s, many highly-qualified YPFB workers were relocated or joined other companies. Many analysts consider that the role of YPFB in the nationalisation operation is clever propaganda in the run-up to the constituent assembly but they doubt it can effectively take over operations as it needs to build up its logistical, engineering and management capacities.[86] A hydrocarbon expert claimed to Crisis Group that the government has a simplistic vision of the sector, shaped by ideology, and it does not grasp the international implications. Though YPFB's president is aware of the personnel need, the lack of know-how is likely to create two future problems: its payroll could be bloated, and the company could become inefficient. And YPFB could become politicised as the government's cash cow. If there is under-investment and corruption takes hold, any benefits from nationalisation would be lost.[87]

This suggests the foreign companies are needed to help strengthen YPFB. Bolivia's Hydrocarbon Chamber has invited YPFB to join and proposed to help train personnel but neither the ministry nor YPFB have contacted it,[88] and declarations by Minister Soliz suggest the administration prefers intergovernmental help. However, there has not yet been a response to the offer Dutch government representatives made during Morales's January visit to help in improving Bolivia's natural gas management capacities.[89] Ideological biases could affect the once close relations between the ministry and a number of the companies and favour Petróleos de Venezuela (PDVSA), though it is questionable whether Venezuela can transfer high-tech natural gas know-how: its specialty is oil, and most of its best-trained people were fired or otherwise left PDVSA after a 2002-2003 strike.[90]

A comprehensive hydrocarbon policy is still needed that addresses guidelines for gas and liquid hydrocarbons exports, exploration and development of reserves, gas industrialisation and internal market policy (regulation and prices to final consumers), as well as guarantees legal stability for foreign firms and attracts private investment.

### 1. Brazil's and Argentina's stakes

Shortly after the nationalisation decree was issued, European and U.S. officials expressed worry about legal uncertainty.[91] Bolivia is not a major player in global energy markets but its natural gas exports are strategically important for Brazil and Argentina (and indirectly Chile), which have rapidly growing demand. About 85 per cent of gas production is exported, over 80 per cent of that to Brazil. Argentina is actually a net exporter of gas, but imports from Bolivia are important because the logistics

[83] The 82 per cent participation of the state would be transitory, intended to accelerate the renegotiation after which the state's participation would be lower. Crisis Group interviews, La Paz, 4 May and 16 June 2006.
[84] *La Razón*, 18 May 2006.
[85] In early March 2006 YPFB announced construction of the "Bolivian gas pipeline to the west" to connect the fields in Tarija to Tupiza and Uyuni (in Potosí), Oruro (Oruro) and El Alto (La Paz) and supply natural gas in the western highlands. *La Razón*, 8 March 2006. On 19 April, Presidents Morales, Nicanor Duarte (Paraguay), Tabaré Vásquez (Uruguay) and Chávez (Venezuela,) signed in Paraguay an agreement to build a pipeline connecting the Bolivian gas fields with Paraguay and Uruguay. YPFB has discovered new crude oil reserves in La Paz, Pando and Beni. Exploration could be done with the help of third parties in association contracts (or mixed societies) but exploitation costs would be high, leaving these as strategic reserves for the time being. Crisis Group interview, La Paz, 26 April 2006. The Common Market of the South, Mercosur, includes Argentina, Brazil, Paraguay, Uruguay and, most recently, Venezuela, as member states. Bolivia has been an associate since 1997.

[86] Crisis Group interviews, La Paz, 26 April and 4 May 2006.
[87] Crisis Group interview, Santa Cruz, 10 May 2006.
[88] Crisis Group interview, Santa Cruz, 10 May 2006.
[89] Crisis Group interview, La Paz, 12 June 2006
[90] Crisis Group interviews, Santa Cruz and La Paz, 10 May and 16 June 2006.
[91] *La Razón*, 3 May 2006,

are better for certain regions and allow the country to sell its own gas to Chile, to whom Bolivia refuses to sell.[92] About one-third of Bolivia's export income in 2005 came from the sales to Brazil. However, tension has been palpable since Morales's inauguration.

The outcome of the emergency meeting the Bolivian, Brazilian, Argentinean and Venezuelan heads of state held in Puerto Iguazú, Argentina on 4 May was more benign for the Morales administration than expected. While not disguising the strains, Brazil and Argentina accepted the nationalisation decree as a sovereign decision and walked away with little more than an agreement to negotiate the price of the natural gas they buy from Bolivia[93] and assurances that supply would be maintained. Bolivia gained a promise it could take part in the proposed but still distant "Great Pipeline of the South" project.[94] The night before the meeting, Hugo Chávez made a surprise visit to Bolivia to call Morales's nationalisation policy patriotic and heroic, and during the meeting, he defended the Bolivian measures even more vociferously than Morales.

Brazilian President Luiz Inacio da Silva was heavily criticised at home for his passive response to the Bolivian policy. Relations with Bolivia are strained over Mercosur leadership, which has prompted Brazil to consider ways to reduce its dependency on Bolivian gas.[95] In the 1990s, the Brazilian government reinforced the country's hydroelectric power grid with natural gas-fired plants, and many of its automobiles run on natural gas. Over 50 per cent of the natural gas consumed in Brazil comes from Bolivia;[96] in Sao Paulo, it amounts to 70 to 75 per cent.[97] Thus, officials' first reaction was to consider the nationalisation decree an unfriendly measure as well as contrary to Petrobras's interests.[98]

The giant company itself denounced the decree as unilateral and inconsistent with what had been under negotiation a few days before. Petrobras's president, José Sérgio Gabrielli, hinted at legal action.[99] And indeed, the company stands to lose a lot: San Alberto, one of the two largest fields, and two refineries (Petrobras Bolivia Refinación SA and Compañía Logística de Hidrocarburos de Bolivia SA) are among its most profitable assets.[100] On 3 May, Petrobras announced it would halt investment in Bolivia and was considering international arbitration or a court case.[101] It has also complained about the rise in gas prices and what it calls the illegal naming of a new board of directors in its Bolivian subsidiaries – people of whom industry experts say they have never heard.[102] For Brazil, the nationalisation puts a major obstacle in the way of plans to source some 68 percent of its growing gas demand from Bolivia by 2010, while Petrobras has begun to consider massive alternative domestic investments.

Nationalisation was a serious blow to Repsol YPF, which in early 2006 had opened talks with YPFB for an estimated $150 million joint investment in the energy sector: construction of three plants (urea production, electricity generation and LNG production) and the Carrasco–Cochabamba gas pipeline.[103] On 5 May, the Spanish government sent a delegation to La Paz to discuss the nationalisation measures and how Repsol YPF would be affected. Argentina's gas demand is 7.5 million cubic

[92] This, despite Chile's offer to pay much more than Brazil or Argentina and provide other incentives. Argentina has acknowledged that in effect, Bolivia is exporting to Chile via Argentina, but Hydrocarbons Minister Soliz responded that "the moment that [President] Kirchner declared that the gas is for Chile, the difficulties started". Bolivia is not willing to sell Chile natural gas until it agrees to negotiate an access to the sea for Bolivia. See below.

[93] Brazil pays $3.68 per MMBtu (million of British thermal units). Bolivia expects to raise $2.00 per MMBtu. Crisis Group interview, Santa Cruz, 10 May 2006. Argentina pays about $3.20 per MMBtu according to published reports. It had asked that Chile attend the negotiations but Bolivia refused.

[94] Also under consideration is the "Great Gas Pipeline of the South" project, promoted by Venezuela but also involving Brazil and Argentina. It involves an 8,000 km. duct connecting the huge but little-developed Venezuelan gas reserves (192 trillion cubic feet of proven and probable reserves in 2004) to Brazil and Argentina. It would transport 150 million cubic metres daily through the Amazon rainforest, at an estimated cost of $20 billion. It is said that beyond 3,000 km, natural gas is cheaper liquefied and shipped than piped. To pay back the investment, the gas would need to be sold at $10 per MMBtu. It would be affordable to consumers only if heavily subsidised. Despite the technical and practical difficulties, Brazil and Argentina seem to be persuaded. However, a hydrocarbon expert believes the more a trial balloon they have launched to press Bolivia to lower its price. "The explosive nature of gas", *The Economist*, 11 February 2006, p. 51; Crisis Group interview, Santa Cruz, 10 May 2006.

[95] Brazil's proven and probable reserves (2004) are 33 trillion cubic feet (TCF), against projected demand (2006-2025) of 28 TCF. In 2003, gas deposits were discovered off its south east coast that some experts say could significantly ease demand, but, until now, tapping that gas has not been profitable. Brazil is to spend $8.8 billion in the next four years to develop these gas beds and find alternative sources outside Bolivia. "The explosive nature of gas", op. cit.; *The New York Times*, 5 May 2006.

[96] 520 million cubic feet per day (MCFD).

[97] Crisis Group interview, Santa Cruz, 10 May 2006.

[98] *La Razón*, 2 May 2006.

[99] *La Razón*, 4, 5 May 2006.

[100] Crisis Group interview, La Paz, 4 May 2006.

[101] *La Razón*, 4 May 2006; *The New York Times*, 5 May 2006.

[102] Crisis Group interview, Santa Cruz, 10 May 2006.

[103] *La Razón*, 4 March 2006.

metres per day and rising.[104] While new supply could be developed in seven years, a second pipeline from Bolivia (at a projected cost of $5.3 billion) could be built in four. If only Bolivian gas prices rise, however, the second pipeline would not be financially feasible. Only a substantial increase also in Argentinean gas prices could make the project viable and encourage new exploration in the country.[105]

But the relationship is interdependent.[106] Brazilian and Argentinean companies need Bolivia to supply their markets, and Bolivia needs the help of the companies – particularly Petrobras and Repsol YPF – to develop its hydrocarbon infrastructure and get its reserves out of the ground.[107] The proven reserves will only last twenty years if gas is sold at the present rate and no new finds are made.[108] Doubts remain, however, about the accuracy of the figures for proven reserves.[109] With the structural constraints on the supply and demand sides, it is unlikely that Petrobras or Repsol YPF will abandon Bolivia, and they probably accept that they must make concessions in order to stay.[110] They will almost certainly have to sign the new contracts, even if only to stick it out until new supplies are available.[111] Indeed the Repsol YPF contract is anticipated to be signed at the end of June, resulting in larger quantities of gas for Argentina.[112]

High government officials have been vague on whether the government will pay an indemnity for taking shares under the nationalisation decree.[113] Minister Soliz threatened to seize company assets if new contracts were not negotiated within 180 days, suggesting the government may force the companies to hand controlling shares to YPFB without indemnity, in confidence the audits will provide justification by demonstrating that the companies did not invest as much as they should have under the privatisation law.[114] However, if the audits are done entirely by Bolivian entities, their objectivity could be questioned.

According to a senior government official, misunderstandings are arising in the negotiations because Petrobras and Repsol YPF had grown accustomed to working with great autonomy and in some instances with the help of corrupt civil servants in a country where the state had little regulatory capacity. The government is now enforcing the law and imposing conditions it believes to be reasonable.[115] However, there is concern that lack of technical expertise and the strong ideological drive of the government's small negotiating team could make progress even more difficult.[116] Ultimately, some form of international arbitration is likely. For now, however, the government is beginning to look for new partners beyond the big three – Petrobras, Repsol YPF and also Total, which together claimed over 85 percent of Bolivia's natural gas reserves before nationalisation.

## 2. The Chilean market

Negotiations for the anticipated new Bolivia-Argentina agreement were reportedly complicated by the Argentines' admission that Bolivian gas is in effect resold to Chile, an indication of the continuing effect the unresolved issue of Bolivian sovereign access to the sea has on regional economic relations. The present circumstances, however, including the coincidence of new governments in both countries, may offer an opportunity for some progress.

The general approach of the Bachelet administration in Santiago has been more open to considering Bolivia's grievances than previous Chilean governments, with Foreign Minister Alejandro Foxley stating that it does not

[104] In 2002, Argentina converted gas prices from dollars to pesos and froze them. As the peso devalued and the economy recovered, demand boomed but supply did not keep pace, as foreign companies stopped exploring due to low prices. As proven gas reserves fell by 35 per cent between 2000 and 2004, the government cut exports to Chile; Argentina's proven and probable reserves (2004) are 27 TCF, against a projected demand (2006-2025) of 37 TCF. "The explosive nature of gas", op. cit.

[105] Press accounts indicate that Argentina has agreed in principle to pay 47 per cent more for Bolivian natural gas (from $3.38 to $5.00 per million BTUs) and that the deal will be signed by Presidents Néstor Kirchner and Evo Morales, who are also expected to sign an agreement to build a pipeline to carry an additional 20 million cubic metres of Bolivian natural gas to Argentina daily. "Argentina reportedly agrees in principle to major price hike on Bolivian gas", Associated Press, 26 June 2006.

[106] Crisis Group interview, La Paz, 3 May 2006.

[107] Crisis Group interview, La Paz, 28 April 2006.

[108] Crisis Group interview, La Paz, 4 May 2006.

[109] The issue is surrounded with controversy. Crisis Group interview, LaPaz, 16 June 2006. YPFB is said to have taken on the task of verifying oil and natural gas reserves itself, or to be considering doing it with PDVSA's help, after Bolivia dropped the U.S.-based petroleum consulting firm DeGoyler & MacNaughton, which it considered had overestimated the reserves. DeGoyler & MacNaughton said it was unable to complete a 2005 estimate because its access was cut off. "Bolivia gas reserves declined in 2005 at major fields: consultant", *Platts*, 25 May 2006.

[110] Crisis Group interview, La Paz, 26 April 2006.

[111] Crisis Group interviews, La Paz and Santa Cruz, 2 and 10 May 2006.

[112] Crisis Group interview, La Paz, 16 June 2006.

[113] *La Prensa*, 24 April 2006.

[114] Crisis Group interview, La Paz, 2 May 2006.

[115] Crisis Group interview, La Paz, 2 May 2006.

[116] The government negotiating team includes Hydrocarbon Minister Soliz, YPFB President Alvarado, YPFB Presidential Counsellor Manuel Morales and Superintendent Víctor Sainz. Crisis Group interviews, La Paz, 16 June 2006.

rule out the possibility of giving Bolivia sovereign access to the sea in some form.[117] Chile also has reasons to seek a deal since it pays a big economic price for not being able to get direct access to Bolivian gas.[118]

Bolivia insists it has no ideological opposition to Chile obtaining its gas but it wants to shape the process, essentially by starting a bilateral "gas-for-coastline" discussion. The Morales administration may have more room to manoeuvre since the nationalisation decree reduces domestic concern that Bolivia would not benefit from Chilean purchases. Bolivia also could anticipate receiving a higher price for its gas from Chile than even what is likely in the deals that are in negotiation with Argentina and Brazil, as well as Chilean help (already offered) to build new pipeline infrastructure.[119] At the least, the time appears ripe for the issues to be reviewed.

