

Review Article

Strategies to Increase the Value of Foreign Direct Investment in Bolivia

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Abstract

Investment plays a crucial role in the growth and development of any nation. Unfortunately, Bolivia faces a challenge with a low level of net foreign direct investment (FDI) compared to neighboring countries. According to data from the Ministry of Economics and Public Finances (MEFP), Bolivia has attracted minimal foreign direct investment in recent years. In response to this situation, the Bolivian government has resorted to public spending to stabilize the Gross Domestic Product. However, this approach is becoming increasingly difficult with time. To improve the economic landscape, it is essential to promote and attract both domestic and foreign investment. This study employs a mixed-methods approach, combining quantitative and qualitative research. A literature review explores the underlying causes of Bolivia's investment challenges, while existing data is analyzed to examine the trends in FDI within the country. Additionally, interviews with experts have been conducted to identify potential strategies to enhance investment opportunities. The findings indicate that it is crucial to provide stability and security for investors. Contracts should incorporate specific clauses that safeguard against nationalization. Foreign investors need to feel assured and confident that their companies will not be subject to nationalization, potentially supported by international law. Furthermore, the tax system must distinguish between domestic and foreign entities. Experts suggest that offering greater incentives to foreign investors, such as reducing corporate tax rates, could enable these companies to enhance their profitability.

Keywords

Economic Growth, Foreign Direct Investment, Fiscal Deficit

1. Introduction

Investment is a vital driver for a country's growth and development as it significantly enhances productivity capacity. It has the potential to propel the economy forward by improving employment rates, increasing income levels, enhancing financial stability, boosting tax revenue, and raising the overall living standards of the population [2]. However, Bolivia faces challenges due to its low levels of foreign direct investment (FDI), and investment in Bolivia is usually focused on natural resources. Sectors such as mining and oil

extraction require substantial initial capital for exploration, infrastructure development, and operational activities [17]. Unfortunately, many developing nations, including Bolivia, often lack the financial resources necessary to support such extensive projects. Consequently, they turn to foreign investors for the essential funding needed to advance these initiatives [2].

Numerous studies have highlighted the low levels of FDI in Bolivia, identifying key issues such as economic and political

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instability, nationalization policies, inadequate judicial protection, bureaucratic obstacles, corruption, and a lack of transparency. However, these studies typically fall short of providing viable solutions to these challenges. Profit-seeking foreign investors require security, transparency and incentives, which can take various forms. Addressing these concerns and applying the right strategies could create a more favorable environment for investment in Bolivia [11].

2. Methodology

This research utilizes quantitative and qualitative methodology. Existing data related to foreign direct investment is analyzed; additionally, a bibliographic review is conducted along with interviews with experts to understand the current situation Bolivia is facing and to propose solutions in the form of strategies to increase the values of foreign direct investment.

3. Results

There are several theories that support that foreign direct investment drives the economic growth of a country. On one hand, there is the neoclassical theory of economic growth based on the seminal model of Solow; this theory supports a positive effect of foreign investment on the economy [17].

The second theory is the endogenous growth theory proposed by Paul Romer in 1986; this theory modifies some assumptions of the neoclassicals; for example, it replaces the assumption of constant returns with increasing returns due to cumulative factors; it considers that the production function depends mainly on development research and the accumulation of human capital; with the aforementioned arguments, foreign investment has positive effects on the economy

through the accumulation of knowledge or learning, learning by doing or observing, which are considered within the production function [15, 16].

