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Lessons from Colombian Economic Development

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Discussion Draft

2009 Latin America
Emerging Markets Forum

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March, 2009

Abstract

Colombia is an interesting case study within emerging countries. Through 150 years of democratic tradition and seven decades of sound fiscal and monetary policies, the country has displayed institutional strength and economic growth, in spite of strong external shocks, rent-seeking by sectoral business confederations, and, recently, narco-traffickers and guerrillas. Reforms made during the nineties, just as in other Latin American nations, did not result in the expected take-off in growth. In Colombia, the reason lies partly in the consequences of discovering considerable oil reserves, the escalation of the internal conflict, the fiscal consequences of the 1991 Constitution and huge fiscal commitments related to pensions and social expenditure. In the last decade Colombia has made vast progress in invigorating the sources of economic growth, improving welfare of the poorest strata of population and reinstating the rule of law across the country. The current international crisis poses a considerable challenge in terms of growth and threatens social advancement achieved so far.

Key Words: Government, fiscal policies, national security and war, national budget, economic development, institutions and growth

JEL classification: H1, H3, H56, H6, O1, O2, O43

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Introduction

Latin America is a continent rich in natural resources. Ironically, this has been in part its curse, as it has: made the political economy harder to deal with; created stronger sectoral business confederations dedicated to rent-seeking and keeping; and, due to the dependency on commodities' exports, made the economy very vulnerable to international price shocks. Economic and social tensions, resulting from strong cyclical fluctuations have been accompanied by political swings between weak democracies and dictatorships. Colombia is an interesting case study as it has dealt with these issues through 150 years of a democratic tradition. The proposition of this paper is that Colombia is actually quite an interesting case study for emerging countries, owing to both its achievements and its mistakes during the last few decades. Four main features support this argument.

Firstly, two decades ago Colombia achieved the dubious honor of being the number one world producer and exporter of cocaine. This phenomenon presents truly enormous institutional challenges concerning international pressure, delinquency, corruption, illegal capital inflows and money laundering, as well as military involvement in the war on drugs. The country has been quite creative in handling its long internal conflict and, in spite of it, has achieved considerable advances in terms of social and economic goals.

Secondly, a drastic change of strategy at the beginning of this century yielded substantial positive results against left-wing guerrillas and narco-trafficking.

Thirdly, Colombia exhibited positive economic growth and sound fiscal and monetary management over seven decades, which is remarkable in the light of 20th century Latin American history as a whole. However, its trajectory seems to indicate that its rulers and policy-makers chose a 'low risk–low return' path of social and economic development. As a result, the country did not experience sharp falls in gross domestic product (GDP) for most of the century, but neither did it produce an economic miracle. Hence, an interesting list of do's and don'ts emerges from its development path.

Fourthly, in the middle of the 1980s this nation embarked on an ambitious reform agenda. However, Colombia's recent economic history does not have a foundational period at the end of the 1960s, from which most of the institutional design and economic management derived. In Colombia, authorities responded to three identifiable bust and boom cycles, which were linked to the world economic cycles (1966-1981, 1982-1994, 1995-2008).The reform agenda included:

1. A broadened political base for its democratic system, with elections of municipal mayors and provincial governors
2. A new political constitution granting greater access to social rights
3. A deeper fiscal decentralization, with substantial transfers to the regions
4. The pursuit of the so-called neo-liberal agenda, i.e. the Washington Consensus, for the short run, and macroeconomic policies plus a multilateral reform inventory for the long run, including:

- Pension reform
- Increased labor code flexibility
- Health and education reform
- The privatization of public utilities and estate-owned enterprises
- Physical infrastructure concessions
- Financial-system and foreign-exchange liberalization

In most cases poor economic performance was the motivation for structural reforms, indicating that the dominant development model was inappropriate. Between 1966 and 1981, it was the failure of the import-substitution regime and international shocks (coffee price fluctuations). Sudden drops in foreign exchange availability triggered economic crises, which created the urgency to diversify exports and enhance competitiveness, in sectors different from existing ones.

Steiner and Edwards[1] point out that unlike many reforms, president Gaviria's reforms at the beginning of the 1990s did not arise from an economic crisis. In fact, by 1988 the peso was stronger, international reserves had increased and the government had adjusted and achieved fiscal equilibrium (albeit temporarily). The reforms and constitution of 1991 were triggered by two events: peace agreements with guerrillas supported the feeling that the country needed 'fairer' institutions; and recent oil discoveries made everyone believe that Colombia was now a rich country. This belief was reflected in the constitution with an increase in transfers to the regions and in large education and health budgets.

Between 1995 and 2008, the sense of urgency came from the challenge to the state by cocaine trafficking and the power of reinforced rural guerrillas. The economic crisis at the end of the 1990s also strengthened the consensus for economical reform and deployment of defense forces.

Wiesner[2] argues that one of the most important sources of reforms is the people's demand for them. He says: 'The lower (higher) the real political demand for macroeconomic stability the higher (lower) will be the transactions costs of coordination between fiscal and monetary policy and the less (more) macroeconomic stability will result.' However, demand for reforms is a function of the information available[3], 'information is the most binding political economy restriction. The strategy for policy reform and the development of the 'right' institutions has to focus on mitigating this restriction'.

However, just as in other Latin American nations, this agenda has not resulted in the expected take-off in growth. In Colombia, the reason lies partly in each of the following:

- The consequences of discovering considerable oil reserves
- The escalation of the internal conflict
- The fiscal consequences of points 1-4 above

This disappointment is analyzed in terms of the lessons it yields for reform in emerging countries. The paper discusses those features that helped Colombia to either achieve positive goals or make harmful mistakes. Not all of the good outcomes can be replicated elsewhere, but certainly some bad ones can be avoided by using precautionary strategies.