### 3. Other international players

Bolivia's hydrocarbon potential intrigues many investors eager to tap new oil and gas fields. Mexico manifested interest in a deal to buy liquefied natural gas (LNG) to be shipped to its Pacific coast.[120] Russian Gazprom as well as Chinese and Indian companies likewise have shown interest in investing.[121] According to YPFB's Alvarado, there have been talks with Gazprom about an investment of $2 to $3 billion.[122] The introduction of new players is seen as likely if negotiations with the current set of foreign companies fail.[123] But the way nationalisation has been carried out has made companies around the world wary, even if some will not admit it publicly.[124]

But what has emerged after the nationalisation is the growing interest of Venezuela in Bolivia's hydrocarbon sector.[125] This has opened Morales to criticism from PODEMOS and UN and strained relations with Brazil's Lula and others in the international community.[126] Morales's willingness to join the "Great Pipeline of the South" mega-project despite questions about its technical feasibility has been harshly criticised in Bolivia,[127] where some see it as eventual competition for expanded Bolivian exports to the Southern Cone.

Venezuela is offering itself as a partner eager to help YPFB develop as an international player. It first offered a $40 million investment in the Río Grande facility (55 km from Santa Cruz), a plant that recovers natural gas liquids such as propane and butane, which are incorporated into the gas sold to Brazil and Argentina.[128] On 26 May, Bolivia and Venezuela sealed their partnership in the hydrocarbon sector during a MAS rally in the Chapare region, when Presidents Chávez and Morales signed agreements involving $1.5 billion in investments. YPFB and PDVSA are to create a joint venture, Petroandina, to operate 35 gasoline stations throughout Bolivia;[129] PDVSA may send auditors to determine the real situation of Bolivian gas reserves; and a fertilizer plant (Fertisur) is to be built to supply 150,000 barrels of diesel fuel monthly to Bolivia in return for agricultural products.

Some analysts see PDVSA's growing presence as leverage the government can use against other foreign companies during the negotiation of new contracts; others believe Venezuela's influence could undermine the negotiations if the government tries to imitate the tough stance of that country, an oil giant with access to many markets and much different from Bolivia, which produces gas for only two

[117] "Bolivia: Chile signals possible accord over Pacific coast", *Latinnews Daily*, 18 April 2006.
[118] Chile presently pursues more expensive alternatives such as importing LNG and paying Brazil to export electricity to Argentina to free up gas. Its power and industrial sectors, particularly in the north, are vulnerable to unreliable gas supply and arbitrary price changes, since Argentina allocates gas toward domestic priorities first.
[119] "Bolivia Endangers Southern Cone Growth", *Energy Economist*, 1 June 2006.
[120] In early March 2006, a Mexican delegation including the energy secretary and PEMEX representatives went to Bolivia to discuss and possibly reactivate the agreement President Carlos Mesa signed in 2004 but was suspended due to the political turmoil. *El Diario*, 3 March 2006. In addition to the technical complexities involved in building a natural gas liquefying harbour in Peru or Chile, the deal would be unpopular in Bolivia. The fall of President Gonzalo Sanchez in October 2003 was produced by the prospect of a sale of natural gas to Chile. Sending resources through Peru is not likely to be as controversial because there is not the same history of war and lost territory.
[121] Crisis Group interviews, La Paz, 26 April and 2 May 2006.
[122] A Russian business paper underlined that since nationalisation foreign companies are suspicious of the Bolivian government and that Gazprom has been called in to help. It also reported Prime Minister Fradkov's announcement that Gazprom could be a stake holder in the construction of the transcontinental gas pipeline megaproject. "Gazprom pomozhet Bolivii", *Vsgliad, Delovaya Gazeta*, 8 June 2006.
[123] Crisis Group interview, La Paz, 3 May 2006.
[124] The Russian ambassador to Bolivia called the nationalisation "absolutely logical" when discussing Gazprom's development strategy; *International Oil Daily*, 9 June 2006. Crisis Group interviews, La Paz and Santa Cruz, 3 and 10 May 2006.
[125] Crisis Group interview, La Paz, 3 May 2006.
[126] Crisis Group interview, Santa Cruz, 8 May 2006.
[127] Crisis Group interviews, El Alto and Santa Cruz, 5 and 10 May 2006. Crisis Group interview, La Paz, 4 May 2006.
[128] *New York Times*, 5 May 2006; Crisis Group interview, Santa Cruz, 10 May 2006.
[129] According to Law No.3058 (2005), Petrobras Bolivia Refinación and six other wholesalers (Shell, Dispetrol, Copenac, Pisco SRL, Refipet and Texim) will hand over their fuel distribution operations to YPFB in July 2006. *La Razón*, 22 June 2006.

regional markets. In the unlikely event of a rupture of talks with the companies, however, PDVSA would be strategically placed to take over large chunks of Bolivia's oil and gas sector that YPFB cannot yet handle.[130]

## B. OTHER NATIONALISATIONS, LAND REFORM AND TRADE

Minister of Mining Walter Villarroel announced the next nationalisation could include the U.S.-owned San Cristobal mine in Potosí (lead, silver and zinc). However, Vice President García quickly calmed matters, saying private mining companies would only face higher taxes and royalty payments.[131] Nevertheless, President Morales said in his May Day speech that nationalisation would also cover mining, forestry and natural resources in general.[132] These contradictory statements make it difficult to know the government's true intentions.[133]

Despite government efforts to discourage civic committees from defending foreign interests, the Civic Committee of Puerto Suárez (Santa Cruz) spoke out on behalf of a Brazilian investor interested in developing the Mutún iron ore field.[134] It was concerned that nationalist rhetoric and government actions voiding the Brazilian iron investment would mean loss of jobs, local revenues and future development. The government's decision also paved the way to put the Mutún project up for public auction. Finally, after repeated deferments, the government awarded the project to Indian Jindal Steel and Power on 1 June.[135] Venezuela has also expressed interest in the mining sector. On 26 May, Presidents Chávez and Morales signed a document in which their respective ministries of mining agreed to create Minera del Sur (Minesur), a joint venture expected to start operating soon in the western highlands.

There is also uncertainty on land reform. As the government did not announce its plan for months, Santa Cruz Prefect Rubén Costas took the initiative in early May.[136] On 16 May, the government finally announced its plan, involving redistribution of 2.2 million hectares of public lands to settlers, peasants and indigenous peoples, with possibly an additional 2.5 million hectares of idle land within eight months and a total of 20 million hectares over five years.[137] Landless women, especially widows and single mothers, are expected to be among the first to benefit.[138] Though the government wanted to discuss its plan with the National Agrarian Commission[139] and the Agrarian Chamber of the East,[140] talks broke down and Morales announced his intention to proceed on 3 June.[141]

The majority indigenous population's lack of access to land and the vastly disproportionate control of a few wealthy Bolivians have long been at the roots of rural poverty.[142] Land reform, however, could spark conflict between the eastern lowlands and the central government. Sensitivities in the east are likely to mobilise people.[143] Landowners have criticised the government for promising to reach consensus while encouraging illegal occupation of land by poor peasants and MAS militants.[144] Some fear

[130] Crisis Group interviews, La Paz, 27 April and 2 May 2006.
[131] Crisis Group interview, La Paz, 26 April 2006.
[132] Evo Morales' speech on 1 May 2006.
[133] The case of the Mutún iron ore field illustrates the point: as protesters from the Civic Committee Puerto Suárez (Santa Cruz) complained about the government's order to stop construction of the Brazilian EBX cast iron plant and the potential loss of 1,500 jobs (three ministers were held hostage on 18 April), the government argued that EBX did not have the proper environmental permits and was in violation of a constitutional prohibition forbidding foreigners to own Bolivian soil or subsoil within 50 km of the international borders. EBX denied wrongdoing, arguing it had the proper licences from local authorities. The government stood its ground, the strikes were called off, and EBX began to dismantle the plant.
[134] The Mutún has 4,000 million tons of iron ore reserves. *La Razón*, 2 June 2006. Crisis Group interview, La Paz, 4 May 2006.
[135] Jindal Steel and Power won with a $2.3 billion bid to develop and operate the mine for 40 years. The Bolivian state will receive $50 million annually and a 48 per cent share. The award of the project to an Indian company calmed the fears of possible manipulation to favour Venezuelan interests. *La Razón*, 2 June 2006.
[136] This was interpreted by an analyst as yet another attempt to increase prefect competencies. Crisis Group interview, Santa Cruz, 9 May 2006.
[137] The forceful occupation of *Cruceño* institutions by MAS militants was rejected by *Cruceño* people. That is why the vice-president "beheaded" MAS leaders Adriana Gil and Vidal Quenta in Santa Cruz. Crisis Group interview, Santa Cruz, 8 May 2006.
[138] Crisis Group, telephone interviews, 21 June 2006.
[139] It represents federations of settlers and indigenous peoples (CIDOB) and the union of peasant workers (CSUTCB).
[140] It represents the interests of large landowners and agro-industrial entrepreneurs.
[141] *La Razón*, 4 June 2006.
[142] Bolivia has had land reforms in the past. A key question is whether this time poor families will receive the credit and marketing and technical assistance to permit them to farm the land profitably. See also Crisis Group Report, *Bolivia at the Crossroads*, op. cit., pp. 19-20.
[143] Crisis Group interview, La Paz, 3 May 2006.
[144] There had already been troubling precedents: illegal occupation of private property by the "movements without land" (MST) in Oruro, Cochabamba and Santa Cruz and the "movement without roof" (MST) in Oruro. In Caranavi, social movements had mobilised against the private sector (a coffee processing facility of Copacabana industries). The government is said to have been informed about the excesses but to have done nothing to protect property rights. Crisis Group interview, La Paz, 25 April 2006.

a great risk of social conflict if the government relocates people from the west to the eastern lowlands, to the point of large landowners creating "strike forces" to defend their land.[145] In the last weeks of June, the campaigns for the constituent assembly and the referendum on regional autonomy in the east have focused on defence of land rights. Since the situation could become explosive, analysts believe the government will go after only the most conspicuous law violators,[146] mostly taking away idle land, land owned by Brazilians near the borders and land owned by speculators.[147] However, the government should be cautious about sparking anti-Bolivian sentiments in Brazil.

The macroeconomic situation is positive. Mining and hydrocarbon exports produce a positive balance of payments,[148] and there is a construction boom in La Paz.[149] However, uncertainty over nationalisation and land reform, as well as the closing down of external markets such as soybean exports to Community of Andean Nations members[150] and the likely end of the Andean Trade Promotion and Drug Eradication Act with the U.S.[151] cast a shadow on Bolivia's capacity to sustain growth if international commodity prices plunge. The Peoples' Commercial Agreement (TCP) signed with Cuba and Venezuela on 29 April is not likely to be much of a safety net: it appears to have been motivated more by politics than commerce, an idea Morales came up with when his government was being criticised for inaction in the defence of Bolivian exporters.[152]

## IV. THE CONSTITUENT ASSEMBLY AND THE AUTONOMY REFERENDUM

Special Law No.3091 of 6 July 2005 issued by the government of Eduardo Rodríguez provides for the election of a Constituent Assembly (CA) on the first Sunday of July 2006 and for a National Pre-Constituent and Pre-Autonomy Board.[153] The CA is the product of demands by the indigenous peoples for more social and political inclusion. Claims by indigenous movements from the eastern lowlands go back to the early 1990s. Their "March for Life, Dignity, Sovereignty and Natural Resources" in 2002[154] made three demands: a) reform of congress and constitution by a CA; b) repeal of a law on sustainable development of forestry concessions that seemed more focused on timber production than conservation; and c) a series of changes in the agrarian reform law.

The CA is meant to be a sovereign and representative assembly, with participation from all social sectors, to transform the state's structure.[155] It became the battle cry of rural indigenous populations all over the country, and with time, also an idea that many sectors of society saw had potential to end segregation and lack of inclusion of indigenous groups living in rural and poor urban settings.[156] Although President Morales, who forcefully pressed the issue in his campaign, has repeated that the CA aims to found a new Bolivia ("*refundar Bolivia*"), some analysts told Crisis Group Vice President García believes only 10 per cent of the current constitution should be modified.[157] Nevertheless, that would give indigenous peoples a stronger say, enhance citizenship and improve the legitimacy of state institutions. A source close to the MAS said the CA will be more reform process than revolution,[158] a view supported by people in El Alto.[159] Nevertheless, once a CA is convened, some groups undoubtedly will seek much more ambitious goals.

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[145] Crisis Group interviews, Santa Cruz, 8 May, 12 May 2006 and telephone interview, 21 June 2006.
[146] Crisis Group interview, La Paz, 4 May 2006.
[147] Crisis Group interview, Santa Cruz, 8 May 2006.
[148] See Bolivian Central Bank website at: https://www.bcb.gov.bo/pdffiles/Mayo2006/ReporteBalanzaPagos.pdf.
[149] Crisis Group interview, La Paz, 27 April 2006.
[150] The Andean export market was worth $466 million (300 products) for Bolivia in 2005; Bolivia is likely to lose the Colombia soybean market ($176 million annually) to the U.S. under the Free-Trade Agreement (FTA) Colombia and the U.S. are about to sign. *La Razón*, 13 March 2006.
[151] Preferences are scheduled to end in December 2006. However, in a major policy reversal, on 1 June 2006 the government announced its interest to sign an agreement with the U.S. to extend the preferences. With those preferences, Bolivia exports $160 million annually to the U.S., supporting 50,000 jobs, especially in El Alto textile firms. *La Razón*, 2 June 2006; *La Prensa*, 17 June 2006.
[152] The TCP, as presented in a document distributed by the MAS, proposes the return to a model where the state tightly controls trade. The private sector cautioned against this. Crisis Group interviews, La Paz, 25 April 2006.

[153] See Crisis Group Report, *Bolivia at the Crossroads*, op. cit., pp. 11, 18-20.
[154] The march began in Santa Cruz on 13 May 2002 and finished in La Paz on 13 June with the government's signature of an agreement to reform the constitution; Carlos Romero, *El proceso constituyente boliviano: el hito de la cuarta marcha de las tierras bajas* (Santa Cruz, 2005), p. 236.
[155] Ibid, p. 139.
[156] One million people are unemployed, and more than three million work in the informal sector. Crisis Group interview, La Paz, 26 April 2006.
[157] Crisis Group interview, La Paz, 26 April and May 2006.
[158] Crisis Group interviews, Santa Cruz, 12 May 2006
[159] Crisis Group interviews, El Alto, 5 May 2006.

Indeed, it is too early to know whether the government and MAS intend to follow a reformist course in the CA or if their declarations have only been meant to appease distrustful sectors in society before they adopt a more radical stance at the CA. It is not out of the question that the Morales administration is working on a two-tier strategy that includes both radical socio-economic change, such as nationalisation of the hydrocarbon sector and land reform, and more cautious measures geared at institutional change through the CA. Government and MAS agreement to the referendum on regional autonomy could be interpreted as a concession to the opposition in the eastern lowlands, especially in Santa Cruz and Tarija province. The government and MAS know they will not be able to dominate the CA, and it is important not to antagonise the opposition but they also have to satisfy their own supporters.