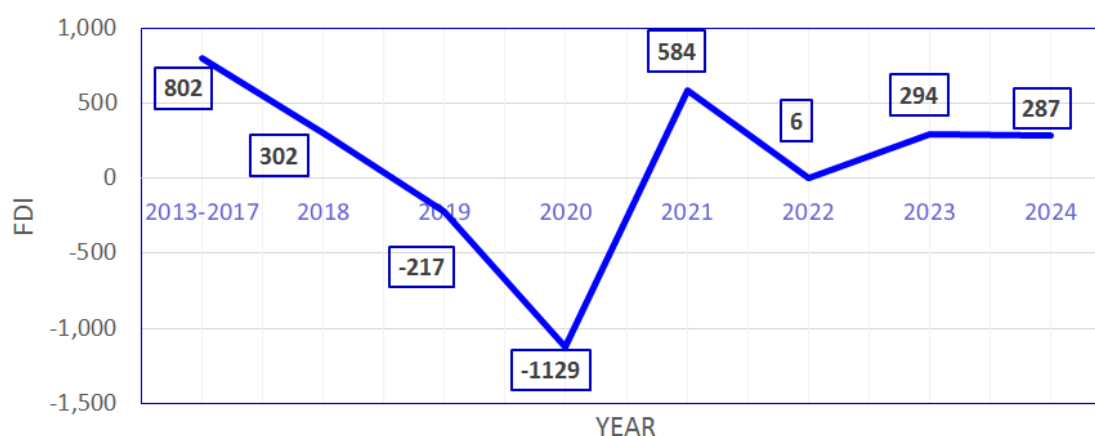
Other versions, such as the new Keynesians (NEK) or also called the new neoclassical synthesis focus its analysis on the model (IS-LM) proposed by John Hicks in 1937; the contribution of this theory lies in the expansion of the model (IS-LM) for an open economy.

On the other hand, Kaldor in 1966 stated that the dynamism of economic activity is determined by trade balance, arguing that the exchange of goods between countries depends on external demand and the reduction of costs; this theory relates economic activity to technological diffusion and resembles the guidelines of the endogenous theory [15].

FDI is generally believed to promote economic growth in the recipient country by increasing global investment and improving efficiency through the introduction of new technology and better management practices [5].

3.1. Current Situation of Foreign Direct Investments in Bolivia

If Bolivia does not create the conditions that allow foreign direct investment, economic growth may be seriously affected. Until a few years ago, Bolivian economy was stable; this was due to the economic model Bolivia utilizes, in which public spending plays an important role. However, the revenue the State gets has lessened due to a lot of variables making it difficult to keep the stability of the country. Central government spending remains at high levels in the face of falling revenues. Furthermore, some public investment projects are sources of inefficiency. Figure 1 shows the evolution of Foreign Direct Investment in Bolivia these last years [11].



Source: Ministry of Economics and Public Finance, 2023.

Figure 1. Development of foreign investment in Bolivia in Millions of Dollars.

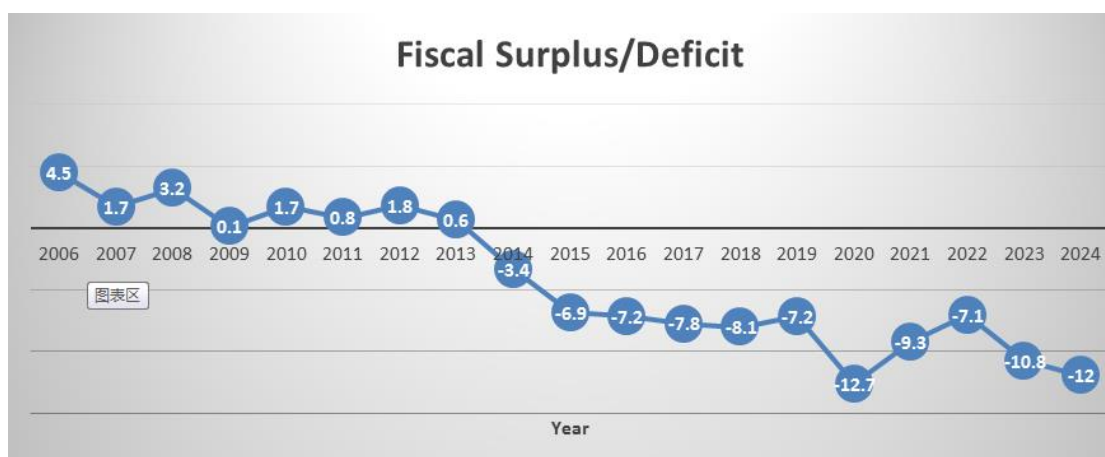
In 2020, foreign investment in Bolivia reached -1,129 million dollars, the lowest value ever; in 2021, it reached 584