A short history of modern Colombia

Colombia is located at the northwestern corner of South America. Ever since colonial times, the most important sources of wealth have been agriculture, mining and commerce. The Spanish colonized the territory in the 16th century and installed social and political institutions – notably unequal wealth distribution – the legacy of which still resonates in Colombia today.[4] The independence achieved at the beginning of the

[1] Steiner and Edwards, 2008
[2] Wiesner, 2007. P. 27
[3] ibid: 25
[4] For a detailed look at the colonization of Colombia and its legacies, see Acemoglu, Johnson and Robinson 2001 and 2003; and Engerman and Sokoloff 1997 and 2002

19th century did not change such deeply ingrained values, but brought about internecine struggles for supremacy between domestic parties.

It was not until the beginning of the 20th century that the country's economy received a shock that changed things permanently. Colombia's peasant families created a stable export economy for coffee, which was in effect a surplus crop, and therefore immune to the fluctuations of the international price for the commodity. Then, a middle class of farmers was established. This group was able to accumulate capital, which subsequently supported commerce and industry. Additionally, the international shocks of the first half of the last century, namely the two world wars and the financial crisis of 1929, created the conditions for internal manufacturing development. At the same time, the urban population was increasing, in conformity with trends in developing countries everywhere.

The second half of the century witnessed a conscious policy of industrialization based on import substitution. This created incentives for small units of production in every city, of which Colombia has many. Goods were directed to small regional markets, with very limited economies of scale. The isolation from external competition created few incentives for technological innovation, hence labor and total factor productivity stagnated vis-à-vis international standards. Foreign direct investment (FDI) was concentrated in products that were oriented towards the domestic market and rarely exported.

Increasing demands for employment, social services, and infrastructure from the emerging urban population led to a broader involvement of the state. The government of the day subscribed to the mixed-economy model that resulted from the world capitalism-communism dichotomy of the 1950s and 1960s. Hence, state-owned enterprises provided public utilities and urban transportation, while mixed ownership firms spread across many sectors of economic activity.

At the time, political parties were dominated by exclusive white elites. Colombia adopted the typical technological and institutional advances of the era, such as labor legislation, universal suffrage, separation of the state from the church, and the spread of civil rights. However, the tradition of exclusion from the highest echelons of power caused resentment among a growing educated urban middle class. One response from the state to this issue was the creation of public employment that paralleled the increasing government involvement in many spheres of social life. This strategy was limited in scope by the typically low productivity of state jobs, and budgetary boundaries to public employment. Labor unions and political interests prolonged this status quo as much as they could, thereby increasing bureaucracy and inefficiency.

The private sector grew under the umbrella of coffee exports – the largest provider of foreign exchange and the source of capital for financial markets. During the 1950s and 1960s the economy grew steadily, boosted by the golden age of world capitalism. Although income distribution improved after the mid-1950s, the urban and rural dichotomy intensified, leading to massive migration to the cities. Slumps and poverty became part of urban life, but families experienced a generational improvement that served as an incentive to remain in the cities. The events of the last three decades will be surveyed in the following sections, where we elaborate on the lessons emerging countries could learn from the Colombian experience.

Since 1958 Colombia has been ruled by a 'system of coalition governments[5], by which the two traditional parties – the Liberals and the Conservatives – settled their deeper,

[5] See García and Jayasuriya 1997; Henderson 2006; and Posada 2006.

ideological differences and opted for a system of power-sharing in all spheres of the executive branch. According to Robinson and Mazzuca:

> the correlation between the emergence of order and the introduction of power-sharing institutions [was] not coincidental, but causal. Before 1905, institutions favoring power monopolization by a single party forced the opposition into revolutionary tactics and the government into violent repression, whereas starting in 1905 the emergence of institutions ensuring [each party] a share of political power roughly proportional to its electoral force allowed for a peaceful interaction between government and opposition. From the standpoint of power-sharing mechanisms, the key institutional change was the replacement in 1905 of majority rule by incomplete vote, a special kind of electoral system. Colombia in turn switched from incomplete vote to proportional representation in 1929.[6]

Negotiated in accordance with the electoral rules and the simultaneous participation of both parties in the executive branch, power-sharing gave peace to the country. When those mechanisms weakened as the defeated party lost its confidence in them, there was a switch of power from a five-decade-long conservative hegemony (1882–1930) to a new liberal one (1930–1946). The country swiftly returned to internal conflicts, as witnessed by a startling increase in the homicide rate. The combative state of affairs of the 1930s and 1940s worsened when the Conservatives returned to power in 1946 – particularly after the so-called Bogotazo, in which a prominent populist Liberal leader was assassinated. The inter-party equilibrium was restored in 1958 with the enactment of the Frente Nacional', a system that constitutionally established a four-year alternation of the presidency and power-sharing in the executive branch.

Although the alternation of the presidency was officially abandoned in 1974, the power-sharing stipulation continued until 1986. That same year, the attempted adoption of a government opposition system ended in failure. Since then Colombia has restored bipartisan coalitions in Congress, and power sharing in the executive. However, since the 1960s, various political alternatives have been mooted, aimed at ending bipartisan rule. Some of the proponents of these schemes have resorted to violence and guerrilla tactics.