According to Law No.2150 of 2000, the country is divided into departments, provinces, provincial sections and cantons. A minimum of 500,000 inhabitants is needed for a department; provinces require at least 30,000; provincial sections or municipalities need a minimum of 10,000 (provincial sections in international border regions only 5,000); a canton requires a minimum of 1,000.[160] The Popular Participation Law of 1994 is the basis for election of municipal mayors and the establishment of administrative and financial autonomy of municipalities. It also promotes involvement of civil society at the local level.[161] The Administrative Decentralisation Law of 1995 was issued as a departmental level complement. However, it resulted only in administrative changes, as prefects continued to be appointed by the president until direct elections were introduced in 2005. Departmental councils are still appointed by municipal councils (one representative per province).[162]

Despite measures geared at decentralisation and more participation at local and regional levels, such as the Popular Participation Law and direct election of prefects, the civic committees and the indigenous groups in the east still consider the country to be highly centralised. They have made autonomy demands of two sorts. The Santa Cruz Civic Committee began a territory-based campaign in 1984 calling for decentralisation and direct election of departmental governments. It advocates a state with distinct national, departmental and municipal competencies, the direct election of departmental governments (prefect and members of the departmental assembly) and autonomy for economic development, investment, trade, industry, agriculture, public works, culture, legislative initiatives and management of natural resources.[163] It has collected 500,000 signatures supporting its vision of autonomy.[164]

On the other hand, the Confederation of the Indigenous Peoples of Bolivia (CIDOB) began in 1992 to campaign for the right to define the political, economic and cultural standards under which their territories should be governed.[165] The Coordination of Ethnic Peoples of Santa Cruz (CPESC) calls for recognition of their right to self-governance in their ancestral lands, including independence from the authorities in decisions on administrative, political, economic, cultural and natural resources issues.[166]

Though both the CA and the RRA were sanctioned by Special Law No.3091, the latter was not a priority for the MAS. During the presidential campaign, the party supported the demand for administrative autonomy for indigenous peoples, but not the departmental approach proposed by the civic groups, especially those from Santa Cruz and Tarija. This lack of interest was made evident in the new cabinet, which eliminated the ministry of popular participation and transferred its responsibilities to the vice ministry of decentralisation (subordinated to the ministry of the presidency).[167]

## A. THE LAWS

On 7 February 2006, President Morales submitted his government's CA bill and asked congress for quick passage so delegates could be elected no later than 2 July and the first session convened by 6 August. Given that the National Electoral Court (CNE) needs at least 120 days to prepare elections, congress had only until 4 March to analyse the government's bill and those submitted by opposition parties and civic groups.

The number of constituents, the electoral mechanism (direct vote or party/group lists) and the type of representation (ethnic, voting districts, departmental) were

[160] Politico-Administrative Units Law No.2150 (20 November 2000). However, some departments, provinces and cantons do not meet the demographic criteria in the law. *Ventana Ciudadana*, 18 April 2006, p. 4C.

[161] This law, still in effect, was intended to promote state presence throughout the country and reinforce citizen participation at the municipal level. From 24 municipalities that first implemented it in 1994, 327 municipalities now enjoy administrative and financial autonomy, Roberto Barbery, *Participación popular: descentralización y autonomías departamentales en Bolivia*, (La Paz, 2005), p. 101.

[162] Ibid, pp. 66-67.

[163] Romero, op. cit., pp. 599-617.

[164] See Crisis Group Report, *Bolivia at the Crossroads*, op. cit., p. 19.

[165] Romero, op cit., p. 576.

[166] Ibid, p. 583.

[167] Intervention of Roberto Barbery, roundtable "Popular participation face to the constituent assembly and the referendum on regional autonomy", La Paz, 25 April 2006. Barbery was minister for popular participation in the Carlos Mesa administration.

the toughest issues to agree on. The government bill proposed 210 delegates, three to be elected in each of the country's 70 voting districts, with the party obtaining the most votes in a district entitled to two and the runner-up to one; if a party won more than 50 per cent of the vote in a district, it would get all three. This kind of distribution, as well as some declarations from MAS legislators and representatives of social movements close to the party, fed fears of the opposition and the civic groups that MAS wanted absolute control over the CA without respect for minorities.[168]

PODEMOS Senator Carlos Böhrt submitted a draft proposing 144 delegates: nine with national representation, one from each of the 70 voting districts, eleven representatives of minority indigenous peoples, and 54 from departmental voting districts according to territory and population size (with gender equality in candidate lists). The UN bill proposed 109 delegates: three from each of the nine departments and 82 according to population (with gender equality in the candidate lists). The *Cruceño* group's[169] proposal was for 155 delegates: five from each of the six smallest departments and 125 according to population. The Human Rights Permanent Assembly of Bolivia (APDH) wanted 181 delegates: two from each department, the rest according to population. The Unity Pact[170] sought 242 delegates, with the same provisions as the MAS bill plus 32 distributed according to special indigenous voting districts. The Pando parliamentary group called for 135 delegates: fifteen from each department. And women groups proposed 181 delegates: five from each department, the rest allocated among the 70 voting districts.

On the 4 March 2005 deadline, after Vice President García had put together a consensus among political parties and regions, Law No.3364 calling for the election of a Constituent Assembly (CA) and Law No.3365 for the Referendum on Regional Autonomy (RRA) were passed. President Morales signed both on 6 March. It was no easy undertaking, considering that MAS dominance in the congress was not sufficient to assure the necessary two-thirds majority, so PODEMOS's agreement was essential.[171] MAS was compelled to negotiate and yielded to the inclusion of departmental representations in the CA. Some analysts believe this concession was motivated by fear that regional conflict might reignite and the government be accused of dividing the country.[172] Others emphasise the vice president's ability to encourage dialogue, even if radical elements in his party would prefer to dominate the political arena.[173] Overall, the result confirmed the reconfiguration of the political landscape: MAS control of the central government, with the opposition strong in the regions.

The following are the main points of the law on the CA:[174]

- There will be 255 delegates equal in status, rights and duties, 210 elected in 70 voting districts (three per district) and 45 from the nine departments.[175]
- State institutions will work normally; the CA will be autonomous and not interfere with their functions.
- The CA will convene in Bolivia's constitutional capital, Sucre, and deliberate for no less than six months and no longer than one year.

[168] In his inauguration speech, President Morales warned that if congress did not convene a CA, the social movements would. On 1 February, meeting with El Alto social movements, Morales said he wanted a CA with "unlimited powers", to "found a new country and not just reform the constitution" and requested creation of a "people's general staff" (*estado mayor del pueblo*) to defend the transformation process headed by his government. In a meeting in Santa Cruz, civic leaders from Beni, Pando and Tarija threatened to boycott the CA if the MAS bill passed unchanged. Civic leaders in Chuquisaca, Oruro, Cochabamba, Santa Cruz, Potosí and La Paz demanded the bill include departmental representation. PODEMOS and MNR supported the bill on regional autonomy presented by the Civic Committee of Santa Cruz. MAS militants threatened to take the streets if PODEMOS, UN and MNR blocked the CA bill in congress. The civic committee of Santa Cruz announced mobilisation of the *Cruceño* Youth group (*Juventud Cruceñista*) to defend autonomy. "People's general staff" leader Román Loayza theatened to take to the streets on 6 March if the law was not passed, and Local University Federation (FUL) executive secretary Róger Martínez of the University Gabriel René Moreno called for armed defence of Santa Cruz interests. *La Razón*, 2 February, 9 February, 28 February 2006, and 2 March 2006; *El Diario* and *El Deber*, 3 March 2006.

[169] It is a group of congressmen from Santa Cruz from several parties.

[170] The Unity Pact gathers the majority of the eastern indigenous organisations: CSUTCB, CONAMAQ, the Confederation of Colonizers of Bolivia, the National Federation of Peasant Women Bartolina Sisa, the Movement Without Land (MST), the Ethnic People Coordination of Santa Cruz, the *Mojeño* People Organization and the *Guaraní* People Assembly.

[171] The MAS needed 105 votes to pass the law, but only had 84 congressmen. Therefore, support from PODEMOS (thirteen senators and 42 members of the lower house), UN (one senator and eight members of the lower house) and the MNR (one senator and seven members of the lower house) was necessary.

[172] Crisis Group interviews, La Paz, 3-4 May 2006.

[173] Crisis Group interview, La Paz, 27 April 2006.

[174] Law No.3364 (6 March 2006).

[175] Three persons will be elected from each one of the country's 70 voting districts: in each, two seats go to the party list with the most votes, one to the runner-up; five delegates will be elected from each of the nine departments: two seats in each department will go to the party list with the most votes, and one each to the party lists polling the second, third and fourth highest totals; if the third or fourth highest placed do not get 5 per cent, however, the remaining seats will be distributed between the top two lists.

- Candidates can be proposed by parties, civic groups or indigenous peoples. Lists must alternate male and female candidates. Elected officials,[176] appointed officials,[177] judicial personnel,[178] other elected or appointed state officials,[179] civil servants, military and police personnel, ecclesiastics and contractors with state entities all cannot stand unless they resign their other positions at least 60 days before the election.[180]
- The text of the new political constitution must be approved by two-thirds of the delegates present and ratified by absolute majority in a referendum; the president has no veto right and must promulgate the new constitution within ten days after the referendum result is official.
- The state will make available BOL$30 million ($3.7 million) to pay for the CA and the RRA.[181]

The RRA will ask the following question:

> Do you agree, within the framework of national unity, to give the Constituent Assembly the binding mandate to establish a departmental autonomy regime, applicable immediately after the promulgation of the new Political Constitution of the State, in the departments where this referendum obtains the majority, in such a way that its authorities are elected directly by its citizens and receive from the national state the executive competencies, administrative normative attributions and economic-financial resources the new political constitution of the state and the laws assign to them?[182]

The RRA result will be binding department by department: the CA will have to incorporate in the new constitution an autonomy regime for those departments where the "yes" answer receives a simple majority. Though the question makes clear that the unity of the country will not be jeopardised, and the new departmental competencies will come into force only after the new constitution is approved, it has been criticised for its complicated phrasing and the difficulty voters may have to interpret its implications.

## B. THE ROAD AHEAD

The constituent assembly will deal with three key issues: a) regional autonomy, by far the most complex, because it involves the risk of territorial reconfigurations that could lead to conflicts over natural resources; b) a new economic model; and c) the struggle of indigenous groups against social exclusion.[183]

There could also be tensions between the government and the National Electoral Court (CNE) over a recent revision of the electoral census.[184] President Morales harshly criticised the CNE as not impartial, suggested there may have been fraud, and demanded immediate resignations.[185] Though there seems to be a truce in advance of the CA and RRA polls,[186] the dispute could resume if MAS does poorly.

### 1. The political forces

On 3 April, 25 political parties and civic and indigenous groups registered to stand for the CA. Nine have national lists; sixteen will compete in only one or two departments.[187] The largest party, MAS, has a national strategy, with candidates in all voting districts and departments. Morales has said he expects the party to win at least 70 per cent of

[176] President, vice president, senators, members of the lower house.
[177] Ministers, vice ministers, director generals.
[178] Supreme Court justices, magistrates of the constitutional tribunal, magistracy counsellors, judges of district superior courts.
[179] Comptroller general, attorney general, superintendents, prefects, mayors, municipal council members, departmental council members, electoral court members.
[180] See Article 8, Law No.3364 (6 March 2006).
[181] See below.
[182] "¿Está usted de acuerdo, en el marco de la unidad nacional, en dar a la Asamblea Constituyente el mandato vinculante para establecer un régimen de autonomía departamental, aplicable inmediatamente después de la promulgación de la nueva Constitución Política del Estado en los Departamentos donde este Referéndum tenga mayoría, de manera que sus autoridades sean elegidas directamente por los ciudadanos y reciban del Estado Nacional competencias ejecutivas, atribuciones normativas administrativas y los recursos económicos financieros que les asigne la nueva Constitución Política del Estado y las Leyes?". Article 4, Law No.3365 (6 March 2006).

[183] Crisis Group interview, La Paz, 3 May 2006.
[184] In October 2005, pursuant to the Electoral Code (Article 76), the CNE removed 864,285 voters from the 2004 electoral census, reducing it to 3,679,886. See "Boletin Estadistico", CNE, No.5, November 2005.
[185] Morales had also criticised the electoral OAS observers mission's trustworthiness, arguing it had ties to neo-liberal governments. *Bolpress*, 14 and 18 December 2005, available at www.bolpress.com.
[186] Crisis Group interview, La Paz, 28 April 2006.
[187] According to press sources, the National Electoral Court (CNE) left the Movement of Patriotic Social Unity (MUSPA) out of the CA election because it did not have approval from the Comptroller General (Contraloría); party lists have also been decimated by resignations: 849 candidates have resigned and only 645 have been replaced. The most affected party is CN, with 110 resignations and 67 replacements, followed by TRADEPA (98 resignations, 61 replacements), UN (88 and 64), PODEMOS (74 and 68), MIR (68 and 40) and MAS (47 and 45). *La Razón*, 24 May 2006. See http://www.cne.org.bo.

the seats[188] but this is mathematically impossible. Even if it polled a majority in every district and department, it could obtain at most 158 of 255 seats (140 constituents in the 70 voting districts and 18 constituents in the departmental representations – 62 per cent).[189] If the 18 December 2005 elections results were repeated, MAS would get 118 CA seats (46.3 per cent).[190] MAS is building alliances that it hopes will allow it and its partners to sweep some of the districts.[191] But even if this strategy works, MAS will have to negotiate to get its proposals accepted.[192] Absolute control of the CA is unlikely.[193]

A risk for MAS is that people might vote for individual candidates, not a party list.[194] As its most popular leaders are in the government and cannot stand for the CA, MAS has fielded its second team, while the opposition is often putting forward more charismatic figures.[195] The urban middle classes, if not the party's hardcore indigenous base, may be tempted to vote for the better known candidates in their voting districts. However, the urban areas, with 65 per cent of the population, comprise only 28 of the 70 districts.[196]

President Morales may be tempted to compensate for the likely relative weakness of the MAS delegation at the CA by attempting to play a powerful role in the behind-the-scenes negotiations.[197] Delegates will be under great pressure not only from the government, but also from social movements, trade unions and civic groups. Too much and too overt interference in the deliberations, however, could put into question the independence of the CA.[198]

Bolivians have shown a tendency towards political confrontation in recent years rather than negotiation and consensus building.[199] Whether this will show itself again in the CA, or in reactions to the CA, is a great unknown. People in the opposition believe the government is projecting everything it has failed to deliver on to the CA, thus creating unrealistic expectations. "There is total confusion between governmental politics and constitutional politics in this country", said an analyst.[200] However, people in the social movements of El Alto told Crisis Group they expected their organisations would be cautious about mobilising pressure on the delegates. The stakes are very high: they fear the country might split apart if the CA fails.[201]

The weakened opposition needs to work together, either as a bloc or in ad hoc coalitions on specific issues, if it is to counterbalance the MAS and its allies in the CA. But some of their old, discredited leaders plan to stand for the CA in an attempt to revive their careers.[202] It will be difficult to gain voter support if the opposition ties itself too visibly to the politics of the recent past.[203] Surprisingly, Acción Nacionalista Democrática (ADN) is not standing under the PODEMOS umbrella in some departments, as it did in December 2005.[204] Jorge Quiroga, the PODEMOS presidential candidate and Evo Morales's main rival, is not a candidate and seemed virtually to have vanished from the political scene[205] until June, when he reappeared to condemn Hugo Chávez's intrusions into Bolivian politics.