million dollars; in 2022 FDI only reached 6 million dollars and in 2023, it reached 294 million dollars, and in 2024, foreign investment reached 287 million dollars. Compared to other countries in Latin America, Bolivia is one the countries that attracts minimal FDI [9].

Being a country rich in natural resources, with all climates and ecological floors, enormous reserves of minerals, hydrocarbons, fresh water, forests, fertile lands, Bolivia should attract a lot of foreign direct investment, but the statistics show the opposite. Being a country with resources does not always guarantee that investment will take place. Some researchers call the resources curse [1, 3, 9].

To battle against the consequences of minimal foreign investment, Bolivia's government does a lot of public spending, but this is a heavy burden for the state. In addition, spending has been increasing these last years; a country that spends more than it gets, and that resorts to loans to cover its debts, no matter how good the intentions, generates a great imbalance in the economy of the country in question [11].

At the end of 2024, the fiscal deficit was -12% of the Gross Domestic Product (GDP) as shown in Figure 2, an indicator that demonstrates the lack of recovery of the economy these last years.



Source: Ministry of Economy and Public Finance, 2024.

Figure 2. Evolution of the fiscal surplus or deficit of Bolivia, 2000-2024.

3.2. Variables that Affect Foreign Direct Investment

Foreign investors consider a wide range of variables before investing, the most important of which are: economic, political, legal stability, security, market size, good infrastructure, low costs of labor and inputs, and incentives. Foreign Direct Investment depends mostly on the variables shown in the following figure [4, 10].

However, there are many types of foreign investors, some prefer natural resources, while others are in search of bigger markets, or are trying to lower production costs or acquire companies with technology and brands [7].

Depending on the type of foreign investment a country is trying to attract, incentives should be worked out. Mostly Bolivia tries to attract FDI in search of natural resources. In Bolivia, natural resources are abundant but political stability, security and incentives are lacking [10].

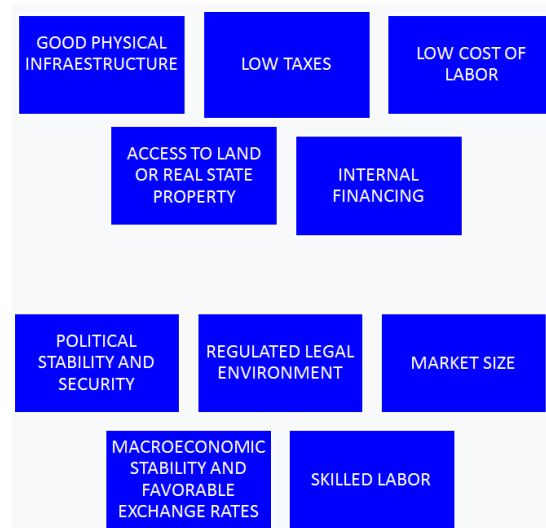


Figure 3. Variables that influence Foreign Direct Investment.

Source: Adapted from The Global Competitiveness Investment Report (2019-2020).

Table 1. Motivation according to the type of foreign investors.

Motivation to Invest	Investment effect
FDI in search of natural resources enters the country to exploit locally available natural resources [1].	It leads to the export of natural resources or products based on natural resources [1].
Market-seeking FDI enters the country to gain access to domestic markets.	Leads to national sales of final products. to consumers or intermediaries for companies [19].
FDI in search of strategic assets enters the country to improve the capabilities of the investing company, acquiring a firm with technology and brands that have a competitive advantage.	It leads to the sale of final goods in the country of origin and third parties.
FDI in search of efficiency enters the country to save costs in international production networks (relocation) [10].	It leads to the import of intermediate goods and the export of final or intermediate products.

