10
Bolivia
Pulling in Two Directions: The Developmental State and Basel Standards

Peter Knaack

Introduction

Bolivia had plans for one of the most ambitious implementations of Basel standards among lower-middle-income countries around the world. A novel financial services law promulgated in 2013 established the legal framework for a wholesale adoption of Basel II, including all advanced internal model-based components, and elements of Basel III. Among our case studies, Pakistan is the only other country where the regulator has taken such an ambitious approach. It is puzzling to see such a wholehearted embrace of Basel standards by a left-wing government that follows a heterodox approach to economic policymaking. Domestically oriented and opposed to the neoliberal stance of its predecessors, the current administration espouses a developmental state model that employs quantitative lending targets and interest rate caps to promote economic growth and financial inclusion. Why would a government want to combine such financial interventionism with such an ambitious plan to adopt Basel standards?

Building on archival research and interviews with twenty-six regulators, bankers, politicians, and financial experts in Bolivia, this chapter shows that Bolivia's case is an instance of regulator-driven convergence on Basel standards. Bolivia's financial regulatory agency is embedded in transnational technocratic networks with regulators in the region and in advanced Basel member jurisdictions, an institutional environment that fosters peer learning and emulation. Bolivian regulators regard Basel as the gold standard in prudential regulation, and they played an important role in drafting the law. As the draft law changed hands from regulators to politicians, interventionist policy instruments were grafted onto the prudential regulatory framework. The result is a rather unique combination of measures that aim to achieve two different policy goals: financial stability and inclusive growth. The latter is not a priority for regulators from the rich jurisdictions that dominate the Basel Committee, but it is an essential prerogative for developing countries around the world. Bolivia's policy innovation—whether

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deliberate or not—therefore merits attention by regulators in other countries that seek to chart a path towards financial sector development that delivers on both resilience to economic shocks and inclusive growth.

At the same time, this study finds a significant implementation gap as only a small subset of Basel II and III components is currently in force. This gap can be attributed to regulatory capacity constraints and a lack of demand for the more complex Basel components by market actors and the government. This chapter also shows that the process of policy innovation underlying the new law has not occurred without friction. The tension between politicians and technocrats in the policymaking process led to unintended consequences that may be detrimental to financial inclusion and financial stability in the future.

This introduction is followed by a description of the key features of Bolivia's political and economic system that provide the background for the development of the new Financial Services Law (FSL). The next section identifies the current state of Basel standards adoption and implementation in Bolivia. The fourth section presents an analysis of the political economy of Basel adoption in the country, highlighting in particular the relationships between a transnationally embedded regulator, a government focused on state-led domestic development, and a banking sector with few international incentives for Basel adoption. The concluding section derives lessons learned from the case study.

Political economy context: evolution of Bolivia's banking sector

Shaken by a financial crisis and political turmoil at the beginning of the twenty-first century, the Bolivian economy has experienced a remarkable period of stability, sustained growth, and significant improvement of social indicators over the last decade. GDP growth has averaged around 5 per cent per year since 2006, and GDP per capita has doubled to over $3000 in current dollar terms (ca. $7000 PPP; see Table 10.1). During this period, both the poverty rate and income inequality have fallen. This is especially noteworthy in a country where elite cohesion has historically constrained the capacity of the state to extract and redistribute wealth (Fairfield, 2015).

Like many other lower-middle-income countries, Bolivia's financial services sector is bank-dominated. Few private companies are listed on domestic securities markets, and local exchanges serve as venues for the issuance of debt rather than equity (S&P Global Ratings, 2016). Public companies are the main issuers of securities, and domestic pension funds are the dominant actors on the buy side.

The banking sector is vibrant, and market concentration is not high (see Figure 10.1). About a dozen universal banks manage close to 70 per cent of deposits and 60 per cent of loans in Bolivia. Three banks that cater specifically to small and medium enterprises (SMEs) account for a further 5 per cent of the

Table 10.1 Bolivia: key indicators

Bolivia	
GDP per capita (current US$, 2017):	3,393
Bank assets (current US$):	18.6 bn
Bank assets (% of GDP):	54.9
Stock market capitalization (% of GDP, 2012):	15.9
Credit allocation to private sector (% of GDP):	64
Credit allocation to government (% of GDP):	0.9
Polity IV score:	7

Note: All data is from 2016 unless otherwise indicated.
Source: FSI Database, IMF (2018); GDI Database, World Bank (2017); Polity IV (2014)

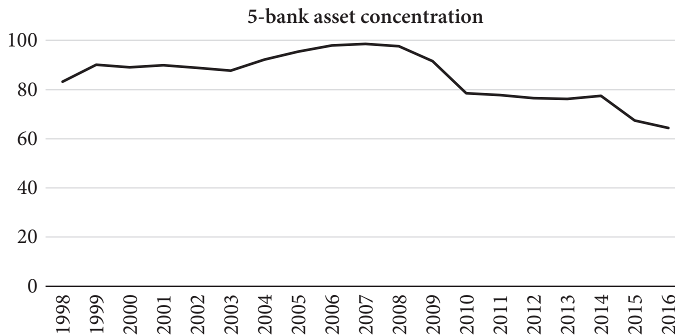

Figure 10.1 Bolivia: banking sector concentration (asset share of the five biggest banks).
Source: World Bank, Global Financial Development Database

market share. The rest of the financial services sector includes close to one hundred small-scale cooperatives and development finance institutions that tend to specialize in microfinance.