Only until the 1970 elections was one of these alternative coalitions able to challenge the traditional parties seriously. In the last three decades, emergent guerrilla groups have opted for diversified sources of financing, including kidnapping and narco-trafficking. Other leftist guerrilla groups entered into successful peace negotiations and joined the mainstream political process, achieving their greatest success in the 1991 Constitutional Assembly.

One key by-product of this entente between the traditional political contenders has been the fact that, as García and Jayasuriya put it:

> the conservative bent of both parties has clearly helped successive regimes avoid sharp swings in policy. Although each administration attempted to leave its own mark through various policy changes, such changes fell within a relatively narrow range of possible decisions. The primary reason for this behavior is that the political system has institutionalized regime changes and thus minimized the need to resort to populist measures to gain control of government. That is to say, the masses have by and large been excluded from the policymaking process.[7]

[6] Robinson and Mazzuca 2005. The quote is from p. 2

[7] García and Jayasuriya 1997, p. 85

Hence, during the last 50 years, political and economic policy stability are to be explained in substantial part by this system of power-sharing, at the cost of excluding social and political participation.

Internal conflict and economic development[8]

In the 1980s, Colombia became the main supplier of cocaine to the world markets. Estimations of total production and net revenues indicate that for 2001, this illegal business may have been equivalent to between 2 and 4 per cent of the country's GDP – depending on the number of hectares of coca leaf planted and productivity per hectare estimated by different analysts.

The country embraced its own version of the war on drugs, the purpose of which is to cut all the links in the cultivation/processing/transportation/money-laundering chain. This involves obstructing all the steps of this traffic, from curtailing the inflow of inputs and destroying crops and processing units, to interdicting transportation and preventing domestic money laundering. This war has cost Colombia dearly, both economically and institutionally.

The direct effect of the war on drugs should be an increase of cocaine prices to the consumer. Therefore, its efficacy is measured by a variable that assesses consumers' responsiveness to price increases, i.e. the price elasticity of demand in the United States and Europe. The empirical evidence in this respect indicates a troubling result: cocaine demand is inelastic (insensitive) in the short run, but elastic in the long run. The war on drugs, then, makes sense only in terms of the second scenario. Therefore, the questions that need to be asked are: How short is the short run, and can the country resist such a time span? The jury is still out on this, but the short run has at least proved to be long enough to curtail the fighting morale of many echelons of Colombian society.

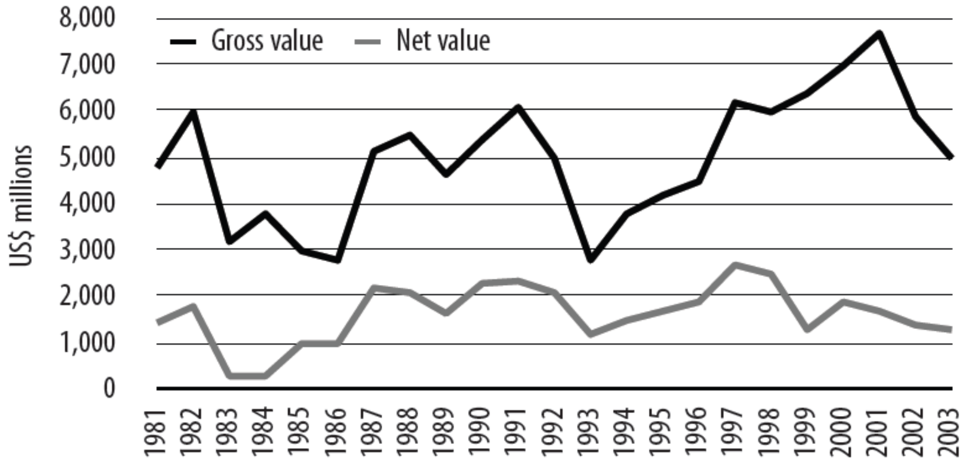
In terms of the country's internal conflict, there is ample evidence of the correlation between cocaine exports and the dramatic increase in the number of homicides committed in Colombia since the mid-1980s. Serious research has also established that the number of men under arms, in both guerrilla armies and paramilitary forces, is closely related to the cocaine business. This has certainly been the case over the last decade at least.[9] According to official sources, these illegal armed groups currently comprise more than 30 000 people. The number of municipalities in Colombia that have been hit by violence also increased sharply during the 1990s. (This has been studied in an increasingly important branch of literature that looks at the regional pattern of diffusion of the armed conflict and its devastating consequences.)

Figure 1 shows the estimation of gross revenue and net profit contributed by cocaine exports from Colombia. Figure 2 displays the estimation of the number of hectares planted in the Andean countries. It has been estimated that the annual income of the guerrillas – of which the most powerful groups are the Fuerzas Armadas Revolucionarias de Colombia (FARC) and the Ejército de Liberación National de Colombia (ELN) – is between US$400 and US$700 million. Of this, 40 per cent is supposed to come from the illegal drug business; 40 per cent from extortion, robberies and kidnapping; and 20 per cent from corruption and investments.