Source: Extracted from Dunning and Lundan (2008).

As shown in Table 1 and Table 2, foreign direct investors have different motivations when investing. This must be considered to decide the incentives to use to attract a type of investor to the country. The rationale for investment policy must be addressed considering this type of investor. Companies involved in foreign direct investment in search of natural resources value political stability, security and incentives more

than investors with other types of motivations according to experts. Resource-focused foreign direct investment entails purchasing or managing assets in industries like mining, oil, gas, and agriculture that leads to exports. This type of investor is not very interested in market size or technological advancements or brands in the recipient countries. [20].

Table 2. Motivation for foreign investors.

Access new markets or clients
Lower production costs or establish a new export base.
Coordinate the company's value chain, such as being closer to suppliers
Acquire another firm that provides the Company with new technologies or brands
Access natural resources and raw materials, such as oil, gas, or agricultural products

Source: Adapted from Global Investment Competitiveness Report (2017-2018).

3.2.1. How Taxes Affect Foreign Direct Investment Levels

One of the motivations that foreign investors have according to Dunning and Lundan, (2008) is the search for profits. The tax burden is a variable that plays a very important role when deciding where to invest. Investors frequently perceive Bolivia's tax system as intricate and difficult to maneuver [10]. The high tax rates, coupled with extensive

bureaucratic requirements, can pose significant obstacles for foreign businesses, raising concerns about the overall ease of conducting business in the country. There are increasing concerns about the transparency of tax regulations and their enforcement. Many investors may struggle to fully grasp their tax obligations, potentially resulting in compliance challenges and heightened operational risks. As shown in table 3, tax incentives can vary in form, therefore Bolivia must decide which incentives to use [10].

Table 3. Most Important tax incentives for Foreign Investors.

1	Reduced Corporate Income Tax	Reduced rates can be attractive [14].
2	Tax Holidays	Temporary exemptions can be particularly attractive.
3	Import Duty Exemptions or Reductions	Exemptions or reductions on import duties for capital equipment, raw materials and

		semi-finished components.
4	Investment Tax Credits	These credits allow companies to deduct a portion of their investment costs from their tax liability.
5	Accelerated Depreciation	Allowing companies to depreciate assets more quickly can reduce taxable income in the early years of investment.
6	Location- Based Incentives	Special economic zones and other designated should have enhanced tax incentives.
7	Sector-Specific Investments	Incentives targeted at specific sectors can encourage investment in strategic areas. [19].
8	Reinvestment Incentives	Offer tax benefits for reinvested profits [20].

Source: Adapted from the Report of Global Investment Competitiveness (2019-2020).

3.2.2. Variables that Affect the Low Level of Foreign Direct Investment in Bolivia and Alternative Solutions

The stability of a country cannot depend only on public spending, foreign direct investment can complement it by further feeding the productive apparatus and generating more economic development. To attract foreign direct investment, Bolivia needs to increase political stability and transmit security to foreign investors. Through its history, Bolivia has nationalized companies a few times, taking control of all the assets the private companies held. Foreign companies want to minimize this risk; thus, Bolivia needs to work out contracts that are reliable and prevent expropriation. In addition, the tax system needs improvement, since it is currently challenging. The tax system in Bolivia has a high compliance burden, high complexity and multiple taxes; it is administered by multiple levels of government and needs modernization. Taxes are necessary, but they can have a negative effect on fiscal accounts [12].

When the tax burden is high, there is a tendency not to pay

taxes. As the tax rate increases, the number of companies may decrease because they decide to work in the informal market or close the business completely. According to Laffer, whenever taxes increase, there are irrecoverable losses of efficiency. This also applies to FDI [6].