The only state-owned commercial bank, Banco Union, has grown at high speed, expanding its loan portfolio by an average rate of 34 per cent per year during 2007–13. The bank operates on a lower net interest margin and lower profitability than its private competitors. It has grown to become Bolivia's second-largest bank with a 10 per cent market share (Moody's Global Credit Research, 2013). Foreign banks play a very limited role, as the overwhelming majority of Bolivia's banking sector is domestic-owned (see Figure 10.2). One of the three foreign-owned banks is part of a private banking conglomerate headquartered in neighbouring Peru. The other two are subsidiaries of state-owned Brazilian and Argentine banks, with a very small market share.

Commodities represent four fifths of Bolivia's exports, and the super-cycle of the early 2000s has produced a windfall for private agriculture business, the state-owned hydrocarbon sector, small-scale mining cooperatives, and others.

Figure 10.2 Bolivia: foreign bank assets (% of total bank assets).
Source: Claessens and Van Horen (2014)

Supported by macroeconomic stability and the commodities boom, Bolivia's financial system expanded massively in recent years, with credit growth rates of 18 per cent per annum from 2008 to 2014 (S&P Global Ratings, 2016). The favourable economic context allowed banks to maintain capital buffers comfortably above regulatory limits and write off sour loans from the financial crisis at the beginning of the century (Figure 10.3).

Moreover, the last decade was a period of outstanding profitability for Bolivia's banks, with return on equity peaking at over 21 per cent in 2007, and remaining high throughout the global financial crisis (GFC) (Figure 10.4).

The election of Evo Morales and his Movement for Socialism Party in 2005 marked the end of a long neoliberal phase in the Bolivian political economy. The first indigenous head of state in a majority-indigenous country, Morales set out to reduce dependence on the Bretton Woods Institutions, implement redistributionist economic policies, and forge economic and political ties with fellow left-wing governments in the region, in particular Hugo Chavez's Venezuela. The economic outlook of the Morales administration is much more domestically oriented than that of its predecessors. Rather than seeking to attract foreign investment, the new government increased the role of the state in the economy. Within months of assuming office, Morales nationalized the country's hydrocarbon sector, forcing resident multinationals into renegotiations of assets and contracts with the state.

Morales' rise to power coincided with the beginning of the commodities super-cycle. The favourable global environment provided the government with the opportunity to dramatically increase social spending while implementing a

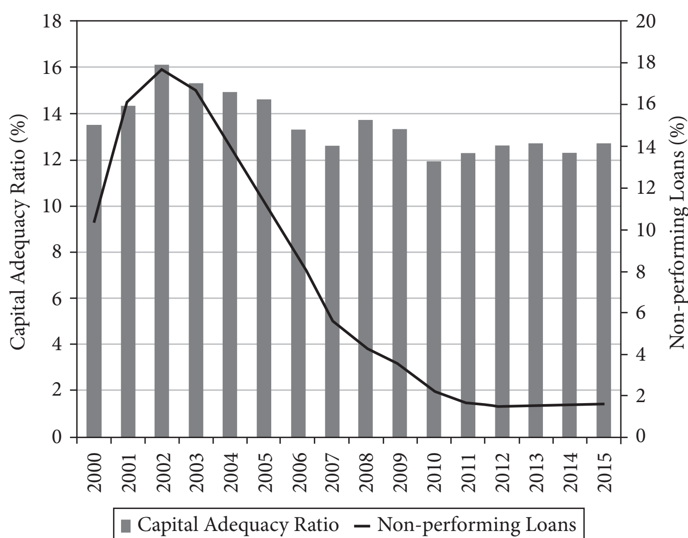

Figure 10.3 Bolivia: capital adequacy ratios (CAR) and non-performing loans (NPLs).
Source: International Monetary Fund (IMF)

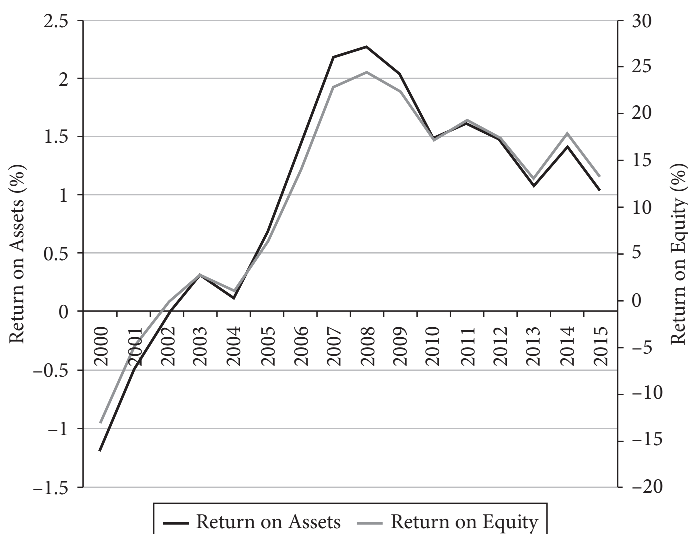

Figure 10.4 Bolivia: rates of return on assets (RoA) and equity (RoE).
Source: Bankscope and Orbis Bank Focus, Bureau van Dijk (2018)

prudent macroeconomic policy, which combined balanced budgets, a stable exchange rate, growing foreign exchange reserves, and low inflation. The Bolivian economy has remained remarkably stable to date, weathering the GFC and the precipitous fall of commodity prices in recent years while many neighbouring countries have fallen into recession.