The UN party is relying on its leader and former presidential candidate Samuel Doria to attract votes in La Paz. It has also enlisted constitutional expert Jorge Lazarte – frequently invited to discuss CA and RRA issues by the local media – to stand in La Paz. Former President Gonzalo Sánchez resigned as head of the MNR in an attempt to rejuvenate its leadership for the CA elections.[206]

The MIR, which did not field a presidential candidate in 2005 and has been severely weakened by mismanagement, corruption scandals and ideological contradictions, has forgone much media publicity to concentrate on campaigning at the regional level. It has also had problems in the regions, however, notably in Santa Cruz where former Senate President Hormando Vaca was unable to

[188] *La Prensa*, 28 March 2006; *La Razón*, 28 March 2006.
[189] Crisis Group interview, La Paz, 26 April 2006.
[190] "¿Cómo ganar MAS asambleístas?", *Pulso* 28 April to 4 May 2006, pp. 10-11.
[191] According to press sources, MAS received support from parties such as the Movement Without Fear (MSM) of La Paz Mayor Juan del Granado as well as labour unions, social and indigenous movements, such as the National Council of Ayllus and Markas of the Qollasuyo (CONAMAQ) in La Paz, Oruro, Potosí, Chuquisaca and Cochabamba departments, the Regional Workers Union (COR) and the Federation of Neighbourhood Councils (FEJUVE) of El Alto, the mayors of Cochabamba and Oruro, the Amazonian Movement of Renovation of Pando and Cambio Total Uno of Cochabamba. *La Razón*, 28 March 2006.
[192] Crisis Group interview, La Paz, 2 May 2006.
[193] Crisis Group interview, La Paz, 26 April 2006.
[194] Crisis Group interviews, La Paz, 27 April 2006.
[195] Crisis Group interview, La Paz, 27 April 2006.
[196] Crisis Group interview, La Paz, 2 May 2006.
[197] Crisis Group interview, La Paz, 27 April 2006.
[198] However, a MAS candidate said it is important to define lines of action with the government and to hear the social bases, but the MAS group in the CA will not necessarily vote as a unit. Crisis Group interview, Santa Cruz, 12 May 2006.
[199] Crisis Group interview, La Paz, 3 May 2006.
[200] Crisis Group interview, La Paz, 3 May 2006.
[201] Crisis Group interviews, El Alto, 5 May 2006.
[202] *La Razón*, 8 April 2006.
[203] Crisis Group interview, La Paz, 27 April 2006.
[204] The ADN leadership argued that the party does not want to lose its legal registration for not having run in the last elections with the ADN acronym; *La Razón*, 28 March 2006.
[205] Crisis Group interview, La Paz, 26 April 2006.
[206] *La Razón*, 2 April 2006.

conclude a coalition with the MIR leader, Víctor Paz.[207] It is uncertain whether it can make a comeback in the CA election or continue as a political force.

Other political groups seem to have made little impression on public opinion. One reason may be the late start to campaigning due to a two-month dispute in congress over financing of the process. The agreement to allocate $3.7 million from the national budget has been severely criticised as the parties represented in congress (MAS, PODEMOS, UN and MNR) are the only ones that will receive public financing for their campaigns.[208]

The inclusion of gender alternation in CA candidate lists is considered an achievement of the Morales government. According to the CNE, 40 per cent of the candidates are women.[209] That no political group standing for the CA has sufficiently promoted gender issues in its platform has prompted independent groups of women to endorse the creation of an office in Sucre to lobby for gender issues during CA deliberations.[210] The parties themselves have generally been reticent about announcing their proposals, and there has been little debate about issues likely to be addressed in the assembly.[211] Such discussion as there has been has recently been overshadowed by a MAS smear campaign against PODEMOS's Quiroga and his responses in press conferences and TV spots denouncing Chávez.[212]

### 2. Regional autonomy and indigenous representation in the CA

If the political parties are unable to challenge MAS, the only real opposition may come from the regional groups and alliances, most importantly in Santa Cruz, Tarija and, to a lesser extent, Pando.[213] The civic committees seem to be more interested in gaining greater power and autonomy for the departments than in the national issues,[214] to the extent that there is fear in some sectors that national territorial unity and regional financial solidarity could be endangered if those groups do well on 2 July. If they make overly ambitious demands, especially on budget and tax matters, they could stimulate a comparable radicalism from other directions, including partisans in the west of a more centralised state and pro-independence movements in the east.[215] Some actions of the new prefects have been interpreted as efforts to spearhead the autonomy drive, thus exacerbating tensions with the central government.[216]

However, a political analyst told Crisis Group the civic committees are less united than they may appear. In addition, the presidential election showed MAS strength in Santa Cruz and Tarija, making an uprising in the east unlikely even if the CA's final product is not what the civic committees want and expect.[217] Additionally, while Santa Cruz and Tarija are the most interested in autonomy, other departments are well aware of their own dependence on budget transfers from the central government.[218]

The regional autonomy issue took a new turn on 29 March, when civic groups launched a campaign for creation of a new Chaco department encompassing municipalities in Tarija, Chuquisaca and Santa Cruz. Road blocks in the Chaco region of Tarija department followed as the Gran Chaco and O'Connor provinces claimed jurisdiction over the Chimeo canton, where the Margarita oil and natural gas field is located.[219] The blockade was lifted on 7 April after the central government agreed to review the claim within 30 days.[220] One source told Crisis group the

[207] *Los Tiempos*, 18 April 2006.
[208] Crisis Group interviews, La Paz, 16 June 2006. As congress deliberated, MAS forced its militants to donate 5 per cent of their monthly wages to the campaign. *La Razón*, 12 April 2006
[209] See http://www.cne.org.bo.
[210] Crisis Group telephone interview, 21 June 2006
[211] PODEMOS had a proposal during the December campaign but it was not circulated. Crisis Group interviews, Santa Cruz, 9 May 2006.
[212] UN's leader and CA candidate Samuel Doria has accused the Venezuelan company PDVSA of paying for a recent campaign highlighting government achievements, which is perceived as an effort to improve MAS's image in the run-up to the CA elections. This amounts to a charge that the government has violated the financial regulations in the Political Parties' Law No.1983 (1999). *The Miami Herald*, 23 June 2006.
[213] Crisis Group interviews, Santa Cruz, 8 May 2006.
[214] The peasants federation of Santa Cruz (FDUTCSC) leader, Benigno Vargas, complained that the civic committee did not represent the majority of the *Cruceño* population and wanted to use the RRA to concentrate power in the departmental capital. *El Diario*, 3 March 2006. Crisis Group interview, La Paz, 26 April 2006. The Civic Committee of Santa Cruz aims at transferring over 40 central government competencies to the department. Crisis Group interview, Santa Cruz, 10 May 2006.
[215] Crisis Group interviews, El Alto, 5 May 2006.
[216] The dispute between the government and the Tarija prefect concerns management of oil and gas matters; with the prefecture of Santa Cruz it concerns health and education autonomy. Remarks of the vice minister for decentralisation, Fabián Yaksic, roundtable, "Popular participation face to the constituent assembly and the referendum on regional autonomy", La Paz; Crisis Group interviews, La Paz and Santa Cruz, 26 April and 10 May 2006.
[217] Crisis Group interview, La Paz, 26 April 2006.
[218] Crisis Group interview, La Paz, 25 April 2006.
[219] Protestors demanded the abrogation of a Tarija prefecture resolution on the definition of provincial borders and the allocation of royalties. On 2 April, heavy rains damaged three pipelines from the San Antonio oil and gas field (Tarija department). The city of Tarija was partly blacked out, and natural gas exports to Brazil and Argentina dropped from 26 to 21 million cubic metres per day, as road blocks prevented delivery of spare parts needed to perform repairs.
[220] During the parliamentary debates on the CA and the RRA, a PODEMOS member of the lower house from the Chaco,

intervention of the minister of the presidency to stop the strike implied the government's de facto recognition of a new status for Chaco,[221] and indeed a verbal dispute quickly broke out between Tarija Prefect Mario Cossío and President Morales.[222]

Though no party has yet declared its support of the Chaco demand, some analysts fear it could be used by MAS to discourage autonomy demands by Santa Cruz and Tarija. Chaco representation in the CA will be minimal but the secession demand could gain momentum if supported by MAS.[223] If it was successful, Tarija would be stripped of revenues, as the relatively small Chaco population receives 40 per cent of the hydrocarbons tax.[224] Without the Chaco region, Tarija department would be highly dependant on the central government.[225]

A MAS source indicated in late April that the party would promote an affirmative vote on the RRA nationally, as an opportunity to strengthen regional structures in a way that could enable greater solidarity between rich and poor departments, unlike the Santa Cruz autonomy demand that exacerbates existing disparities.[226] However, opening the Pandora's Box of new territorial divisions – not only in the Chaco, but also in Chiquitania (Santa Cruz), Quillacollo (Cochabamba), and Riberalta (Beni) – could jeopardise the financial viability of some departments and thus call into question the support of affected areas in the CA, including even the support of some MAS delegates.[227]

The MAS position on autonomy has been erratic. After signing the RRA law, President Morales said MAS would support autonomy. The opening of a Presidential Representation for the Constituent Assembly (REPAC) office in Santa Cruz that will deal with CA and RRA issues pointed in that direction.[228] However, Vice Minister for Decentralisation Fabián Yaksic soon evidenced unease over the extent of competencies local governments are seeking.[229] Grassroots leaders like Román Loayza of the "People's High Command" (*Estado Mayor del Pueblo*), an organisation close to MAS, affirmed they would campaign for a "no" vote as their constituents do not agree with departmental autonomy.[230] A survey showed that by late April popular support for regional autonomy had slightly diminished in La Paz, El Alto, Cochabamba and even Santa Cruz.[231]

Vice President García said the government should be neutral on the issue, and MAS should discuss it internally before adopting a definitive position.[232] On 16 June, in a speech in Cobija (Pando), Morales reaffirmed his personal aversion to autonomy but said it was for the people to decide.[233] Parties, civic groups and social movements are still divided. The "yes" camp seems to have gained strength recently in five departments (Tarija, Beni, Pando, Cochabamba, and, once again, Santa Cruz) and among eight parties (ADN, MBL, MIR, MNR, MSM, PODEMOS, UCS[234] and UN). Parties such as MAS, TRADEPA, CN and ASP, social movements such as CSUTCB and Patria y Soberania, and the prefectures of Oruro, Potosi and Chuquisaca, however, are now campaigning for a "no".[235] According to one analyst, "no" was likely to win in poor departments like Oruro and Potosí, where dependence on the central government is strong.[236] However, another analyst argued that overt MAS opposition to autonomy could prompt social groups in the east, hitherto opposed to the confrontation rhetoric of the eastern civic committees, to move into the "yes" column.[237]

William Cardozo, complained about the unrepresentative nature of the Tarija civic committee and accused its leaders of complicity with international oil and gas companies. *El Diario*, 3 March 2006. Though the creation of the Chaco department is rooted in the Guaraní people's demands for more autonomy, it also reveals problems in allocation of financial resources and royalties at the intra-departmental level.

[221] Crisis Group interview, La Paz, 26 April 2006.

[222] Cossío demanded that Morales respect the integrity of Tarija and criticised lack of support from the central government during the crisis. Morales accused the prefect of lying and said the government helped solve the crisis. *La Razon*, 18 April 2006.

[223] Crisis Group interviews, La Paz, 27 April and 3 May 2006. The Tarija prefecture has prerogatives on oil and natural gas management, according to Law No.3065 (30 May 2005). The Chaco region will have nine delegates representing 118,695 voters in the CA. See Instituto Nacional de Estadística at http://www.ine.gov.bo/ and CNE at http://www.cne.org.bo.

[224] Crisis Group interviews, Santa Cruz, 9 May 2006.

[225] Crisis Group interview, La Paz, 26 April 2006.

[226] Sources in the social movements of El Alto confirmed their support for more departmental autonomy, not limited to *Cruceño* demands. Crisis Group interviews, La Paz and El Alto, 28 April and 5 May 2006.

[227] Crisis Group interviews, La Paz and Santa Cruz, 27 April and 8 May 2006.

[228] *La Razón*, 8 March 2006.

[229] Yaksic remarks, op. cit.

[230] *La Razón*, 15 May 2006.

[231] La Paz (52 per cent in March, 41 per cent in April), El Alto (64 per cent in March, 36 per cent in April), Cochabamba (70 per cent in March, 38 per cent in April), and Santa Cruz (83 per cent in March, 69 per cent in April); *La Razón*, 15 May 2006.

[232] *La Razón*, 17 May 2006.

[233] *La Prensa*, 17 June 2006.

[234] Union Civica Solidaridad – APC Lider.

[235] *La Prensa*, 17 June 2006.

[236] Crisis Group interview, La Paz, 26 April 2006.

[237] Crisis Group interview, La Paz, 16 June 2006. On 21 June, press sources reported the release of a new plan by Decentralisation Minister Fabián Yaksic, which would divide the country into 45 regions according to ecosystem and socio-cultural criteria, and give administrative responsibilities

In any case, the Chaco demand for creation of a tenth department has made the Tarija elite conscious of the need for decentralisation at the intradepartmental and municipal levels.[238] One source told Crisis Group that some people in Santa Cruz have not yet realised that it is not possible to speak of departmental autonomy without touching the relative autonomies of provinces, sections of provinces, cantons, municipalities and even possibly the status of indigenous communities.[239] By late May, the opposition parties were proposing intra-departmental autonomy.[240] The Chaco issue demonstrates how important it is for the departments that are expected to vote in favour of the referendum to build a multi-layer autonomy regime – prefecture, province, and municipality – to deactivate conflicts over resource allocation.[241] All parties will need to ensure, however, that whatever a new autonomy regime may be, it will not substantially modify governance at the municipal level as laid out in the Popular Participation Law, which has significantly increased popular participation in local affairs.[242]

Another big challenge for the CA will be to reconcile the indigenous peoples' traditions with the representative democratic system.[243] According to a MAS source, the party believes that indigenous peoples should leave their imprint on the new constitution in order to end their marginalisation. The "community" will thus be a central issue in the CA: the Andean meaning of the term has survived centuries of domination; the predominant communitarian property model in the western countryside, while not part of the present state structure, has been successfully reproduced in the cities by the neighbourhood associations. Therefore, a new constitution based solely on the relationship between the state and the individual would not satisfy the needs of the majority of the population.[244] As a Bolivian analyst put it, from now on, the indigenous component will be more important in Bolivian politics and the respect and promotion of its interests will be the bedrock of the new society.[245]

However, the CA composition does not include an explicitly ethnic quota. The Regional Confederation of Workers (COR) of El Alto and the indigenous movements of the eastern lowlands have expressed the social and indigenous movements' unease about their relative lack of representation on MAS lists.[246] As pioneers in the demand for a CA, the indigenous peoples of the east are frustrated that they did not get ethnic voting districts.[247] Growing disaffection of those movements could hurt MAS in the CA, as they are a fundamental component of its strength in the east.