Hence, not every increase in tax rates contributes to increasing state revenue. When taxes are excessively high, individuals find less usefulness in their investments and jobs. In these cases, an increase in the tax rate would mean at some point a reduction in revenue. In the opposite case, a reduction in income tax rates incentivizes investors to climb in terms of investment. [6].

If, because of the tax increase, potential GDP falls relatively more than the tax rate increases, then revenue will be reduced; in turn, if, because of a tax cut, potential GDP increases relatively more than the tax rate falls, then revenue will increase.

Strategies must be put into action to solve the low levels Foreign Direct Investment in Bolivia. According to the experts' interview, the following strategies must be taken into account to attract more Foreign Direct Investment (FDI):

Table 4. Strategies to attract foreign direct investment.

New Investment Promotions	Transparency in the contracts, reducing the fear of volatile nationalization or expropriations with the use of specific clauses in the contracts or the use of warranty slips to reassure investors [8].
	Freezing Clauses (Exempt investments from new laws).
	Equilibrium Clauses (Compensate for financial losses due to regulatory changes).
	Hybrid Clauses (Combine freezing and equilibrium clauses).
	Expropriation Clauses.
	Issue Linkage to Bilateral Relations (Linking contracts to broader bilateral relations between and home countries) [7].
Set up an Investment Promotion Agency	An Easy tax system to work with and to understand.
	Tax Incentives, Foreign investors should have incentives such as lower taxes and other specific investments for large investments.
	Target suitable foreign Investors and provide customized assistance including legal, tax and market advice; link them to the areas they are interests in.
	Provide information to investors and learn about the investor's requirements. The Agency works as a link to transfer information smoothly from investors to the State and vice versa. In addition, it should engage in after

	investment care and the potential for reinvestments.
	Identify sectors and activities where the State requires investment to drive economic growth.
Targeting Sectors or activities.	Offer tax, legal and trade benefits [18].
	Infrastructure Improvements and market access facilitations.
	Provide fiscal benefits
	Improve roads, energy, water distribution and telecommunications to facilitate interactions between local and foreign firms.
Encourage spillover from FDI into the economy	Attract specific types of foreign firms that are likely to create spillovers [13].
	Encourage backward and forward linkages by supporting local firms to become suppliers or buyers from foreign firms.
	Align Business Strategies with national interests.

Source: Own elaboration with Interview Information and Literature Review

4. Conclusion

Bolivia is a country with a lot of natural resources however it suffers from low levels of foreign direct investment. If Bolivia wants to increase foreign direct investment, it should consider which types of investment fit well with the country and all the variables that affect decision making when companies choose a country where to introduce foreign capital.

The types of investors; the motivations of investors are different, some are looking for a bigger market, others want to take advantage of low production costs, others are looking for technological advancements and brands, and others are looking for natural resources. When foreign investment is destined for natural resources most investors look for political stability, security, and tax incentives. To increase security for foreign investors, contracts with investors must be backed up by treaties to guarantee protection against expropriation. In addition, different tax incentives can be offered depending on the activity, area, and place. In this context, a lot of uncertainty arises regarding fiscal accounts when it comes to reducing taxes or offering incentives. With the proper incentives, the number of domestic and foreign companies might be higher, and the revenue might be the same or perhaps higher in the long term, and the GDP index will grow, and the unemployment rate will be lower. Additionally, other benefits will manifest such as a reduction in tax evasion and less corruption in the procedures related.

Abbreviations

GDP	Gross Domestic Product
FDI	Foreign Direct Investment

Author Contributions

Yoshida Gonzales: Conceptualization, Data curation, Analysis, Funding acquisition, Investigation, Methodology, Project administration, review & editing

Matias Rasmussen Gómez: Conceptualization, Investigation, Project administration, review & editing

Conflicts of Interest

The authors declare no conflicts of interest.

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