Private Bolivian banks have been immensely profitable over the last decade, but relations with the governing elite are tense. This is because the government has issued a series of interventionist financial policies to channel some of the sector's profits towards social purposes. In 2012, it imposed an additional 12.5 per cent income tax on financial entities whose returns on equity exceeded 13.0 per cent. In addition, all banks have to pay 6 per cent of pre-tax profits into a guarantee fund destined for social purposes. Finally, Bolivia's financial regulator issued a rule in December 2015 that requires all banks to retain 50 per cent of net profits as a capital buffer. In response, private banks complained about the 'stigmatisation of profits', without much of a result (ASOBAN, 2015).

Bolivia's financial regulator prides itself on its relatively high degree of professional sophistication. Currently headed by a former Morales cabinet minister, the regulatory agency is clearly aligned with the financial policies of the government, but it self-identifies and operates as a technocratic organization of considerable independence.

One distinguishing feature of Bolivia's banking system is the breadth of its financial market. With microfinance institutions at the top of world rankings and significant increases in financial access despite low population density and difficult geography, Bolivia is at the forefront of a global movement towards financial inclusion (Ekka et al., 2010). Microfinance entities provide over 30 per cent of total credit in the country, and the number of borrowers grew by 70 per cent in the period of 2008–15. The microfinance sector operates within the perimeter of prudential supervision, and non-performing loan ratios are as low as those of the banking sector more broadly. Moreover, Bolivian microfinance institutions have made significant efficiency gains that allowed them to lower average interest rates from 65 per cent in 1992 to just below 20 per cent in 2015 (Ekka et al., 2010; Heng, 2015; McGuire et al., 1998).

In sum, Bolivia's financial sector has experienced a period of sustained growth in a stable macroeconomic environment that has allowed banks to clean up their balance sheets and make substantial profits. In this favourable environment, the government has seized the opportunity to gear the financial services sector towards a more pronounced social purpose, albeit with some unintended consequences. Both the governing elite and market actors tend to be domestically oriented, and foreign public and private actors play a rather subdued role in the Bolivian political economy.

Bolivia's implementation of Basel banking standards

Bolivia's regulator had plans for one of the most ambitious Basel implementation strategies among lower-middle-income countries around the world. The new FSL of 2013 provided the legal framework for a wholesale adoption of Basel II and

even parts of Basel III. According to the law, Bolivia has adopted all ten components of Basel II and two out of eight of the Basel III components. Yet only a small subset of these Basel rules is currently in force.

In the 1990s and 2000s, Bolivia's banking system was subject to the Banking and Financial Entities Law. Issued in 1993 and modified in 2001, the law incorporated capital requirements and risk-weighting methods based on Basel I, and required banks to hold higher levels of capital than the international standards require. Bolivia has been an over-complier with Basel standards, in that its prudential rules require banks to hold Tier 1 capital equivalent to 7 per cent of risk-weighted assets, and an additional 3 per cent of Tier 2 capital.

Supervision of the Bolivian financial system was under the purview of the Superintendencia de Bancos y Entidades Financieras until 2009. Like many regulatory agencies in Latin America, the Superintendency featured a high degree of organizational autonomy, a salient professional identity, and strong links to technocratic peers abroad (Jordana, 2011). Only one year after Basel II was finalized, the Superintendencia issued the rules to implement the Basel II standardised approach to credit risk (SBEF, 2005). Many organizational characteristics of the Superintendencia were carried over to its successor agency, the Autoridad de Supervisión del Sistema Financiero (ASFI).

Bolivia's financial supervisors received a positive assessment from international financial institutions. In the 2011 Financial Sector Assessment Program (FSAP), the last one undertaken to date, the IMF and World Bank commended Bolivian authorities for significant improvement in financial supervision. Bolivia was judged to be compliant or largely compliant with nineteen out of twenty-five Basel Core Principles, including key aspects such as capital adequacy and provisioning. The IMF and the World Bank even suggested that the supervisor had gone too far in financial sector transparency, and recommended easing reporting requirements for small financial institutions in order to reduce their administrative burden. On the other hand, the international authorities noted deficiencies in anti-money laundering rules and urged ASFI to move towards a risk-based approach to financial supervision, taking into account market, operational, and interest rate risk, among others (IMF and World Bank, 2012).

The FSL of 2013 incorporated many of the FSAP recommendations. It established the legal framework for the regulation of target markets and operational risk. Moreover, the law gave banks permission to use both the standard and the internal ratings-based approaches for the calculation of credit, market, and operational risk (Estado Plurinacional de Bolivia, 2013a, para. 35f). Banks are free to develop internal rating models, but must submit them to the ASFI for approval. The new law maintained the previous requirements of 7 per cent Tier 1 and an additional 3 per cent Tier 2 capital, but it implemented a stricter definition of capital in line with the new Basel III standards. Banks are required to maintain a 10 per cent capital adequacy ratio as mentioned above, but the Executive

branch has the authority to increase capital requirements 'in line with official recommendations of the Basel Committee' (Estado Plurinacional de Bolivia, 2013a, para. 417). In addition, the ASFI can apply a conservation buffer of up to 2 per cent at its discretion, bringing the total capital requirement to a maximum of 12 per cent of risk-weighted assets. This capital buffer can be used as a counter-cyclical measure by the regulator—even though it does not follow the technical prescriptions of the Basel Committee, it is designed to serve the macroprudential purpose associated with the counter-cyclical buffer of Basel III. In fact, counter-cyclical loan-loss provisioning rules have been in place since 2008, pre-dating the latest Basel Accord (S&P Global Ratings, 2016). While the new law did not incorporate Basel III liquidity ratios, it carried over pre-existing requirements and obliges banks to provide the regulator with evidence that 'adequate' liquidity buffers are maintained. In sum, other than a modified version of a counter-cyclical buffer and a stricter definition of capital, the law did not adopt any components of Basel III.