Discontent is also fuelled by political egos,[248] and there is unhappiness as well among social movements about their numbers on the list. The Confederation of the Ayllus and Markas of the Qollasuyo (CONAMAQ) demanded twenty representatives from MAS and got only seven. These are mostly isolated cases, however, that may not be a serious problem for the party.[249] A parallel CA promoted by the CONAMAQ could well fail, and the stubborn opposition of the Confederation of Bolivian Workers (COB) head, Jaime Solares, to the Morales government is considered to be self-destructive.[250] The sacrifice of some political allies by not including them on the CA lists is an attempt by MAS to distance itself somewhat from radical views that could discourage urban voters.[251]

### 3. Preparations for the CA and the RRA

The Morales government has been criticised for not creating minimal advance consensus on the CA agenda. A set of proposals discussed among many sectors of civil society – an exercise of many years and more than 2,500 interviews – was gathered by the Bishop's Conference and given to the vice president in March 2006 but has had little response from the political parties and media.[252] There has hardly been a public information and education campaign about what the CA and the RRA stand for and on what delegates can and cannot accomplish. Special Law No.3091 (2005) authorised a national pre-CA, pre-RRA board to discuss the issues and facilitate consensus but the Morales government abandoned the concept, because, an analyst suggested, it could not control it.[253]

to indigenous territories. While the proposal has only been endorsed by the minister's party, Movement Without Fear (MSM), MAS may well support it in order to counter autonomy demands. Crisis Group telephone interview, 23 June 2006.

[238] Crisis Group interview, La Paz, 27 April 2006.

[239] Crisis Group interviews, La Paz and Santa Cruz, 26 April and 2 and 9 May 2006.

[240] MAS, PODEMOS and ADN propose autonomy at the departmental and provincial level. *La Razón*, 29 May 2006.

[241] Crisis Group interview, La Paz, 26 April 2006.

[242] Crisis Group interview, La Paz, 3 May 2006.

[243] Crisis Group interview, La Paz, 27 April 2006.

[244] Crisis Group interview, La Paz, 28 April 2006.

[245] Crisis Group interview, La Paz, 26 April 2006.

[246] Crisis Group interviews, El Alto and Santa Cruz, 5 and 12 May 2006.

[247] The ethnic voting district proposal aimed to obtain representation for indigenous peoples in the CA regardless of their demographic weight. Crisis Group interviews, La Paz, 26 April 2006.

[248] El Alto civic leader Edgar Patana complained at being left off the MAS list.

[249] Crisis Group interviews, La Paz, 27 April and 2 May 2006.

[250] Crisis Group interview, La Paz, 27 April 2006.

[251] Crisis Group interview, La Paz, 2 May 2006.

[252] Crisis Group interviews, Santa Cruz, 9 May 2006.

[253] Crisis Group interview, 3 May 2006.

Instead, Morales proposed on 7 February the opening of the REPAC office in Santa Cruz, in order to reach consensus with the social movements and civic groups on a decentralised system.[254] Shortly after he signed the CA and RRA laws, he gave the order to open the office, under the direction of the ministry of the presidency.[255] However, it began operation only in late May, and it is unlikely to achieve substantial consensus before the CA is convened.[256] The government allocated $10 million for the office, and Vice President García asked for donors to give assistance to CA delegates. He called USAID to help the government prepare,[257] while the European Commission (EC) is already contributing €300,000 to CA-related activities.[258] Venezuela is said to be helping the government with the infrastructure needed in Sucre.[259] On 20 April, Organisation of American States (OAS) Secretary General Miguel Insulza agreed with the government to create a special OAS mission to support the CA and RRA. While the OAS does not yet have a budget for this,[260] the EU has deployed an observer mission.[261]

Various analysts told Crisis Group few candidates have knowledge of constitutional and institutional design.[262] If the REPAC does not fulfil its mission, an ill-prepared CA that produces no results could be a catastrophe.[263]

[254] *La Razón*, 8 February 2006.
[255] Gisela Lopez, a well-known journalist, was appointed office director. The REPAC will have a central office in Santa Cruz and offices in the other capital cities of departments. It will operate according to a three-stage plan: 1) pre-CA (2 May 2006-6 August 2006): it will facilitate debate among political actors, civil society and others to reach minimal consensus on a new social pact; 2) CA (6 August 2006-31 December 2007): it will give delegates technical and logistic support; 3) post-CA (1 January 2008-31 December 2008): it will support information efforts before the referendum on the new constitution. See REPAC advertising spot in *El juguete rabioso*, No.154, 11-24 June 2006, p.7.
[256] Crisis Group interview, 3 May 2006.
[257] Crisis Group interview, La Paz, 4 May 2006.
[258] Crisis Group interview, La Paz, 3 May 2006. See Section V.B. below.
[259] Venezuela has promised $1 million in infrastructure development for the CA in the city of Sucre. Crisis Group interview, La Paz, 4 May 2006.
[260] OAS-Bolivian government joint press release, 20 April 2006, at http://www.oas.org/OASpage/press_releases. Crisis Group interview, 16 June 2006.
[261] See below.
[262] Crisis Group interview, La Paz and Santa Cruz, 3 and 8 May 2006.
[263] Crisis Group interviews, Santa Cruz, 9 May 2006.

## V. EU SUPPORT FOR DEMOCRATIC CHANGE AND INSTITUTIONAL STABILITY

Democracy returned to Bolivia in 1982, after eighteen years of military rule, when Hernan Siles was elected president. Due to a disastrous economy and fierce political opposition, he was forced to step down in 1985.[264] His successor, Victor Paz, implemented the New Economic Policy (NPE) that became the blueprint for radical neo-liberal reforms,[265] and foreign capital became the engine of the economy. Complying with international financial institution (IFI) demands, Bolivia became the poster child of neo-liberal reforms. The "pact democracy" governments that followed gave continuity to free trade and foreign investment. In 1986, after six years of interruption, the World Bank (WB) resumed aid to Bolivia. By 2005, Bolivia's external debt was $4.93 billion in IMF, multilateral[266] and bilateral[267] loans for development projects and support of socio-economic reforms.[268]

While EU-Bolivian cooperation dates back to the European Communities' agreement with the Andean Pact in 1983, the current legal basis is the 1993 Regional Framework Agreement on Cooperation, in force since 1998. It commits the EU to contribute to sustainable development, improve living standards, promote new markets, improve investment flows and technology transfer (reinforcing investment protection), raise employment, improve human productivity, promote rural development and better rural conditions and support Andean regional integration.[269] A new Political Dialogue and Cooperation Agreement, signed

[264] President Siles implemented an economic policy based on demand expansion, supported by central bank financing. The central back issued money without sufficient foreign currency reserves, producing hyperinflation. Siles, who received only 34 per cent of the vote and did not have a legislative majority, fell prey to trade union and left-wing party pressure as well as the opposition of right-wing parties. Carlos Torranzo, *Rostros de la democracia: una Mirada mestiza* (La Paz, 2006), p.275.
[265] The reforms aimed at building a free-market economy. "Shock" measures were taken to end hyperinflation, such as Presidential Decree No.21060 (29 August 1985).
[266] IMF: $243 million, Inter-American Development Bank: $1,622 billion, World Bank: $1.666 billion, Andean Promotion Corporation (CAF): $871 million, others: $144 million.
[267] Spain: $139 million, Brazil: $121 million, Japan: $63 million, Germany: $34 million, France: $13 million, others: $45 million.
[268] "Temas globales en Bolivia: Deuda externa y comercio justo en tiempos de cambio", Report No.2, United Nations Research Institute for Social Development (UNRISD), May 2006, p.8.
[269] Regional Framework Agreement on Cooperation, European Economic Communities-Country Members of the Cartagena Agreement, 1993.

in 2003, will replace the 1993 agreement once ratified. From 1994 to 2001, the EC and the government focused on four areas: poverty reduction, modernisation of the state, private sector development and regional integration. Over the years, European cooperation has also been important for water and sanitation, education, health, food security and alternative development programs. Between 1998 and 2001, the EC disbursed on annual average over €28 million in aid.[270]

Despite the reforms, Bolivia has remained South America's poorest country. Between 1990 and 2002, 62.7 per cent of the population lived in poverty, 34.3 per cent with less than $2 a day and 14.4 per cent with less than $1.[271] The economy was badly hurt by the global recession at the end of the 1990s, and coca-grower protests increased when anticipated alternative crop income did not materialise. Popular mobilisation began in 2000 when people in Cochabamba demonstrated against higher water prices.[272] In September 1999, the World Bank and the International Monetary Fund forgave the external debt of the poorest countries but in order to qualify for this relief, those countries were required to elaborate Poverty Reduction Strategy Papers (PRSP).[273]

Through its participation in the Highly Indebted Poor Countries (HIPC) Initiative, Bolivia gained access to $1.79 billion in debt relief funds from the IMF, the World Bank and Japan.[274] The government developed its PRSP in 2001 with broad civil society participation through a National Dialogue.[275] It addressed six main areas: job and income generation; social participation and integration; safety and protection for the poor; social integration of indigenous peoples; gender equity; and sustainable natural resources management.

On 17 May 2002, the EC adopted a Country Strategy Paper (CSP) to cover 2002-2006.[276] Taking into consideration the Bolivian PRSP, it prioritised improved access to services and sustainable livelihoods (including promotion of equitable access to social services, food security and sustainable rural development); economic growth (including economic cooperation); and regional integration and cooperation (including transport infrastructure and strengthening regional networks).[277] The EC also chose to cover areas which at the time had not yet attracted much international donor interest, such as water and sanitation, regional integration and infrastructure and alternative development.[278] The CSP for 2007-2013 is being drafted, following release on 16 June of the Bolivian national development strategy.[279]

Since May 2005, EU political engagement has been driven by an ambitious EU Action Plan for Bolivia, drafted by the Commission services and endorsed by the Political and Security Committee of the EU Council.[280] It sets out a series of short- and medium-term responses, with an overall thrust for the EU, including its member states, to intensify cooperation and collaboration both in Bolivia and in Europe and with both Bolivian political and social actors, so as to prevent escalation of the country's crisis.[281] This includes a greater role for the local office of the EU Presidency so there can be quicker European responses. The Action Plan explicitly noted that "special attention should be paid to the opposition, in particular the MAS and its leader Evo Morales".[282] Further short-term objectives include: proactive engagement with other regional actors and the U.S.; increased international investor confidence; and support for the CA process. Medium-term objectives include: continued support to the government to revise its PRSP and for land reform.[283]

Once Morales was elected, EU efforts focused on helping Bolivia through the transition. As already noted, Morales was invited to Europe, where he had to address thorny issues, such as investment stability and his plans to nationalise the hydrocarbon sector, and his hosts in Madrid, Brussels, The Hague and Paris expressed concerns.

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[270] The EU has also financed cooperation with civil society (NGOs) working on environment, tropical forests, human rights and democracy and humanitarian aid programs, as well as the Disaster Preparedness Program (DIPECHO). "Bolivia Country Strategy Paper 2002-2006", European Union, 2002, pp. 17-19.

[271] See UNDP at http://hdr.undp.org/statistics/data/countries.cfm?c=BOL.

[272] Crisis Group Report, *Bolivia's Divisions*, op. cit., p. 4.

[273] Torranzo, op. cit., p.171

[274] "Temas globales en Bolivia", op. cit., p. 8.

[275] The PRSP had to be comprehensive, have clear objectives and be the product of social participation processes. The participation in Bolivia was at the municipal level.

[276] In November 2000, a statement by the European Council and the EC identified defined the EU's six main cooperation priorities: trade and development, regional integration and cooperation, support for macro-economic policies and the promotion of equitable access to social services, transport infrastructure, food security and sustainable rural development and institutional capacity building.

[277] "Bolivia Country Strategy Paper 2002-2006", European Commission, 17 May 2002, p. 22.

[278] The UN, the U.S. and Spain now work alongside the EC in a number of these areas.

[279] On the strategy paper, "Dignified, Sovereign, Productive and Democratic Bolivia to Live Well", see Section V B below.

[280] Crisis Group interview, Brussels, 12 June 2006.

[281] Crisis Group was told cooperation between the EC Delegation in La Paz, EC officials in Brussels and the member states is excellent. Crisis Group interviews, Brussels, 12 June 2006.

[282] "EU Action Plan for Bolivia", European Commission, 30 May 2006.

[283] Ibid.

In Madrid, Morales met King Juan Carlos, Prime Minister José Rodríguez Zapatero, Foreign Minister Miguel Angel Moratinos, Minister of Industry José Mantilla and Ibero-American Affairs Secretary Enrique Iglesias, as well as entrepreneurs[284] and trade union members. While some officials spoke of their worries about Spain's private sector investments, Zapatero stressed its interest in acting as a bridge between Bolivia and Europe and announced his government's intention to forgive over €100 million of Bolivian external debt so the resources could support education projects.[285]

In Brussels, Morales met with the EU's High Representative for the Common Foreign and Security Policy, Javier Solana. An EU source said Solana stressed the importance of foreign investment stability and assured the new president of the continuity of European development cooperation as well as of EU good offices at the World Bank for forgiveness of the external debt.[286] In Paris, President Jacques Chirac congratulated Morales as the first representative of the "Indian nation" to become president of Bolivia.[287] At the same time, he asked him to guarantee a stable legal environment, an allusion to Total's presence in Bolivia[288] as well as indirectly to what happened in early 2005 to a French subsidiary.[289] In The Hague, Foreign Minister Bernard Bot renewed his country's annual €30 million aid commitment and offered technical cooperation for natural gas exploration and management.[290]

When the presidential decree on hydrocarbon nationalisation was issued, Europe's first response was to caution against violation of contracts and expropriation of assets that could jeopardise investments and labour stability.[291] Reactions in Spain were perhaps the most outspoken. Accusations of oil smuggling against Repsol YPF's subsidiary Andina S.A. had already disturbed business circles,[292] and the fear of possible expropriations without indemnities prompted the government to send a delegation to La Paz to discuss the decree and how Repsol YPF's interests would be affected. While Spanish officials said aid would not be cut, that it was necessary to have a good climate for investments and the decree was a sovereign Bolivian measure, the rightist Popular Party (in the opposition) strongly criticised the administration's mild posture.[293]

During the fourth EU-Latin America and Caribbean summit in Vienna on 11-12 May 2006, ten days after the nationalisation decree, discussions between Bolivian and European officials were heated. The latter voiced concerns about the possible implications for investments. The declaration of the business summit to the heads of state on 12 May stressed the importance of transparency and non-discriminatory treatment of foreign investors by local and national governments. Morales's tone was more assertive than during his first European tour, as he defended the nationalisation[294] and hinted that Petrobras had stolen natural gas – causing a heated Brazilian protest – and at Spain's unfulfilled promise of debt relief, evoking Madrid's protest. A few days later, at the European Parliament, Morales insisted that what was involved was not expropriation or expulsion but ownership and control over natural resources. Foreign companies would see returns on their investments, but as partners, not owners, he said.[295] He added that high migration rates from Bolivia to Europe would be best addressed by giving farmers and small community businesses better opportunities.[296]

While the Andean organisation (CAN) was severely weakened by Venezuela's withdrawal, the four remaining members met with EU officials in Quito on 13 June to clarify the future of the association agreement talks. The presidents of Bolivia, Colombia, Ecuador and Peru declared that the principles and objectives of the Andean integration process remained strong. They signed a joint appeal to the U.S. president for an extension of the ATPDEA for Bolivia and Ecuador and a letter to EC President José Barroso reiterating firm resolve to begin association agreement talks with Europe as soon as possible.[297] The meeting, during which Bolivia also assumed the CAN presidency, gave Morales an opportunity to distance himself somewhat from Chávez's geopolitical views.