[8] This section is base on Echeverry and Partow 1997; Echeverry, Navas and Salazar 2002; and Echeverry 2004

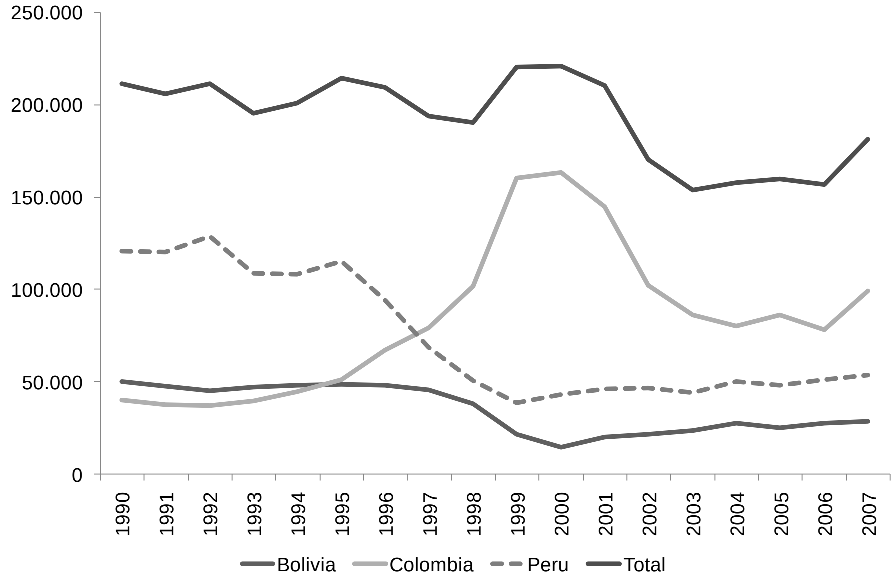
[9] Bottía 2003

Figure 1: Gross and net cocaine- related revenues, 1981-2003



Source: *Ricardo Rocha,* Impactos de la economía ilícita de la droga: estudio de la Colombia, *2006.*

Figure 2: Coca-cultivated area in Colombia, Peru and Bolivia, 1992-2004



Source: UNODC

A crucial question concerns the cost of the conflict for the Colombian economy. Different figures have being proposed, following a battery of methodologies. The results are revealing:

- Rubio concluded that the economy loses 2 percent of GDP yearly because of the conflict[10]
- Granada and Rojas obtained annual costs of 4.2 percent of GDP[11]
- Echeverry estimated that the value of the guerrillas' illegal business is 7 percent of GDP[12]

[10] Rubio 1997
[11] Granada and Rojas 1995

- A related question, which is the ratio of the private investment rate to homicide, has been computed to be -0.66
- Sánchez has concluded that the long-run negative effect on growth is a yearly loss of 1 percent of GDP[13]

According to these estimates, the annual cost of the conflict could be between 2 and 4 per cent of GDP in the short run and 1 per cent in the long run, still a considerable amount.

In a related piece, Echeverry, Navas and Salazar studied the Colombian internal conflict vis-à-vis those of 46 other nations in a post-World War 2 context. Colombia and Sudan are both conspicuous in having had long and repeated conflict during that period (more than 10 years). However, in the case of Colombia until 1996, the GDP growth rate apparently had not suffered much as a result of the armed conflict.[14]

Of course, it is difficult to gauge what the situation in Colombia might have been without a conflict. But the observed indicators of GDP growth, investment, and social development show that in spite of internal war, the country grew faster than the average for Latin America and more than in years of peace. This has been puzzling for researchers and is one of the reasons why Colombia could be an interesting case study for Africa.

Social indicators show that Colombia has achieved important progress in spite of the internal conflict. Table 1 shows that during the last quarter of a century, education coverage increased, infantile malnutrition declined and urban utilities penetration reached almost 100 per cent. This is a remarkable performance in the midst of internal war. One part of the answer to this puzzle is that the Colombian conflict has been mostly rural, and until the end of the 1990s did not affect the cities. Since then, kidnappings have been the channel through which the conflict has impacted on economic activity and urban social indicators.

[12] Echeverry et al 2002
[13] Sánchez 2003
[14] Echeverry et al 2002

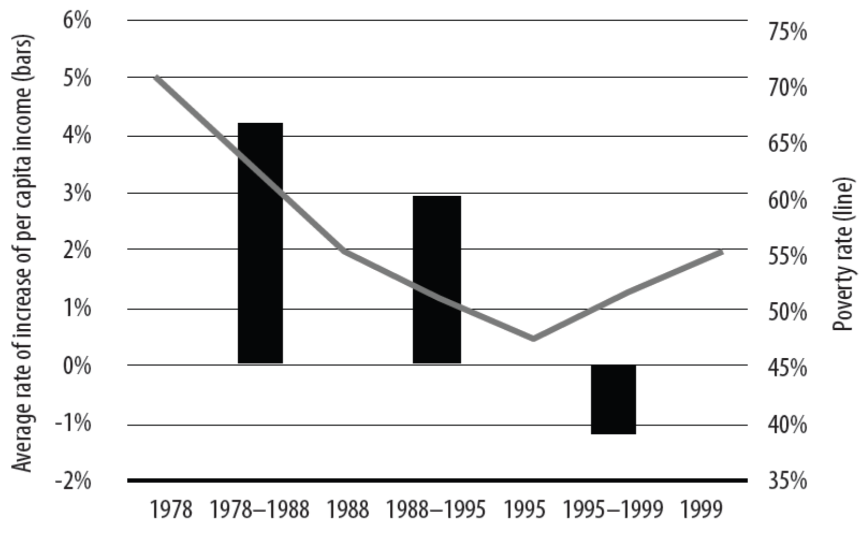
Table 1: Colombian social indicators during the conflict, 1978-1999

Percentage	1978	1999
Average education for older than 18 (number of years)	6.2	8.9
Illiteracy rate	5.3	2.6
Matriculation rate (percentage of population at that age)		
Primary education, 7-11 years	92	95
Secondary education, 12-17 years	77	82
Primary education culmination rate	67	90
Secondary education culmination rat	22	59
Child employment, 12-16 years	12	9.5
Infantile malnutrition		
Stunting (small stature for age)	16.8	6.7
Wasting (low weight to stature)	22.4	13.5
Low weight to age	4.9	0.8
Urban infrastructure coverage		
Electricity	63	99.4
Aqueduct	63	99
Telephone	60	84.2
Sewerage	51	97.3

Source: *National Households' Survey and Colombia Poverty Report,* Departamento Administrativo Nacional de Estadística (*DANE)*, 2002

This is particularly visible in figure 3, where it is clear that between 1978 and 1995 Colombia reduced its poverty rate from 70 per cent to 48 per cent. Only when GDP declined (at the end of the 1990s), did poverty increase.