Regarding prudential supervision (Pillar 2), the IMF and the World Bank commended Bolivia in 2011 for improving risk supervision with a new inspection manual for on-site inspections. The ASFI also counts on an off-site information sharing system that obliges banks to submit data for ongoing surveillance. Even though Bolivia's supervisory system is compliant with most Basel Core Principles, it is unclear to what extent ASFI staff have the capacity to validate the internal capital allocation techniques of supervised banks in line with Basel II and III. All universal banks are audited and publicly listed, but the small scale and limited range of actors in Bolivia's stock market may limit the effectiveness of market discipline (Pillar 3) (Table 10.2).

Somewhat unusually, the FSL stipulates the exact risk weights and capital requirements for credit risk, rather than leaving the elaboration of such rules to the regulator. While risk weights for most asset classes would meet Basel II SA equivalence criteria, credit to SMEs and microcredits are subject to more lenient risk weights of 50–75 per cent, depending on 'payment capacity' to be determined

Table 10.2 Bolivia: adoption of Basel standards

Basel component	Adoption	Implementation
Basel I	Banking and Financial Entities Law 1993	1993
Basel II	Credit risk SA—Circular 492/2005 Credit, market, and operational risk: SA and advanced approaches—FSL 2013 (10/10 components)	Credit risk SA—2005 Market risk, operational risk SA—no rules issued Advanced approaches—no rules issued
Basel III	Definition of capital, counter-cyclical buffer—FSL 2013 (2/8 components)	Rules for both components in force since 2013

by the regulator (AESA Ratings, 2013; Estado Plurinacional de Bolivia, 2013a, para. 418). Additional measures to enhance financial stability include the establishment of a deposit insurance scheme, a credit registry, enhanced anti-money-laundering rules, and new financial consumer protection provisions. Therefore, the FSL broadly represents an ambitious adoption of Basel II, and a selective adoption of Basel III rules.

The law, however, does not represent a coherent move towards the kind of strictly regulated market-based financial system that Basel Committee best practices envision. Instead, the FSL contains a series of policies that pull in the opposite direction. In order to steer the financial system towards inclusive growth, it stipulates several interventionist measures. The law promotes financing of so-called 'productive sectors', including agriculture, mining, construction, and manufacturing—but not commerce. Banks have to dedicate a percentage of their credit portfolio (currently 50–60 per cent) to productive sectors and social housing. Moreover, credit to these sectors is subject to interest rate caps, currently 6 per cent for large, 7 per cent for small, and 11.5 per cent for micro-enterprises. Deposit rates are also subject to interest rate caps (Estado Plurinacional de Bolivia, 2014, 2013b). Furthermore, the law obliges banks to channel a portion of profits towards social purposes that are to be specified by decree. Currently, banks are required to direct 6 per cent of pre-tax profits to a so-called guarantee fund that is designed to complement or replace collateral for loans in productive sectors or social housing. Thus, borrowers in these sectors have the opportunity to take out a loan without a down-payment or pledging collateral if they qualify.

The combination of Basel-compliant prudential standards and interventionist policies in the FSL can be interpreted in two ways. It could be seen as building on the recognition that classic risk management tends to constrain financial inclusion and growth prospects in the real economy. Banks that exclusively follow prudential goals have an incentive to lend to big firms with large collateral and buy government debt, rather than providing credit for riskier market segments such as SMEs and lower-income households. Thus, only a combination of both prudential and social objectives could move financial intermediaries towards the financial possibility frontier (IMF, 2012), achieving greater financial depth, reach, and breadth while respecting the limits of financial sustainability (Yujra, 2016). A second interpretation is that financial stability and inclusive growth are largely incompatible goals, and their incorporation into the same law merely reflects the bounded rationality of lawmakers.

Even though the FSL formally adopts all Basel II and some Basel III components, implementation is much less ambitious. As of mid-2017, ASFI has not issued capital requirement guidelines for market and operational risk. All banks currently use the standard approach for measuring credit risk. None has submitted internal risk-based models for regulatory approval, and only a few large banks have even considered taking steps in this direction. Thus, while the legal

framework is in place for the more sophisticated components of Basel standards, the implementation of these components is much more limited to date.

The political economy of Basel implementation in Bolivia

What explains Bolivia's embrace of Basel II and III standards in the context of its developmental state and domestically oriented banking sector? This section argues that the Bolivian case is an instance of regulator-driven Basel adoption. It shows that financial regulators played a key role in this process, while the domestically oriented government provided support merely for instrumental reasons. Market actors were ambivalent at most. Outward-oriented and involved in transnational technocratic networks, Bolivian regulators have championed the incorporation of Basel II and III into the FSL. In particular, financial regulators' direct involvement in drafting the law paved the way for the adoption of the more advanced components of Basel standards. The gap between formal Basel adoption and implementation can in turn be attributed to a combination of regulatory capacity constraints and a lack of demand both from the banking sector and the government.