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[284] Spanish investments cover many sectors of the Bolivian economy: hydrocarbons (Repsol-YPF), electricity (Red Eléctrica Española and Iberdrola), banks (Bank Santander, Bank Bilbao Vizcaya Argentaria) and media (Prisa, Santillana and Cobra).

[285] Crisis Group interview, La Paz, 13 June 2006. Spanish officials and entrepreneurs welcomed Morales' decision to make Madrid his first stop in Europe, a sign of the importance he assigns bilateral relations.

[286] Crisis Group email communication, 22 May 2006.

[287] *El Deber*, 7 January 2006

[288] Total's investments are shared with Petrobras. However, it has been said Total discovered bigger hydrocarbon deposits than those RepsolYPF and Petrobras are exploiting; *El Deber*, 7 January 2006.

[289] The inhabitants of El Alto demanded that the transnational water company Aguas del Illimani be ousted for breach of contract. The Mesa government yielded to the pressure and revoked the contract. *El Deber*, 7 January 2006.

[290] Crisis Group interview, La Paz, 12 June 2006.

[291] Crisis Group interview, La Paz, 3 May 2006.

[292] See Section IIIA above.

[293] Crisis Group interview, La Paz, 13 June 2006.

[294] Crisis Group email communication, 22 May 2006.

[295] European Parliament press release, "President Morales of Bolivia tells MEPs: 'nationalisation is not expropriation'", 15 May 2005.

[296] Ibid.

[297] *La Razón*, 14 June 2006.

A European source in Bolivia told Crisis Group the EU is ready to begin negotiations but the CAN must do its part to strengthen Andean economic integration, as agreed in the Guadalajara declaration in 2004.[298] An analyst suggested a CAN failure to conclude an association agreement could prompt Bolivia to seek inclusion in a Mercosur-EU negotiation. However, this would not be advantageous, as Brazil's economy, the largest of the five Mercosur states, competes with Bolivia's in almost all markets.[299]

## A. EU ENGAGEMENT

### 1. EU cooperation

The EU (European Commission plus member states) is Bolivia's principal source of aid, and Bolivia is one of the main beneficiaries of EU assistance in South America after Colombia. The EU is responsible for 57 per cent (about $324 million annually) of total assistance to the country.[300] Its financial, technical and economic cooperation in 2002-2006 included €154 million for regional physical integration (€57 million for the construction and rehabilitation of the Santa Cruz–Puerto Suarez road, which will connect Bolivia to Atlantic ports in Brazil); €20 million for alternative development, of which €7 million goes to a program in the depressed mining areas around Oruro and Potosí and €13 million for a program in the Yungas; economic cooperation, including €6.3 million in trade-related technical assistance to improve Bolivia's export capacities; €43 million approved for 2002-2006, plus an additional €7.5 million in 2004 for water sanitation; €14 million in 2006 for food security; and a new five-year program for decentralisation of risk and disaster management, including €1 million for the January-February 2006 floods[301] and another €1.1 million for a regional-level disaster management fund.

EC funding for the CAN amounts to about €5 million annually for drug-related cooperation, technical aid and NGO financing.[302] When socio-political conflict escalated in Bolivia 2003, the EC used its Rapid Reaction Mechanism (RRM) to undertake crisis preparedness and conflict prevention measures. Late that year the RRM was used to fund an OAS study on possible conflicts arising from labour disputes. At the end of 2005, the same mechanism allowed the EU to allocate €1 million to support good governance, and the Political and Security Committee (PSC) of European Council gave the decision strong political backing.[303]

Member states channel an average of €170 million annually into bilateral programs with Bolivia. Germany contributes between €31 and €44 million annually for administrative and judicial reform, civil society, drinking water and sanitation, sustainable agricultural development, protected areas management, financial system development and renewable energies. Spain contributes some €50 million to €60 million annually through Development Aid Fund (FAD) credits for poverty reduction, gender equity, sustainable environment, microfinance, education, health, justice, and national culture. The Netherlands' bilateral aid is €30 million annually, of which almost half goes to a basket fund with Denmark and Sweden, who contribute €5 million each, to support the education ministry. The Netherlands is also involved in cooperation with rural productive development, governance (decentralisation, institutional reform, including anti-corruption, ombudsperson) and public sanitation.[304]

Italy provides €25 million annually for health and child care (food security) programs, natural resources and river basin management and alternative development. Denmark's aid is €21 million annually, for institutional reform, popular participation, decentralisation and support to indigenous people, agriculture and rural development, environment and natural resources management. Sweden

[298] Http://ec.europa.eu/comm/world/lac-guadal/declar/01_decl_polit_final_en.pdf. Crisis Group interview, La Paz, 13 June 2006.

[299] Crisis Group interview, La Paz, 26 April 2006

[300] See http://ec.europa.eu/comm/external_relations/bolivia/intro/index.htm#2

[301] During the January and February 2006 floods, the EC allocated a €1 million emergency fund to be channelled through the European Commission Humanitarian Office (ECHO) for victim assistance. "The European Commission grants €1 million for victims of the floods in Bolivia", press release, 23 February 2006. While initial reports estimated 6,000 families (around 30,000 people) had been affected, a final tally was more than 150,000 victims. This prompted the EC to sign an agreement with the vice ministry for civil defence and cooperation to implement a program on decentralisation of risk and disaster management over the next five years. The Disaster Preparedness Program (DIPECHO) will be in charge. *El Diario*, 23 May 2006.

[302] Crisis Group, email communication, 8 June 2006. The main EC cooperation projects are: food security; alternative development; Arque and Tapacarí valley development; drinkable water and basic sanitation in Beni, Pando and Santa Cruz; support for small mining projects; the health sector; education reform in El Alto; the HIPC initiative; integrated management and the master plan for the Pilcomayo river basin; the human rights and democracy program in the Andean Community; drug-related EU-Andean Community cooperation and technical aid. See http://www.delbol.ec.europa.eu/sp/eu_and_country/cooperation.htm and http://ec.europa.eu/comm/external_relations/bolivia/intro/index.htm#2.

[303] This was done with the Constituent Assembly in mind. See below.

[304] Crisis Group interview, 12 June 2006.

contributes €18 million annually for water and sanitation projects, education and public administration reform, decentralisation, private sector development, research and development, gender equity, human rights and democracy. Belgium helps with €10 million annually for health, food security, rural productive development and democracy support programs. UK aid (Department for International Development, DFID) focuses on pro-poor growth and governance programs, alternative development, social inclusion, human rights and conflict prevention.[305] France offers €600,000 annually for education, health, institutional reform and rule of law.[306]

During an 18 April 2006 visit, German Minister of Economic Cooperation and Development Heidemarie Wieczorek-Zeul discussed with President Morales the possibility of strengthening German aid, which presently focuses on two provinces – Tarija (sixteen municipalities of the Chaco) and Potosí (thirteen municipalities in the north) covering almost half a million inhabitants – as well as helping Bolivia write-off its debt to the IFIs.[307] This includes the possibility that Bolivia could get an additional bilateral and multilateral external debt relief package of $1.94 billion.[308] An EU source told Crisis Group the World Bank had already agreed to forgive about $1 billion, and the Inter-American Development Bank (IADB) is currently studying the matter.[309]

With regard to the EU's alternative development programs, the Chapare project (PRAEDAC) was closed in March 2006 after eight successful years. Since May 2005, the EU has focused on a new project in the Yungas (FONADAL), which gathers the earlier experience and concentrates on access to basic utilities and economic opportunities as well as social cohesion. Some of the funding could also be directed to out-migration and risk zones.[310] FONADAL resources cannot be used in the Chapare, Apolo or Caranavi coca growing regions.[311]

The EU is focussing on the Yungas region because of the increase in coca crops there. The Yungas project supports government policy[312] but EU sources told Crisis Group European countries are worried about the lack of improvement in eradication and alternative development efforts.[313] While it is widely acknowledged that current legislation is outdated, the two legal markets for coca leaf in Villa Fatima (La Paz) and Sacaba (Cochabamba) have failed to prompt a sharp decline in price. The opening of a new coca leaf market in Caranavi (La Paz) violates Law No.1008, which regulates production, interdiction, eradication and marketing of coca.[314] The Morales government went a step further on 17 June, issuing a commercial regulation allowing coca producers to sell unprocessed coca leaf directly in national markets not covered by retail traders. In addition, seized "in excess" coca leaves will not be destroyed, but sold off for industrial purposes or donated to poor populations that traditionally use coca.[315]

In October 2004 the six coca grower federations of the Chapare, then led by Morales, and the Mesa government signed an agreement to conduct an independent study on the traditional use of coca leaf as a basis for deciding if the limit of 12,000 hectares of legal coca crops should be revised.[316] However, little progress has been achieved. Given that the EU has already earmarked funds (€250,000 plus an additional €100,000 for on-the-field surveys, communications and the like) for the study, it is noteworthy that Morales did not mention it when he visited the European Parliament in May. Instead, he justified the cultivation of a *cato* (roughly a 40-square-metre plot) per farmer as a measure to control production and criticised countries that want to impose eradication while not controlling chemical precursors and money laundering.[317]

According to an analyst consulted by Crisis Group, the study could put further pressure on former *cocalero* activists now in power. If it showed a drop in traditional use of the coca leaf (probably the result of urbanisation and modernisation), the Morales government would come under heavier international pressure to eradicate excess coca. Foreseeing the possible discontent this might create among *cocalero* groups, it has shown little interest in promoting the study,[318] though EU sources told Crisis Group the Statistics National Institute (INE) is about to

[305] Aid to Latin America for fiscal year (FY) 2004-2005: £25 million, FY 2005-2006: £20.4 million and FY 2006-2007: £18.3 million. "Plan de Apoyo Regional para America Latina", DFID, August 2004, p.17.
[306] See "Europa: democracia, diálogo, debate. Reflejos del al Union Europea en Bolivia", European Commission Delegation in Bolivia, 9 May 2006, pp.10-11; http://www.delbol.ec.europa.eu/sp/eu_and_country/cooperation.htm; Crisis Group interviews, La Paz, 12 and 13 June 2006.
[307] Crisis Group interviews, La Paz, 3 May and 14 June 2006
[308] "Temas globales en Bolivia", op. cit., p.8.
[309] Crisis Group interview, La Paz, 15 June 2006. Also, see http://web.worldbank.org/.
[310] Families from the declining mining areas in the west migrated into the drug-producing areas of the Chapare.
[311] Crisis Group, email communication, 8 June 2006.
[312] Crisis Group interview, La Paz, 26 April 2006.
[313] Crisis Group interviews, La Paz, 26 April and 13 June 2006.
[314] Crisis Group, email communication, 8 June 2006.
[315] *La Razón*, 18 June 2006.
[316] See Crisis Group Report, *Coca, Drugs and Social Protest*, op. cit., p. 10.
[317] European Parliament Press Release, op. cit.
[318] Crisis Group interviews, La Paz, 26 and 27 April 2006.

submit a proposal for the study.[319] The government may well be headed toward a confrontation with the U.S. and the wider international community if cultivated areas are not substantially reduced.[320]

Though Foreign Minister Choquehuanca said the recent TCP with Cuba and Venezuela would cover coca leaf,[321] there are no known plans of government agencies and national investors for large-scale coca leaf industrialisation projects to absorb surplus production.[322] If the government does not want to continue with eradication, it needs to develop such new industrialisation projects.[323] However, analysts and EU sources said the EU would not support a widening of the scope of the study to cover non-traditional uses (e.g. industrialisation).[324] During Morales's January visit to Europe, Javier Solana said emphatically that the EU's policy on excess coca eradication would not change.[325] A European source told Crisis Group that whatever problems might arise between Bolivia and the U.S., Morales cannot expect to divide Europe and the U.S. on such issues.[326]

The Morales counter-drug policy shows a decided lack of interest in forced eradication but general cooperation on the legal front and apparent support for interdiction. Alternative development projects are supported by most donors but have not been part of the broader rural governance and development strategy that clearly is needed if significant progress is to be achieved on rural poverty reduction.

Notwithstanding the thorny relations Morales had with the U.S. when he was a *cocalero* movement leader, both sides made conciliatory gestures when he became president. However, the first troubles appeared in early February.[327] A meeting with U.S. Secretary of State Condoleezza Rice during the inauguration of Chilean President Michelle Bachelet on 11 March did not reduce tensions.[328] Morales's pledges to a "no-zero-coca-leaf, yes-zero-cocaine" policy and allowing a *cato* of cultivation per coca farmer did not sit well in Washington.[329] His government has preferred not to address the troubling growth in coca-cultivated areas[330] but instead to concentrate on decriminalising the coca leaf.[331]

Although Morales earlier criticised the idea of a Bolivian Free-Trade Association (FTA) with the U.S. as well as the FTA negotiations of Colombia and Peru with the U.S., his government has expressed interest in signing a trade agreement with Washington to extend the preferences contained in the ATPDEA, scheduled to end in December 2006, and protect Bolivian exports. It is not known whether the U.S. will be forthcoming, especially after President Bush criticised the status of democracy in Bolivia (and Venezuela).[332]

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[319] Crisis Group interview, La Paz, 14 June 2006.