Figure 3: Per capita income and poverty rate



Source: DANE, Economic Comission for Latin America and the Caribbean (ECLAC). Note: Currently, the PL is 18%. The definition of "poverty rate" is that of ECLAC, and is the highest among the different methologies for measuring poverty. For instance, according to an alternative measure, i.e. a poverty line (PL) of US$2 per day per person, 25% of the population was poor in 1999, compared with 56% in this graph.

Therefore, a key to solving the puzzle of social advancement in times of conflict seems to be the ability to maintain growth in economic activity. Another important issue was that illegal exports partly supported domestic demand and helped the economy. However, this phenomenon did not last, and finally the conflict hit urban life and economic activity.

Several lessons can be drawn from this process:

1. An internal conflict does not necessarily have substantial domestic, social and economic effects. These depend on the links the conflict has to civic life and its impact on the sources of wealth creation.
2. However, when strife does affect the risk perceptions of entrepreneurs and citizens, the cost can be considerable.
3. In the middle of low-intensity internal conflict (1980-1995), Colombia achieved substantial improvements in social indicators, due mainly to macroeconomic stability, growth, and socially targeted programs.
4. The worst decline in social indicators in decades was associated with poor macroeconomic performance between 1997 and 2001, and to a higher level of conflict owing to kidnappings and corruption. Hence, macroeconomic stability is a prerequisite for social development.

A (recently) successful internal defense strategy

Throughout Colombia's history and especially during the late 1980s and the 1990s, the violence situation constrained economic growth. This phenomenon became crucial during recent administrations: Pastrana (1998-2002) and Uribe (2002-2006 and 2006-2010), when, through Plan Colombia and Seguridad Democrática, the defense strategy gained a primary role.

One feature of the Colombian conflict during the past two decades was that not only war-related crime spread throughout the country, but normal delinquency also escalated. Regions that ought not to have been directly affected by the conflict nevertheless saw their crime rates rise. The reason was studied by Echeverry and Partow, whose conclusions are of interest for emerging economies:

> In recent years, over ninety percent of all crimes in Colombia have gone unpunished. The reasons for this extreme unresponsiveness of the country's judicial system to high rates of violence, in particular since the end of the seventies when drug trafficking became a major source of crime, has been a puzzle regarding Colombia. We conclude that law provision is performed at the regional level, with the response of authorities depending crucially on their perceptions regarding the origins of violence. To the extent that the causes of violence are systematically perceived as originating beyond local boundaries, the response to the violence shock at the regional level will vanish over time. This in turn implies that the total provision of justice in the country will be lower. We claim that this explanation describes the Colombian experience over the past fifteen years in two senses. First, regions within the country have considered the emergence of cocaine traffic to be an extra-regional phenomenon. Second, the

country as a whole has also perceived it to be an international problem. Both of these aspects have led to an under-provision of justice in Colombia.[15]

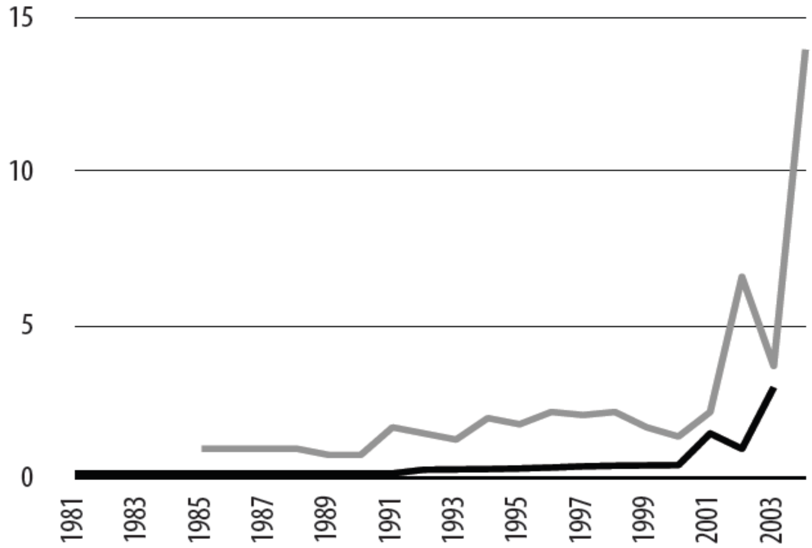
An important lesson of this internal war can be drawn from recent developments in the country. After 2000, the serving administrations applied a hands-on approach with respect to the military. Indeed, part of the reason why the conflict between the two sectors seemed unsolvable was that there was a conflict of interest within some echelons of the military. Although the military did not seem to care very much about tackling the guerillas, the latter's very existence had provided it with a reason to ask for more resources. It had been allowed full discretion over its hiring, salary and pension policies, and in return had kept on good terms with the civilian authorities. The status quo between the military and civilian governments provided a long-lasting equilibrium, with the entente lasting from 1958 until 2000.