However, rather than merely copying Basel provisions off the shelf, the FSL represents an innovative approach that seeks to combine prudential regulation on the one hand and state interventionism on the other, in order to foster productive development and financial inclusion. The combination of these two goals under the umbrella of development-oriented financial regulation is clearly not a priority for the Basel Committee, but it may serve as a model for the adoption of banking standards in other low- and lower-middle-income countries. However, this section also shows that regulatory practice in the wake of the promulgation of the FSL has produced unintended consequences for financial inclusion. It argues that this phenomenon is a consequence of the tension between technocrats and politicians in policy implementation, even though it is not directly related to the Basel standards themselves.

In the decades before Morales' Movement for Socialism came to power, Bolivia's governing elite shared a neoliberal outlook on economic governance, privatizing state-owned companies and seeking to generate a market-friendly regulatory environment. Several of the major banks were owned by the families that also controlled large shares of Bolivia's agribusiness, and the role of the banking sector in general was to provide financial services for the dominant domestic private commodities producers. The governing elite was thus not outward-oriented in terms of its ambitions to establish Bolivia as a regional financial centre, but it tended to follow the policy recipes written in Washington, London, and Brussels at the time.

This changed drastically when Evo Morales won the national elections in 2005. A major achievement of his government was the drafting of a new constitution in 2008/9. It enshrines the rights of the indigenous people by declaring Bolivia a pluri-national state, and it lays the foundations for a more interventionist role of the state in the economy. Much legislative action in recent years was driven by the need to update Bolivia's laws in order to bring them in line with the philosophy underlying its new constitution. Among them, the FSL of 2013 presents significant changes from its predecessor. It emphasizes the social role of financial services in the country, including universal access and support for integral development. The role of the state is that of the 'rector of the financial system', an entity that participates actively and directly in the design and implementation of measures to improve and promote financing within the productive sector, in order to support productive transformation, employment creation, and equitable income distribution (Estado Plurinacional de Bolivia, 2013a, paras. 7, 94).

It is puzzling that a government with a heterodox economic outlook and a clear domestic orientation would be a major champion of Basel standards. In fact, we are not aware of any other jurisdiction that combines ambitious Basel adoption and financial interventionism to the extent Bolivia does.

In line with what would be expected from a left-wing government, the Morales administration did regard Basel standards as a market-indulging policy recipe of neoliberal extraction, at least initially. When the new government took power in January 2006, the Superintendency had just implemented the novel Basel II Standard Approach to credit risk. Moreover, the agency had created an office dedicated to full Basel II implementation, building regulatory capacity in order to assess and authorize the use of internal ratings-based models in the near future. However, interview partners recall that such implementation efforts stalled as soon as the Morales government took power.[1]

In spite of the political U-turn that the rise of Evo Morales engendered, the Superintendency remained outward-oriented. The agency did not take any further steps towards Basel II implementation, but it continued to engage with regulators abroad in consultation and technical training. Bolivia's financial regulator is a member of the Latin American Banking Supervisory network, ASBA. Crucially, ASBA is a hemispheric rather than a regional organization, and its forty-one member agencies include the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC) (all US agencies), and the Central Bank of Spain. These regulatory agencies from the US and Spain host frequent workshops under the ASBA Continental Training Program, which brings together banking regulators for seminars on topics such

[1] Interviews with regulators (former and current), La Paz, 15 and 22 March 2017.

as risk and liquidity management, banking resolution, stress testing, and Pillar II supervisory practices (ASBA, 2017).

Technocratic networks that involve US-trained experts have played an important role throughout modern Latin American history. In the 1920s, a commission led by Princeton Economist Edwin Kemmerer advised several Andean countries on financial institution reform. Bolivia is among the 'Kemmerized countries', and traces of the 'money doctor's' reforms can still be found today (Drake, 1989). From the 1970s onwards, the 'Chicago Boys' and other technocratic networks played a crucial role in designing and implementing neoliberal reforms in several Latin American countries, in addition to and beyond the structural adjustment programmes of the World Bank and the IMF (Centeno and Silva, 1998; Teichman, 2001).

In the world of financial regulation, ASBA has arguably played an important role in dispensing technical knowledge and enthusiasm for Basel standards across Latin America. When the Basel-based Financial Stability Institute conducted a survey in July 2004, only a month after the finalization of Basel II, regulators in 70 per cent of respondent countries expressed their willingness to implement the new standard domestically within three to five years (FSI, 2004).

Even though the Morales administration did not champion Basel II implementation, the Superintendency continued to engage in technical upgrades, following international best practices. An ASBA report from 2008 shows, for example, that Bolivia is a leading jurisdiction in credit risk management in the region, having developed an advanced portfolio classification scheme that lays the foundation for internal ratings-based approaches (ASBA, 2008, p. 17f).

The organizational shift from the Superintendency to the ASFI as the central financial authority in 2009 is not associated with significant changes to the professional identity and transnational embeddedness of regulators in Bolivia. Interview partners recall that at the height of the GFC in 2009, ASFI leadership called the validity of Basel standards into question.[2] But regulators soon returned to a pro-Basel stance, and the 2011 FSAP commended the ASFI for 'aligning its regulatory and supervisory framework with international standards' (IMF and World Bank, 2012, p. 21).