[320] Crisis Group interview, La Paz, 27 April 2006. Government officials maintain that the National Council for the Fight Against Drugs (CONALTID) is also working on the issue. It has organised two workshops on the study, with civil society participation and control. Crisis Group interview, La Paz, 2 May 2006. On 20 April 2006, OAS Secretary General Insulza offered to assist Bolivia in the study through the Inter-American Commission against Drug Abuse.

[321] The Venezuelan government is reportedly investing $125,000 in a plant for coca infusions (*mate*). *La Razón*, 18 June 2006.

[322] Crisis Group interview, 25 April 2006.

[323] Crisis Group interview, La Paz, 2 May 2006.

[324] Crisis Group email communication, 8 June 2006 and Crisis Group interviews, La Paz, 26 April and 14 June 2006.

[325] Crisis Group interview, La Paz, 26 April 2006.

[326] Crisis Group interview, La Paz, 3 May 2006.

[327] The U.S. cut military aid to Bolivia by 96 per cent (from $1.7 million to $70,000) after Bolivia did not ratify a treaty exempting U.S. soldiers from International Criminal Court jurisdiction, *La Razón*, 11 February 2006.

[328] In March 2006, a U.S. embassy military liaison officer announced decertification of the Bolivian Joint Counter Terrorist Force (FCTC), due to mistrust of its operational capabilities; on 9 March, U.S. involvement in the Chinese surface-to-air missiles affair returned to the spotlight as former President Rodríguez, his defence minister and the ex- commander-in-chief of the armed forces were formally accused of high treason over destruction of the missiles by the U.S. in October 2005; on the night of 21 March, two La Paz hostels were bombed, with two deaths and a dozen injuries. A U.S. citizen and his Uruguayan wife were arrested. Though there was no clear evidence of motivation, President Morales declared he feared the U.S. was engaged in terrorist activities in Bolivia, producing a protest from Washington, *Los Tiempos*, 23 March 2006.

[329] Morales inauguration speech, 22 January 2006; *cocalero* militants in the Chapare have demanded the eviction of American drug interdiction forces from Bolivia, *La Razón*, 16 February 2006.

[330] In early March 2006, the U.S. State Department and the International Narcotics Control Board (INCB) released reports warning against the increase in coca-cultivation areas and calling on the government to step up eradication; U.S. anti-narcotics representative Anne Patterson visited on 25 April and demanded the government increase eradication efforts; a USAID development program left Caranavi due to pressure from *cocalero* organisations. Crisis Group interview, La Paz, 4 May 2006.

[331] From 13 to 17 March 2006, in Vienna, the Bolivian delegation to the 49th session of the Commission on Narcotic Drugs unsuccessfully attempted to promote the nutritional properties of the coca leaf and its removal from the forbidden substances list of the 1961 Vienna Convention. In mid-May, Vice Minister for Foreign Affairs Mauricio Dorfler demanded the Inter-American Drug Abuse Control Commission distinguish between the coca leaf's legal and illegal uses and asked for a change of coca's status in international conventions.

[332] *La Razón*, 24 May 2006.

### 2. Other donors

USAID launched its Bolivia Country Strategic Plan 2005-2009 on 22 February 2005. It includes goals to increase economic opportunities in business/agricultural development and trade, especially in rural areas; increase the efficiency and transparency of government and courts at all levels; improve access to health services; improve natural resource management; and promote social and economic development in coca growing areas in order to reduce the dependence on the coca economy.[333] In fiscal year (FY) 2004, USAID contributed $99 million, in FY2005, $94 million and FY2006, $99 million.[334] In addition, Bolivia was selected as a beneficiary of Millennium Challenge Account (MCA) assistance in FY2005 and FY2006.[335] Such aid is given to countries that show progress in good governance and investment in social programs and encourage economic freedom.

A Bolivian envoy (Javier Hurtado), named to head the government's MCA office, met with the Millennium Challenge Corporation authorities for Latin America in Washington in June to discuss how to move forward. The current MCA estimate for Bolivia is $600 million, and one critical issue is already decided. The Morales administration has confirmed that it has adopted the broad focus of its predecessor's original proposal to improve, expand and build new roads, particularly in the north-south corridor, in the north including the departments of Beni and Pando, and in the south including the departments of Potosí, Chuquisaca and part of Cochabamba and involving both inter-city and farm-to-market roads. The proposal also involves expanding credit and financial services, including more micro-finance and credit for small and medium companies engaged in agriculture and export industries.

Several issues remain. The first is for Bolivia's government to pull together its technical staff to complete analyses demonstrating that the projects are technically sound and financially viable. The second is the overall nature of the relationship between the U.S. and Bolivia, which undoubtedly will affect the process before a grant agreement is finalised. The third is for Bolivia to continue to meet the bulk of fifteen broad policy indicators that originally qualified it as MCA-eligible. In the best of circumstances, it is likely to be a year before a formal compact can be signed and then a few more months before money begins to flow. The good news is that the Bush administration has not retreated from willingness to provide such substantial grant assistance to Bolivia, despite some of Morales's critical comments, and that the Bolivian government not only continues to be interested in this potential cooperation but has initiated actions to move forward.[336]

Brazil also has an international cooperation presence in Bolivia. There is a general agreement on scientific and technological cooperation, and specific agreements in agriculture (transfer of technology), the environment (the shared Amazonian border) and health (e.g. Brazil's success with generic medicines). There is also Brazilian know-how in the elaboration of anti-hunger policies. Brazil has written-off the bilateral external debt, pending legislative approval in both countries. It is also interested in helping its neighbour with the construction of roads and bridges for regional integration, via credits from the National Bank of Economic and Social Development. Though bilateral aid is not expected to be affected, recent hydrocarbon developments, the eviction of the Brazilian EBX cast iron plant in Puerto Suarez and the possible eviction of Brazilian agro-industrial investments and poor peasants from the border regions could have a disturbing effect on Brazilian public opinion.[337]

In contrast, Bolivia's relations with Cuba and Venezuela have never been warmer. Morales's first trips as president-elect were to Fidel Castro and Hugo Chávez, during which he stressed that Bolivia was joining the fight against neo-liberalism and imperialism, praised Chávez as his ideological mentor, and defended Venezuela's "exchange of ideas and experiences" with Castro and the "exercise of sovereignty over natural resources".[338] He also signed cooperation agreements with both countries.[339] Chávez agreed to ship 150,000 barrels of diesel fuel per month (worth $150 million) in exchange for Bolivian agricultural products and promised $30 million in aid for financing cooperation programs backed by Cuba, natural resource extraction and a massive ID card program (*cedulación*).[340]

Besides programs in health and literacy, Bolivia and Venezuela have signed agreements on energy, trade and cooperation. In the energy sector, both have agreed with Paraguay and Uruguay on construction of a pipeline

[333] "Bolivia Country Strategic Plan 2005-2009", USAID, 22 February 2005, pp. 12-13. See also http://www.usaid.gov/locations/latin_america_caribbean/country/bolivia/.
[334] See http://www.usaid.gov/policy/budget/cbj2006/lac/bo.html.
[335] The MCA provided $1.5 billion in FY2005 and $3 billion in FY2006 for all eligible countries. Millennium Challenge Corporation press releases, 18 November 2004 and 8 November 2005, at http://www.mcc.gov/public_affairs/press_releases.

[336] Crisis Group interview, Washington, 21 June 2006. *La Jornada*, 13 March 2006.
[337] Crisis Group interview, La Paz, 14 June 2006.
[338] *El Deber*, 1, 3 and 4 January 2006.
[339] Cuban cooperation concentrates on health care and literacy: more than 600 Cuban doctors provide medical care in remote regions of Bolivia; ophthalmology equipment will be installed to operate the free Bolivian vision-impaired program; Bolivians will receive 5,000 scholarships in medicine and health-care-related areas. A 30-month plan, starting in July 2006, aims to provide basic literacy to 1.1 million people (about 13.3 per cent of the population).
[340] *El Universal*, 4 January 2006.

connecting Bolivian gas fields with those two countries. As noted above, Chávez helped bring Bolivia into the "Great Gas Pipeline of the South" project; the state-owned companies YPFB and PDVSA contracted to create a new hydrocarbon company;[341] and Bolivia, Cuba and Venezuela signed the TCP agreement.[342] On 26 May, the three widened their partnership: Cuba will open 30 clinics, Venezuela will buy $100 million in national treasury bonds to ease Bolivia's fiscal deficit, and Venezuela and Bolivia signed a compact for a mining joint venture.[343]

Other agreements have been for construction of a fertilizer plant (Fertisur); $100 million of Venezuelan money to promote credit lines for small and medium-sized entrepreneurs;[344] training of 250 Bolivian students in petrochemical products and 200 Bolivian energy sector workers; a Venezuelan donation of $2 million in asphalt; signature of a security and defence cooperation agreement; and a Venezuelan donation of 520 computers to 52 schools of the *cocalero* federation in Cochabamba.[345]

The Inter-American Development Bank has traditionally been a major supporter of Bolivian development. Its country operational strategy for 2004-2007 states that "fighting poverty is the main objective of the Bank's strategy for Bolivia". It hit a disbursement high of $250 million in 2003 and then showed sharp drop-offs to $100 million in 2004 and less than $30 million in 2005 as political crisis generated uncertainty. In 2005 the bank board approved virtually no new lending for Bolivia. The three action areas in its strategy are:

- improving the state's management capacity and transparency by strengthening government institutions;
- supporting competitiveness and private sector development while protecting environment and natural resources; and
- enhancing efficiency and equity in basic social service delivery, with emphasis on education, health, and sanitation projects that expand access and quality, and strengthening municipal government management capacity.[346]

The World Bank also has a major assistance program and has recently announced a plan to write off Bolivia's debt under the HIPC program. Debt servicing is around 20 per cent of export earnings and constrains the government's investment and expenditures. The World Bank's jointly developed interim Country Assistance Strategy for Bolivia provides some $150 million annually in support of development programs over the next two years. It includes projects designed to help maintain macroeconomic stability and reduce inequality by expanding basic services to the poor, such as health, education, water and sanitation, and by strengthening public institutions and curbing corruption. The current portfolio consists of nineteen projects worth $615.3 million.[347]

## B. NEW EU STRATEGY FOR BOLIVIA

The EC delegation in La Paz and Commission officials in Brussels are in the process of formulating a country strategy paper (CSP) for 2007-2013. The current concentration on rural development and access will be shifted, Crisis Group understands, to an approach encompassing economic opportunities (employment generation in good conditions), social cohesion and support to Bolivia's five-year plan focusing on international watersheds, such as the Pilcomayo river, shared with Argentina and Paraguay.[348] The new CSP will still follow the political direction given by the EU Action Plan but the EU believes it should correspond with the Morales government's vision and is willing to give technical and financial aid in the fields identified in Bolivia's development strategy.

That Bolivian strategy, finally released on 16 June, is based on four pillars: 1) reduction of extreme poverty from 34.5 per cent in 2004 to 27.1 per cent in 2011, general poverty reduction from 69 per cent to 49.7 per cent during the same period and better distribution of national income; 2) openness to international cooperation but more caution about mortgaging national sovereignty and resources to international capital; 3) mining, energy, forestry, water and biodiversity as strategic sectors for generating surplus resources and savings (over $600 million annually via new hydrocarbon contracts), infrastructure development and employment generation in rural and small crafts (90,000 jobs per year); and 4) social and community empowerment. Investment over 2006-2011 is planned at $12 billion, about $6.8 billion in public investment.[349]

[341] Venezuela will invest over $1,5 billion in energy projects: creation of the joint company Petroandina to operate 35 petrol stations and build a plant for extraction of liquids from natural gas; PDVSA and YPFB to determine Bolivian gas reserves.
[342] See Section IV B above.
[343] MINESUR, a joint venture between the mining ministries.
[344] $25 million will benefit 200,000 Bolivians through five projects in the agrarian sector: soybean development and milk, coffee and tea industrialisation in Caranavi province and coca industrialisation in Cochabamba and La Paz.
[345] *La Razón*, 27 May 2006.
[346] See http://www.iadb.org/countries/strategy.cfm?language=English&id_country=BO&parid=3
[347] See World Bank website at http://web.worldbank.org.
[348] Crisis Group email communication, 8 June 2006 and interview, La Paz, 14 June 2006.
[349] "Bolivia digna, soberana, productiva y democrática para vivir bien", Ministerio de Desarrollo de Bolivia. See http://www.planificacion.gov.bo/ and *La Prensa*, 17 June 2006.

After his sweeping election victory, President Morales has the democratic legitimacy and political power to promote big reforms. Europeans view positively his government's determination to take the initiative on international cooperation and development.[350] However, they complain that the decision-making process is too narrowly concentrated around the president, vice president and the planning and presidency ministers, and there is too little information to allow them to determine the proper international role. What has been released about the government's strategy is vague and more ideologically-driven than based on specific projects. Moreover, there is inadequate dialogue. Some Bolivian officials mistrust donor programs, arguing that they were decided and imposed by foreigners; and, even though some express the desire to continue development cooperation, it is clear they prefer to receive money directly, free from the established frameworks.[351] This attitude is justified as part of the recovery of sovereignty and desire to stop being a "beggar state". It fails to acknowledge that the EU's cooperation policy seeks not to impose criteria and decide what to do but to verify the feasibility of projects submitted to it.[352]

The Bolivian national development strategy is in line with EU efforts regarding poverty reduction, rural development, land redistribution and social cohesion. EU member state interests in health, education and basic sanitation are also addressed. In addition, the strategy seeks to promote export diversification based on long-term development of small and mid-sized enterprises that can take advantage of preferential trade agreements, which the EC could complement by offering technical aid as outlined in the CAN's regional strategy for 2002-2006.[353] However, the Morales government emphasises re-legitimising the state by including representatives of indigenous peoples and social movements in its institutions, not by improving efficiency and capacity to deliver. EU priorities such as good governance, accountability, a professional civil service and institutional efficiency are only marginally addressed by the strategy. The Bolivian government should work closer with the EU on these.