Between 1995 and 1999, the military suffered serious defeats in FARC attacks. As a result, President Pastrana (1998–2002) changed the military strategy from one of defending every inch of the territory to a more mobile approach. The United States provided assistance with a strategy called Plan Colombia, whereby more helicopters were deployed and new units called Rapid Deployment Forces (FUDRAS by the Spanish acronym) were created. Each of these units was composed of 1 300 men who could be transported within hours to any part of the territory and stay in place for two months fighting the insurgency. President Uribe (2002–) has had the unprecedented distinction of getting the military to work effectively, increasing the morale of the troops and achieving tangible results.

Figure 4 shows that since 2000, anti-drug (i.e. anti-guerrilla) expenditure escalated from less than 2 per cent of total public expenditure to 14 per cent; and from 0,4 per cent of GDP to 3 per cent. This change in resource destination followed a similar shift in popular sentiment, reflected in figure 5. We see that, since the beginning of the 1990s, the citizenry nominated the domestic security problem as easily the most important national problem, way above the state of the economy. Only after serious advances were reached on the war front, was the public once again equally preoccupied by this second phenomenon.

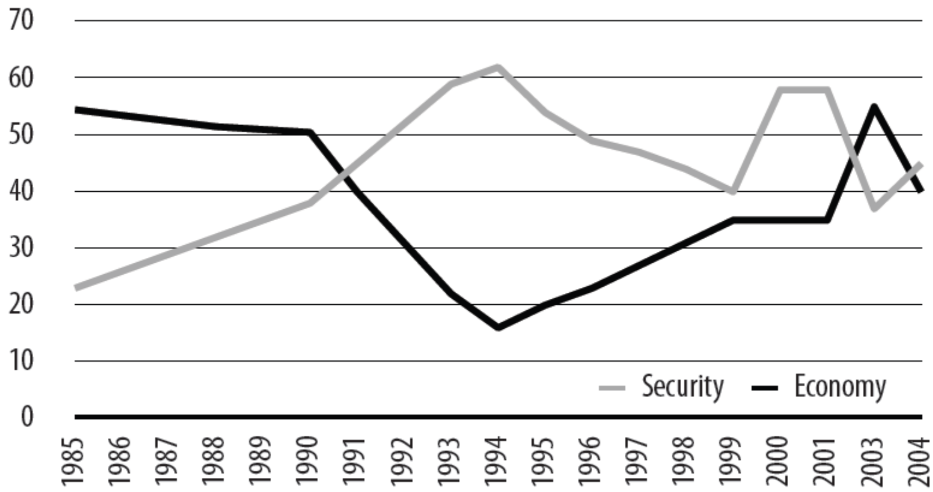
[15] Echeverry and Partow 1997

Figure 4: Government anti-drug expenditure (ADE) as percentage of GDP, 1981-2003



Source: *Gallup Poll quoted in Ricardo Rocha,* Impactos de la economía ilícita de la droga: estudio de la Colombia, 2006

Figure 5: Public perception of problematic areas in Colombia, 1985-2003



Source: Ricardo Rocha, 2006

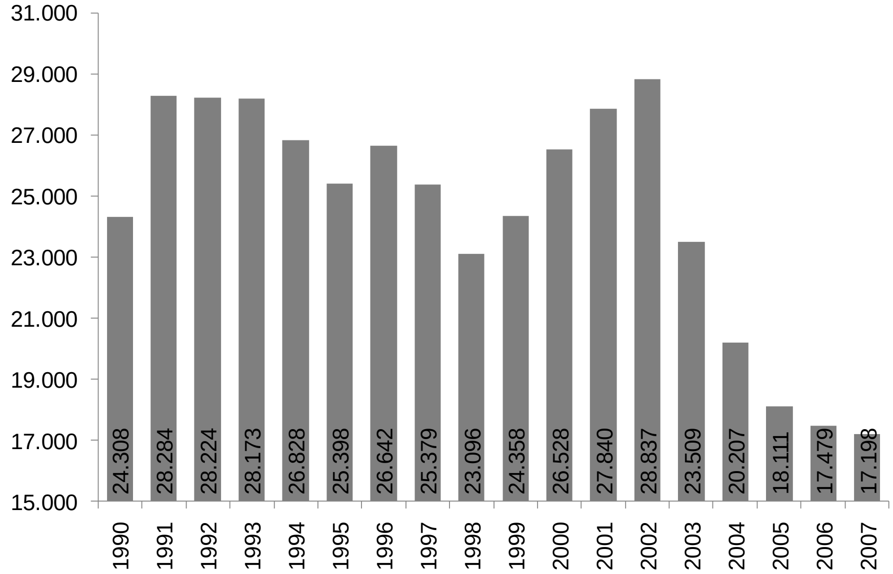
What were the results of the new strategy against the guerrillas and narco-trafficking? Figures 6 and 7 reveal that significant inroads have been made into the incidence of both homicides and kidnappings during the current administration. Although the numbers are still very high by international standards, the change in trend is quite satisfactory.

A negative trend has also been observed in estimated revenues, both gross and net, for the illegal cocaine trade, as figure 1 shows. Indeed, net revenues have experienced a decline since the end of the 1990s, from nearly US$3 billion to half this amount (from approximately 4 per cent of GDP to 1,5 per cent). This decline corresponds to a reduction in the planted area of coca plantations, which arguably has declined from 160 000 to less than 100 000 hectares.[16]

The popular approval of the renewed strategy against the dual malaise of guerrilla warfare and narco-trafficking was so massive that, for the first time in more than 100 years, Colombian citizens re-elected a president – a process that demanded a change in the Constitution. Mr Uribe won his second term in the first round of the 2006 elections, achieving 62 per cent of the popular vote.