In 2011, Bolivia's Ministry of the Economy and Public Finances decided to develop a new law to govern the financial services sector in congruence with the novel constitution. It awarded a consultancy for drafting the outlines of the new legal framework to a former top regulator with a career in the ASFI and the central bank. A technocrat by training rather than a politician, the consultant incorporated the entirety of the prudential regulatory provisions that make Bolivia a high adopter of Basel II and Basel III today. His decision was driven

[2] Interview with former regulator, La Paz, 13 March 2017.

less by strategic considerations of signalling to foreign investors or domestic stakeholders and more by a genuine conviction that Basel banking standards represent the best approach to safeguarding a banking system, whether in advanced or developing economies.[3] A Bolivian regulator interviewee employed a nautical metaphor to express this consensus among his peers, asserting that 'for us regulators Basel is the North'.[4]

The law retains many elements of the draft written by the consultant regulator. In particular, all references to Basel and the unusual stipulation of risk weights remained unchanged. Interview partners in Bolivia advanced different reasons for this phenomenon. Some argued that regulatory provisions stayed intact because legislators and ministerial staff lack the technical capacity to fully understand them.[5]

Other respondents asserted that the government welcomed the adoption of sophisticated Basel elements because it would signal a commitment to financial stability. Key officials in the Morales administration arguably felt the need to engage in such signalling because several stakeholders openly criticized the interventionist measures contained in the FSL.[6] As indicated in the section above, the law includes provisions for interest rate caps and directed lending to certain sectors of the economy—measures that are uncommon in market economies. Economic actors from within the country and abroad voiced their scepticism. For example, a global credit ratings agency stated that 'the regulator's focus has shifted somewhat to support social and developmental policies rather than ensuring the financial system's stability' (S&P Global Ratings, 2016, p. 9). For the same reasons, another ratings agency changed the outlook for the Bolivian banking system to negative (Mendoza, 2014). Even the Confederation of Private Entrepreneurs of Bolivia, some of whose members do benefit from the above measures, criticized the law for leading to inefficient capital allocation, concentration risk, and financial fragility (CEPB, 2013).

The relationship between Bolivia's government and the Bretton Woods Institutions has been tense in recent years. Along with several of his peers in the region, President Morales has denounced the IMF in particular for imposing a neoliberal agenda onto developing countries. For years, Bolivian authorities have publicly rejected IMF concerns and any criticism of domestic economic policies. Article IV Consultations continue in all regularity but appear to be rather acrimonious exercises. In the latest such consultation, the Bolivian government

[3] Interview with former regulator, La Paz, 20 March 2017.

[4] Interview with former regulator, La Paz, 20 March 2017.

[5] Interviews with former regulators and private sector representatives, La Paz, 13 and 20 March 2017, and via Skype, 30 October 2017.

[6] Interviews with current and former government officials, current regulators, La Paz, 17 and 22 March 2017, and via Skype, 2 and 11 April 2017.

'questioned if the IMF should make policy recommendations for Bolivia' at all (IMF, 2016, p. 19).

In turn, the World Bank and the IMF have expressed concerns regarding the interventionist measures of the FSL (World Bank, 2011). The IMF in particular has suggested Bolivia's prudential and development policies are a zero-sum game where state intervention for social purposes is creating market distortions that inevitably contribute to financial fragility (IMF, 2016, 2015, 2014). The last FSAP of 2011 encouraged Bolivian financial authorities to strengthen risk-based supervision, but the report refrained from recommending the adoption of Basel II or III provisions (IMF and World Bank, 2012). However, both the World Bank and the IMF have welcomed the prudential regulatory provisions of the new law (Heng, 2015).

Even though foreign and even domestic investors have played a subdued role in Bolivia's political economy to date, the government was not completely oblivious to their concerns. After governing Bolivia for almost a decade and successfully steering the country through the GFC, the Morales administration had established a track record that made it much less vulnerable to shifts in investor sentiment than Brazil's Luiz Inácio Lula da Silva upon taking office in 2003, for example. Nevertheless, the imprimatur of Basel may have helped to allay concerns that the Morales administration would embark on a path of financial populism with the FSL.

Market actors have been neither champions nor opponents of the Basel components that are currently in force. Bolivia's financial services sector is domestically oriented and not concerned with the reputational benefits of a regulatory upgrade to the more complex elements of Basel II and III. Conversations with banks' risk managers reveal that Bolivia's banks do not associate an upgrade to internal ratings-based models with higher profitability or any other competitive advantage.[7] Moreover, they do not keep separate loan and trading books. In interviews, regulators refer to such low complexity of bank operations as the main reason why Basel II rules on market risk do not need to be written in yet.[8] Adjustment costs to the prudential regulatory provisions of the FSL have been negligible to date. The new law retains the pre-existing capital adequacy ratio requirement of 10 per cent (above Basel standards). It adopts the stringent capital definition of Basel III, but this change barely affects banks because most of their Tier 1 capital is composed of equity and retained earnings (Galindo et al., 2011). Domestic banks did voice opposition to the interventionist elements of the FSL, but their weak political position did not allow them to exert any significant influence in the development of the legal text.[9]

[7] Interviews with senior bank officials, La Paz, 14 and 23 March 2017.

[8] Interviews with regulators, La Paz, 21 March 2017.

[9] Interview with senior bank official, La Paz, 23 March, and government officials, La Paz, 14 March, and via Skype, 11 April 2017.