Cubans and Venezuelans are working in areas that other international cooperation programs do not cover, such as mass health and literacy programs. Europeans consider that working with the Cubans and Venezuelans in these fields would be more of an opportunity than an obstacle, especially as these mass programs could complement their more targeted efforts.[354] The EU looks forward to coordinating efforts but it is up to the Morales government to facilitate this kind of rapprochement.[355] Now that the government's strategy has been released, the EU wants to reactivate the "coordination tables for cooperation" that operated with past governments, so that dialogue can be resumed with all bilateral and multi-lateral donors.[356]

Renewed dialogue with the Bolivian government could help address aspects that worry the Europeans, especially the continuity of some programs; the lack of a specific employment policy; and the creation of a promotion and development bank (Banco de Fomento y Desarrollo)[357] that is to receive $100 million from Venezuela for micro-credits at 4 per cent.[358] That bank, it is feared, could put at risk the viability of the micro-credit system already in place and have a serious impact on Bolivia's own stellar micro-credit institution, Banco Sol, which is the largest provider of micro-credit loans to Bolivians. Donors are also worried about a possible government attempt to eliminate institutions such as the National Road Service (SNC), which has done well in building infrastructure.[359] In addition, the regional autonomy dimension is absent, as the government has not yet clarified how planning and execution will be shared with prefectures and municipal governments.[360] It is to be hoped that the Morales administration will not weaken the Popular Participation Law, which regulates decentralisation at the municipal level and allows mayors and local councilmen to share in the design of development projects.[361]

[350] Crisis Group interview, Brussels, 12 June 2006.
[351] However, some officials are gradually warming to cooperation. Crisis Group interviews, La Paz, 12-15 June 2006.
[352] Crisis Group interviews, Brussels and La Paz, 12-13 June 2006. The national development strategy also denounces international development projects for contributing to the weakening of the state. See "Bolivia digna, soberana, productiva y democrática para vivir bien", Ministerio de Desarrollo de Bolivia, June 2006, p. 3.
[353] "Regional Strategy: Andean Community of Nations 2002-2006", European Community, pp. 32-33.
[354] Crisis Group interviews, La Paz, 4 May, 12-13 June 2006.
[355] Crisis Group interview, La Paz, 12 June 2006.
[356] Crisis Group interviews, La Paz, 12-13 June 2006.
[357] According to the new development strategy, the bank will channel $300 million, including $140 million to the productive sector, $100 million for international trade issues, $30 million for productive infrastructure and $30 million for social housing, *La Prensa*, 17 June 2006.
[358] Some micro-credit programs are backed by European cooperation. They award loans at an average rate of 20 per cent. One reason for this rate is the high cost of operation in Bolivia, especially in rural and isolated areas. Credit at 4 per cent could endanger repayment of existing loans (about $500 million) and put into question the capacity of the financial system to sustain the program. The scheme of loans in place is to be replaced by the government, which will study the loans and take back the portfolio after a three-year grace period. Crisis Group interview, La Paz, 13 June 2006.
[359] Congress is debating its elimination and the creation of a new institution. Crisis Group Interview, La Paz, 13 June 2006.
[360] Crisis Group interview, La Paz, 14 June 2006.
[361] Crisis Group interview, La Paz, 3 May 2006.

EU countries respect Bolivia's sovereign decision on hydrocarbon nationalisation, will leave details to negotiation between the government and the private companies and do not plan to cut cooperation.[362] However, some Bolivian officials tend to demonise the opening up of the economy to foreign capital and irresponsibly deny its importance for developing the hydrocarbon and mineral sectors that are the engine of the economy. The Morales government needs to send clearer signals that contracts will be honoured and foreign investors' assets protected.[363] The EU, which expects bilateral treaties for the reciprocal protection of investments and capital need to be respected,[364] should encourage Morales to take measures to protect foreign investments.

Excess coca is a highly sensitive issue. The Morales government is under international pressure to eradicate but parts of its social base (the *cocalero* movement) do not want it to resume a forced program. In addition, domestic use of drugs is on the rise.[365] The government has to put limits to coca cultivation and sooner or later will have to eradicate. Current strategy is based on voluntary eradication but the authorities have not released figures, so it is impossible to know if it is working. However, there are already some 26,000 hectares under cultivation, more than twice the legal amount.[366] Voluntary eradication, a European observer said, is unrealistic, because drug-trafficking networks will profit from all spaces left uncovered in a state with weak justice institutions like Bolivia.[367]

At the 9-11 May Inter-American Drug Abuse Control Commission, Bolivian officials reaffirmed the government's commitment to fight illegal drugs but requested international acceptance of traditional coca leaf use.[368] The government does not want to eradicate coca crops, and there is no clarity on how to reduce surpluses other than through voluntary eradication by farmers. It is not clear whether public declarations by Morales have been followed by action. New markets – such as the one in Caranavi – should be opened only if there are controls to ensure that the leaves are for legal and traditional consumption. Industrialisation could be the answer, but it is uncertain whether projects are being developed. The government institution in charge of coca affairs was split up by the Morales administration: the vice minister for social defence, Felipe Cáceres, was subordinated to the interior ministry, and the vice minister for coca and integral development, Felipe Barra, was subordinated to the development ministry.[369]

Despite all the problems that may arise over foreign investment, eradication and the lack of a detailed development strategy, the EU wants the Morales government to succeed so Bolivia can enjoy stability and economic growth. European support for the Constituent Assembly and the Referendum on Regional Autonomy will be important, and it has already begun to flow.[370] Recently, the EC, via the German cooperation agency GTZ, made €300,000 available to support the government's REPAC office in Santa Cruz, which is preparing the CA,[371] and on the foreign ministry's invitation, it has deployed an EU Election Observation Mission for the 2 July polls.[372]

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[362] Repsol-YPF (Spain-Argentina), Total (France), BG and BP (UK), Shell (the Netherlands), CLHB (Germany-Peru). Crisis Group interviews, La Paz, 13-15 June 2006.

[363] Crisis Group interviews, La Paz, 3 May, 12-13 June 2006.

[364] Crisis Group Interview, La Paz, 15 June 2006.

[365] Crisis Group interview, La Paz 3 May 2006.

[366] Crisis Group interview, La Paz 3 May 2006. Law No.1008 (1988) established a limit of 12,000 hectares of legal coca crops. While the U.S. White House Office of Drug Control showed an increase from 2004 to 2005 of 2,000 hectares, for a total of 26,500, the United Nations Office on Drugs and Crime (UNODC) coca survey in the Andes region published in June 2006 estimates that coca crops have diminished 8 per cent from 2004 to 2005 (from 27,700 to 25,400 hectares). See the UNODC report at http://www.unodc.org/unodc/en/press_release_2006-06-20.html. Morales declared his government will continue to reduce coca cultivation in the Chapare. *La Razón*, 24 June 2006.

[367] Crisis Group Interview, La Paz, 13 June 2006.

[368] Vice Minister Felipe Caceres, "La política de Bolivia contra las drogas y la revalorización de la hoja de coca", speech at the 9-11 May 2006 Inter-American Drug Abuse Control Commission, and Vice Minister Mauricio Dorfler to the same group.

[369] Crisis Group interview, Santa Cruz, 8 May 2006.

[370] As already noted, the EC used its Rapid Reaction Mechanism (RRM) in late 2005 to channel €1 million into good governance programs, with the CA in mind[370] and to pay for Morales' South Africa trip in January 2006. The Club of Madrid, an organisation of former heads of government working to promote democratic governance worldwide, promoted visits to Bolivia of former Spanish Prime Minister Felipe Gonzalez, and political figures from South Africa and Mozambique (€200,000) and financed the Bolivian Foundation for Multi-Party Democracy's publication and circulation of proposals that will be discussed in the CA in agreement with the National Electoral Court (€100,000); the Federation of Municipal Associations (FAM) received €100,000 to compile decentralisation proposals to be discussed in the CA.

[371] The GTZ will support REPAC though the Programa de Apoyo a la Gestion Publica Descentralizada y Lucha contra la Pobreza (PADEP) program in activities related to training CA delegates, information campaigns and preparation of conferences and discussion sessions on topics such as institution building and autonomy. Crisis Group interviews, Brussels and La Paz, 14-15 June 2006.

[372] The EU mission will be led by Monica Frassoni of the European Parliament. The core team – the chief observer and eight experts – began to arrive in La Paz in the last week of May and was soon joined by 26 long-term observers, A total of 60 short-term observers and possibly diplomats from EU member-state embassies in La Paz will observe the polls. Communiqué IP/06/777 "European Union observes the upcoming polls in

## VI. CONCLUSION

The December 2005 elections profoundly altered Bolivia's political landscape. MAS became the strongest political force, and the executive branch gained at the expense of the legislative, giving the new president greater possibilities to implement its policies. However, while instability has lessened since Morales took power, his government will have difficulty meeting the high expectations for change it created with its campaign promises.

Morales has tried to move swiftly on three central pledges: nationalising the hydrocarbon sector, implementing land reform, and creating a constituent assembly to rewrite the constitution. The nationalisation decree has severely strained relations with Brazil and Argentina and may yet prompt foreign investors to leave the country. As Bolivia needs investment to develop its resources, the government must ensure that contracts are honoured and investments respected.

The government's goal in convening a constituent assembly is to address demands by indigenous peoples for more social inclusion and political participation. This can be achieved if the new constitution is one that encourages consensus building. However, radical groups may attempt a much more ambitious, complete overhaul of the current institutional framework. MAS has done little to appease fears and convince Bolivians it intends only moderate reform. Similarly, there are concerns that if the Referendum on Regional Autonomy is hijacked by the richer provinces, overly ambitious demands could undermine central government competencies, especially on budget and tax collection matters and might even threaten the state's territorial integrity.

Morales's recent decision not to support autonomous regions, as he initially promised, has generated anxiety in the eastern regions. The campaign in favour of the referendum has found new force in the east following the government's attempt to implement a land reform program seen as damaging land tenure rights and harming agro-industrial interests and those of large landowners. The issue has serious potential for sparking violent conflict between landowners and landless peasants, and the government is being widely criticised for promising consensus building to landowners while encouraging illegal occupation of land by poor peasants and MAS militants.

Morales must also move quickly and with a clear sense of direction on drugs. In particular, he needs to strengthen law enforcement and interdiction if he is to convince his neighbours and Washington that he is not prepared to tolerate increased cocaine trafficking.

European donors welcomed the government's recently announced national development strategy as a step towards addressing the common goals of fighting poverty, creating quality jobs and fomenting economic growth. However, the government needs to provide more clarity about the specific projects it will implement and what role it wants the donors to play. If Morales does clarify his strategy and sets aside his ideological prejudices, the EU should adapt its poverty reduction, social cohesion and good governance strategies to work with him. Despite the difficulties of coordinating the assistance of friends of Bolivia as disparate as the U.S., Cuba and Venezuela, it would be desirable for donor activities to be embedded to the greatest extent possible in a multilateral cooperation strategy geared at achieving much stronger synergy between government, civil society and donor programs. With its access to the key players, the EU may be best positioned to help the government attempt this.

**Bogotá/Brussels, 3 July 2006**

Bolivia", European Commission, Brussels, 13 June 2006. The EC has made €1.79 million available from the European Initiative for Democracy and Human Rights (EIDHR), to pay for the mission.

# APPENDIX A

# MAP OF BOLIVIA


Map No. 3875 Rev. 3 UNITED NATIONS
August 2004

Department of Peacekeeping Operations
Cartographic Section

## APPENDIX B

## ABOUT THE INTERNATIONAL CRISIS GROUP

The International Crisis Group (Crisis Group) is an independent, non-profit, non-governmental organisation, with nearly 120 staff members on five continents, working through field-based analysis and high-level advocacy to prevent and resolve deadly conflict.

Crisis Group's approach is grounded in field research. Teams of political analysts are located within or close by countries at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, it produces analytical reports containing practical recommendations targeted at key international decision-takers. Crisis Group also publishes *CrisisWatch*, a twelve-page monthly bulletin, providing a succinct regular update on the state of play in all the most significant situations of conflict or potential conflict around the world.

Crisis Group's reports and briefing papers are distributed widely by email and printed copy to officials in foreign ministries and international organisations and made available simultaneously on the website, www.crisisgroup.org. Crisis Group works closely with governments and those who influence them, including the media, to highlight its crisis analyses and to generate support for its policy prescriptions.

The Crisis Group Board – which includes prominent figures from the fields of politics, diplomacy, business and the media – is directly involved in helping to bring the reports and recommendations to the attention of senior policy-makers around the world. Crisis Group is co-chaired by the former European Commissioner for External Relations Christopher Patten and Boeing's Senior Vice-President, International Relations and former U.S. Ambassador Thomas Pickering. Its President and Chief Executive since January 2000 has been former Australian Foreign Minister Gareth Evans.

Crisis Group's international headquarters are in Brussels, with advocacy offices in Washington DC (where it is based as a legal entity), New York, London and Moscow. The organisation currently operates fourteen field offices (in Amman, Bishkek, Bogotá, Cairo, Dakar, Dushanbe, Islamabad, Jakarta, Kabul, Nairobi, Pretoria, Pristina, Seoul and Tbilisi), with analysts working in over 50 crisis-affected countries and territories across four continents. In Africa, this includes Angola, Burundi, Côte d'Ivoire, Democratic Republic of the Congo, Eritrea, Ethiopia, Guinea, Liberia, Rwanda, the Sahel region, Sierra Leone, Somalia, Sudan, Uganda and Zimbabwe; in Asia, Afghanistan, Indonesia, Kashmir, Kazakhstan, Kyrgyzstan, Myanmar/Burma, Nepal, North Korea, Pakistan, Tajikistan, Turkmenistan and Uzbekistan; in Europe, Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Georgia, Kosovo, Macedonia, Moldova, Montenegro and Serbia; in the Middle East, the whole region from North Africa to Iran; and in Latin America, Colombia, the Andean region and Haiti.

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**July 2006**

# APPENDIX C

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***Colombia and Its Neighbours: The Tentacles of Instability***, Latin America Report N°3, 8 April 2003 (also available in Spanish and Portuguese)

***Colombia's Humanitarian Crisis***, Latin America Report N°4, 9 July 2003 (also available in Spanish)

***Colombia: Negotiating with the Paramilitaries***, Latin America Report N°5, 16 September 2003 (also available in Spanish)

***Colombia: President Uribe's Democratic Security Policy***, Latin America Report N°6, 13 November 2003 (also available in Spanish)

***Hostages for Prisoners: A Way to Peace in Colombia?***, Latin America Briefing Nº4, 8 March 2004 (also available in Spanish)

***Venezuela: Headed Toward Civil War?***, Latin America Briefing Nº5, 10 May 2004 (also available in Spanish)

***Increasing Europe's Stake in the Andes***, Latin America Briefing Nº6, 15 June 2004 (also available in Spanish)

***Bolivia's Divisions: Too Deep to Heal?*** Latin America Report Nº7, 6 July 2004 (also available in Spanish)

***Demobilising the Paramilitaries in Colombia: An Achievable Goal?***, Latin America Report N°8, 5 August 2004 (also available in Spanish)

***Colombia's Borders: The Weak Link in Uribe's Security Policy***, Latin America Report N°9, 23 September 2004 (also available in Spanish)

***A New Chance for Haiti?***, Latin America/Caribbean Report Nº10, 17 November 2004 (also available in French)

***War and Drugs in Colombia***, Latin America Report N°11, 27 January 2005 (also available in Spanish)

***Haiti's Transition: Hanging in the Balance***, Latin America/ Caribbean Briefing N°7, 8 February 2005 (also available in French)

***Coca, Drugs and Social Protest in Bolivia and Peru***, Latin America Report N°12, 3 March 2005 (also available in Spanish)

***Spoiling Security in Haiti***, Latin America/Caribbean Report N°13, 31 May 2005

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***Can Haiti Hold Elections in 2005?***, Latin America/Caribbean Briefing Nº8, 3 August 2005 (also available in French)

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## APPENDIX D

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