Of course, Colombia is not yet out of the woods. Allegedly, there could still be as many as 30, 000 armed men between the guerrillas and the paramilitaries. However, since 2000, the change in strategy towards the armed conflict has resulted in renewed public support and optimism. The new policies put in place proved to be in the right direction and empowered the whole country.

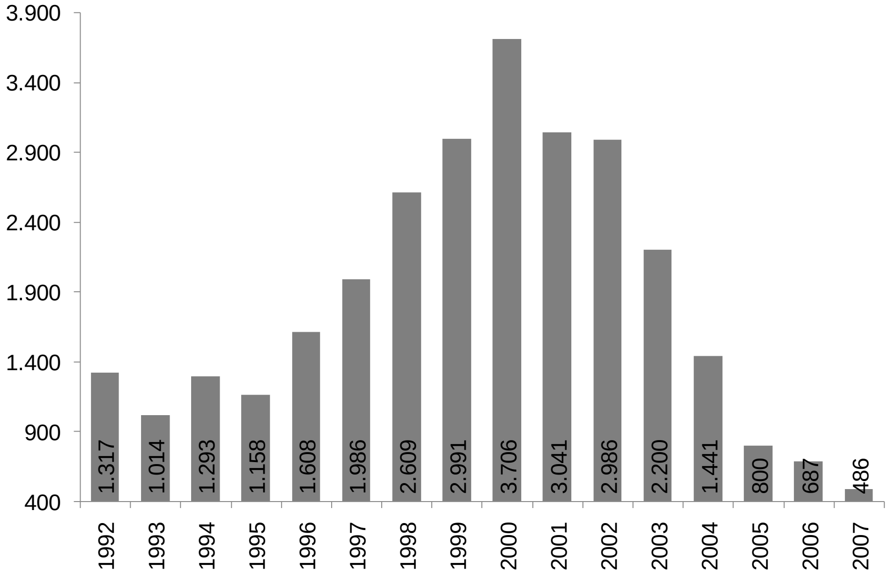
Figure 6: Number of homicides, 1990-2007



Source: Presidencia de la República

[16] However, recent measurements by the Department of State of the United States, published in mid-2006, came up with a figure around 140,000 hectares. New research maintains that, owing to changes in productivity in coca plantations, Colombia could have increased its total production from 600 to 700 tons of cocaine yearly.

Figure 7: Kidnappings, 1990-2007



Source: Presidencia de la República

Several lessons can be drawn from this process:

1. Minor regional outbursts of violence can turn into a national phenomenon, undermining the effectiveness of the justice system
2. Neither delinquency nor mafia shocks fuelled by potentially nation-wide phenomena (such as narco-trafficking) should be disregarded
3. A nation-wide strategy is indispensable to show that crime does not pay; otherwise the spread of these societal illnesses can overtake the response capacity of the authorities and even the military.
4. These types of problems demand new technologies, both in the organization of the military and in the type of weaponry deployed
5. The obstacles faced by the highest echelons of the military and the troops, as well as their fighting morale, should be constantly addressed, because they can become an insoluble problem in the resolution of war
6. Finally, public opinion favors politicians who dare to confront a nation's most sensitive issues.

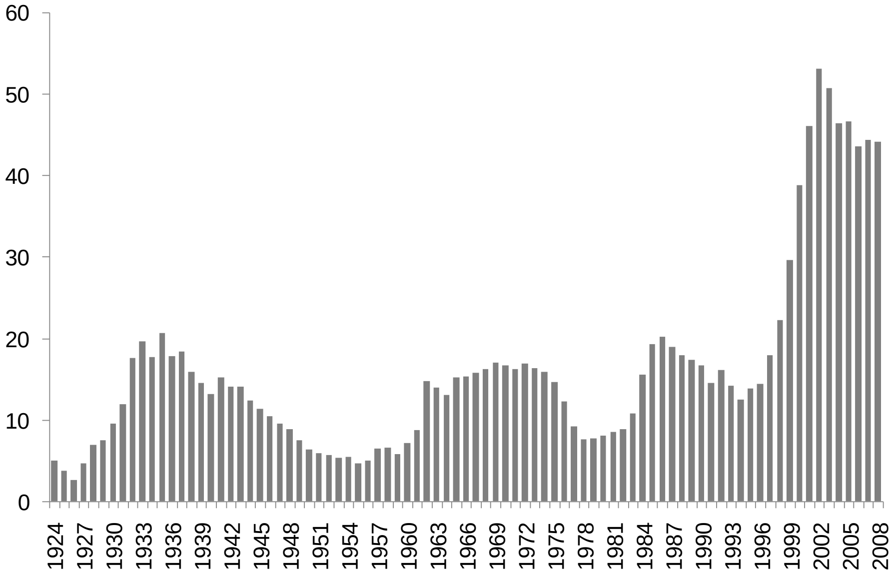
Century-long economic stability, benefits and costs

Colombia stands out in Latin America as an example of sound economic policy, political stability and democracy. Achievements include: not experiencing debt crisis in the 1980s (the rest of the continent's 'lost decade'); avoiding populist governments (such as those of Peron and Chavez) and coup d'états; never experiencing hyperinflation; having comparatively less expensive financial crises; maintaining friendly relations with congress, and therefore governability was kept inexpensive; growing annually by over 4 per cent for 100 years; avoiding an economic recession for 70 years; keeping a democratic regime for almost 150 years (apart from a brief, three-year interruption in the 1950s).