Foreign banks play a marginal role in the domestic market. Two of them are state-owned with headquarters in Brazil and Argentina, respectively. Their business model revolves around serving home country clients in their business in the neighbouring country, and neither has plans to expand towards a significant Bolivian customer base. Because they are headquartered in jurisdictions that are members of the Basel Committee, they are subject to consolidated supervision under Basel III. But again, Bolivia does not feature prominently in their banking business, and lobbying for Basel III implementation in the country would not significantly change their competitive position. Foreign banks have thus been indifferent towards Basel adoption in Bolivia, but it is noteworthy that they did not object to the interventionist measures of the FSL such as the interest rate caps and directed lending. During the period in which Bolivian lawmakers developed the FSL, both Argentina and Brazil were ruled by left-wing governments that shared a critical attitude vis-à-vis neoliberal policies and an affinity for a developmentalist economic model with the Morales administration. Unlike their domestic private peers, the state-owned foreign banks thus did not voice opposition to any element of the FSL.

Furthermore, a look at the balance sheet of Bolivian banks reveals that the sector is relatively self-contained. The large universal banks do not tend to rely on cross-border funding, and the banking sector as a whole is in a net creditor position (S&P Global Ratings, 2016). Foreign investors do play a role in the provision of capital for microfinance institutions, including NGOs. But the transparency and risk management expectations these actors bring to the table bear only a tenuous relationship with Basel banking standards, chiefly because of significant differences in risk management technology between commercial banks and microfinance institutions.

For decades, Bolivia's banking system was vulnerable to volatility in foreign capital markets because a large portion of both its deposits and loans were denominated in US dollars. Macroeconomic instability in general and the hyperinflationary period of the mid-1980s had undermined citizens' trust in the local currency. However, over the last decade financial authorities have instituted a series of policies to de-dollarize the financial sector. The central bank raised reserve requirements for dollar-denominated deposits by a factor of three. Furthermore, the de facto peg to the dollar from 2006 onwards, along with consistently low inflation rates, has boosted public confidence in the boliviano as a store of value. Consequently, the share of dollar-denominated deposits fell from 94 per cent in 2002 to 15.6 per cent by 2016, with dollar loans experiencing a fall from 97 per cent to 3 per cent in the same period (IMF, 2016; S&P Global Ratings, 2016).

Domestic regulators have played an important role in adopting foreign rules at home, a process Dolowitz and Marsh (2000) call policy transfer. Yet the FSL is not merely an instance of policy transfer by technocrats embedded in transnational

regulatory networks. Rather, its peculiar grafting of interventionist policies on prudential regulatory provisions represents a departure from the conservative, prudential approach of Basel. Inherent in this policy innovation is the recognition that the Basel Committee has a mandate to maximize the resilience of the banking sector among its overwhelmingly high-income member jurisdictions, and little incentive to take low-income country prerogatives into account (BCBS, 2013; Jones and Knaack, 2019). In interviews, Bolivian regulators have confirmed that they do not expect Basel standards to foster inclusive financial development in their country.[10] For example, SME and lower-income households are key actors in economic development, yet their access to credit in developing countries is severely constrained. This is because they represent relatively high-risk clients, especially in countries with deficiencies in collateral markets and the rule of law. Under these conditions, it is prudent for banks to minimize their exposure to this market segment and focus on large companies and government securities instead. A policy framework that addresses this issue with interventionist measures, while safeguarding prudential supervision, can be understood as an innovative departure from global best practices, rather than an incomplete policy transfer.

Even though legislators and ministerial officials did not alter Basel provisions, political involvement and modification led to unintended consequences in the application of the interventionist measures of the law. The lending quotas and interest rates set by the Executive branch have been effective in channelling bank loans to the so-called productive sector (Estado Plurinacional de Bolivia, 2014, 2013b). However, the majority of businesses in the Bolivian economy are small or even micro-enterprises in the commercial and services sector. In line with the law and the decrees that specify it, microcredit to such 'un-productive' sectors is discouraged by the lending quota and the interest rate caps that financial institutions must meet (Ekka et al., 2010; Heng, 2015; Moody's Global Credit Research, 2013) (Figure 10.5).

As a consequence, credit to SMEs has stagnated, and microcredit lenders have reduced their client base since 2015 (ASOBAN, 2017, 2015; ASOFIN, 2017; ICBE Data, 2014). This reduction in financial inclusion is at odds with a financial services law that is explicitly designed to 'promote integral development', 'facilitate universal access to financial services', and 'assure the continuity of the services offered' (Estado Plurinacional de Bolivia, 2013a, para. 4). In order to address the unintended consequences of this market intervention, regulators could adjust the current lending quotas and interest rate caps, at least in principle. The draft provisions of the FSL envisioned these parameters to be set by the central bank. Such decisions could thus be taken with a certain degree of isolation from the political process, according to technocratic principles. However, ministerial intervention in the development of the law transferred the authority to change these key prices to the newly created Financial Stability Council (FSC), an organ of high political

[10] Interview, current regulators, La Paz, 21 March 2017.

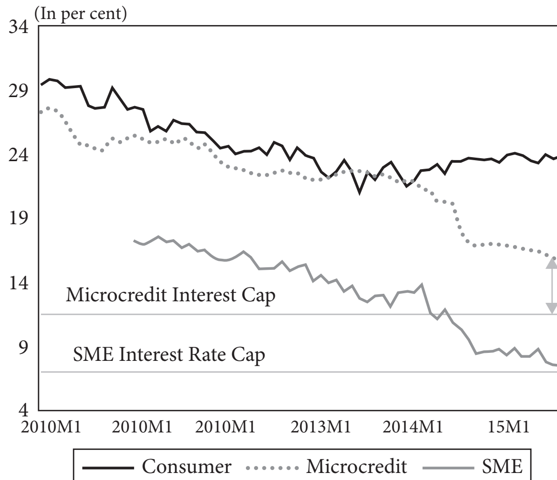

Figure 10.5 Bolivia: interest rate caps.
Source: Heng (2015)

visibility. Its decisions are subject to scrutiny by the population in ways that may be counter-productive. For example, a rise in the interest rate cap for microcredit to productive sectors from 11.5 per cent to 18 per cent may help sustain the business model of microfinance institutions and support financial inclusion, but could be interpreted by the opposition as a 'sell-out to the banks'. Even though the FSC can adjust rates and lending targets at each of its quarterly meetings, it has not changed them once in its two years of operation (Figure 10.6).

In sum, Basel adoption in Bolivia's FSL can be understood as a largely regulator-driven process. Market actors lack external incentives to champion any ambitious adoption of the Basel standards. Similarly, the country's governing elite are domestically oriented. They devised the FSL to implement interventionist financial policies that are designed to foster economic development and financial inclusion. Further, the government is no supporter of advanced Basel II and III implementation. Rather, and to the extent that they were actually capable of a full technical appraisal, lawmakers may have retained the more sophisticated Basel components in the legal text as a signal of prudential integrity to stakeholders who criticized the interventionist measures of the law. The divergence between the provisions of global banking standards in the FSL and the apathy of domestic actors has therefore created an implementation gap, which remains wide because of both demand and supply constraints: market actors show little need for the use of advanced risk models. Interview partners also pointed out that the ASFI currently lacks the regulatory capacity to assess and approve internal ratings-based models.[11]

[11] Interviews with former regulator and senior bank officials, La Paz, 13, 21, and 23 March 2017.

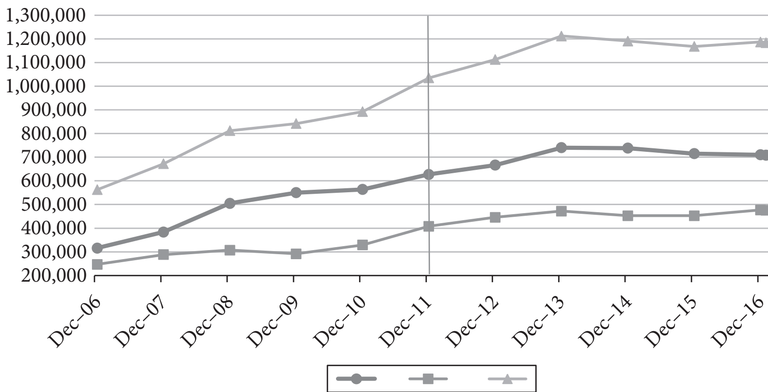

Figure 10.6 Bolivia: number of borrowers, small and microcredit institutions.

Note: ASOFIN: Association of Microfinance Entities (Asociación de Entidades Financieras Especializadas en Micro Finanzas de Bolivia); FINRURAL: Association of Development Finance Institutions (Asociación de Instituciones Financieras de Desarrollo)

Sources: ASFI, ASOFIN, FINRURAL

In its combination of prudential and interventionist measures, the Bolivian approach to financial regulation deviates from global 'best practices'. It incorporates the policy goal of inclusive financial development that is of utter relevance for developing countries but not for the Basel Committee. Some observers would doubt that Basel II and III are supportive of or even compatible with the financial policies of a developmental state. The Bolivian experiment seeks to chart a new path of combining both, which will inform this debate. There are early indications that the FSL entails unintended negative consequences for financial inclusion, but this outcome would be attributable to the institutional setup of interventionist policies, not the Basel standards.

Conclusion

The Bolivian case can be understood as an instance of regulator-driven convergence on international standards. The analysis highlights the active role of technocrats in international policy transfer. Even when banking regulators have no direct contact with the Basel Committee, they are embedded in transnational networks, updating their knowledge of global standards through conferences and technical training courses organized by regional organizations or Basel member agencies. This study also lends empirical support to the conjecture that a gap between de jure adoption and de facto implementation opens when Basel standards do not have domestic champions. As long as neither the government nor market actors see much benefit to incorporating the more sophisticated components of Basel II and III, implementation is likely to remain highly selective.

It would be a mistake, however, to interpret the gap between the number of Basel components in the legal framework and the ones in force as an instance of mock compliance. Walter (2008, p. 32f) states that mock compliance occurs when two conditions are met: signalling compliance and substantive non-compliance. In the Bolivian case, there is no evidence for substantial non-compliance with the standard approach to Basel II. The ASFI has shown no signs of regulatory forbearance to date, although the stringency of supervision, especially of state-owned Banco Union, certainly deserves the attention of analysts in the future.

Rather than mock compliance, Bolivia's implementation gap may be understood as a strategic device with two potential purposes. First, it could serve as a non-costly signal of regulatory stringency and sophistication. The reputational benefits of an ambitious adoption may materialize even when Basel II and III rules are not in force (yet). Second, an encompassing adoption of Basel II and III components may influence the relationship between the government and the regulatory agency. Because legal changes are cumbersome and subject to political negotiations, regulators may consider it advantageous to grant themselves considerable room for manoeuvre to implement individual Basel components as they see fit, without having to consult lawmakers.

Further research is needed to assess the plausibility and effectiveness of either strategy. In addition, more work is necessary to identify the conditions under which the prudential standards of Basel II and III are compatible with interventionist policies designed to promote inclusive financial development, as they appear to be in the Bolivian case to date.

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