These accomplishments have been achieved through a trial-and-error, learning process, in which different ideas and theories have been taken into account. With the help of a competent technocracy, educated in prestigious US and European schools, Colombia has been able to develop successfully. Nevertheless, there is still a long way to go and many achievements made were lost in the 1999 crisis.

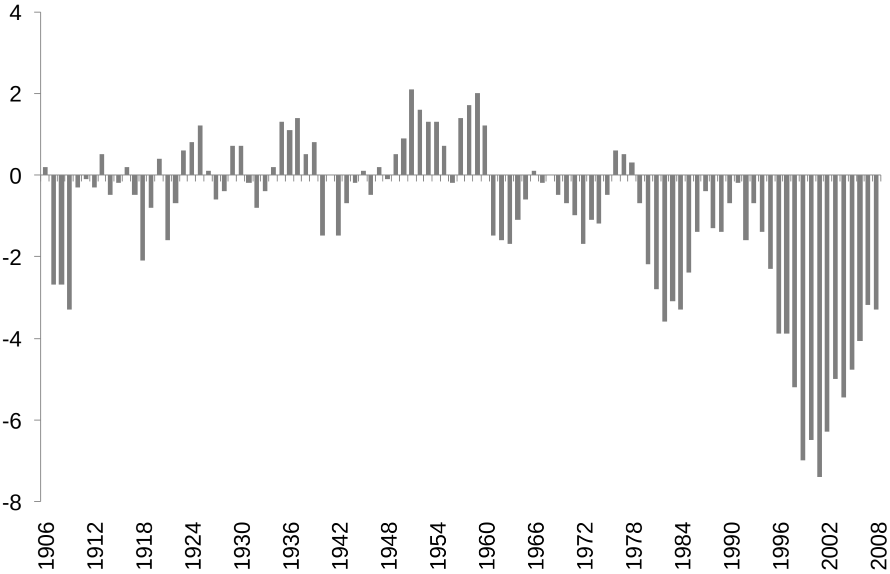
Probably the most remarkable feature of Colombia has been its tradition of gradual economic management aimed at securing stability, even at the cost of sacrificing rapid growth rates. The area where this is clearest is fiscal management. Somehow at the beginning of the last century, the country's elite realized that fiscal and monetary stability was crucial – if not to produce rapid growth, at least to avoid harmful crises. Figure 8 shows that from the 1920s until the mid-1990s, central government debt as a percentage of GDP was systematically below 20 per cent. The reason certainly lies in the sensible management of fiscal deficit, displayed in figure 9, which shows an effective mechanism of 'error correction'.

Figure 8: Central government debt as percentage of GDP



Source: *R. Junguito and H. Rincón*, La Política Fiscal en el Siglo XX en Colombia, 2004, Ministry of Finance and author's calculations.

Figure 9: Central government deficit as percentage of GDP



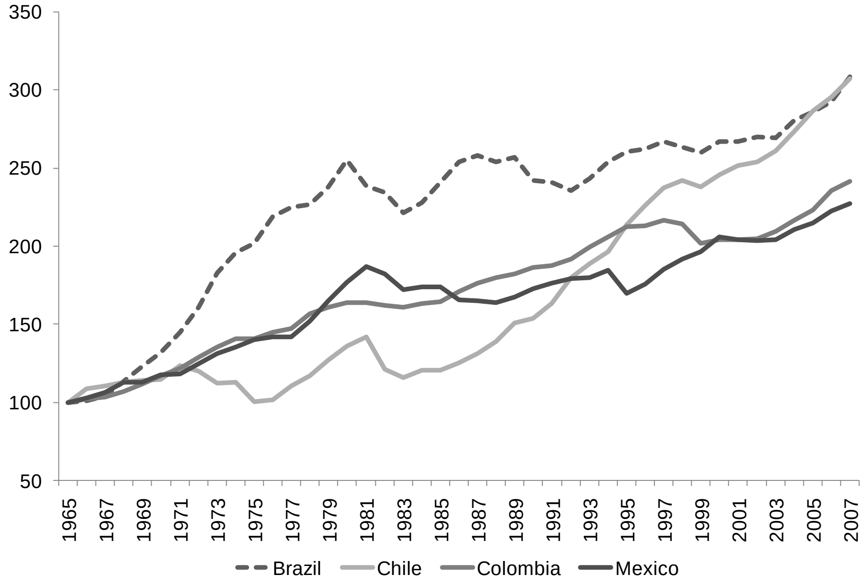
Source: Junguito and Rincón, 2004, Ministry of Finance and author's calculations.

Indeed, between 1905 and 1980, the deficit did not systematically surpass 2 per cent of GDP. It was only in the 1990s that this tradition of sound fiscal management was lost, owing to the surging of systematic deficits surpassing 6 per cent of GDP. We will review the evolution of the previous decades before focusing on the worrisome events of the 1990s.

Compared with those of its neighbors, Colombia's salient characteristic is the smooth and steady growth in per capita GDP. Figures 10 and 11 split the major economies of Latin America into two groups, depending on their per capita GDP growth performance since the mid-1960s. The rapid-growth economies – Brazil, Chile, Mexico and Colombia – appear in figure 10. The first two countries have experienced miraculous phases in that period – Brazil between the end of the 1960s and the end of the 1970s, and Chile since 1985. (In the balance of the period under review, both economies displayed unsteady growth.)

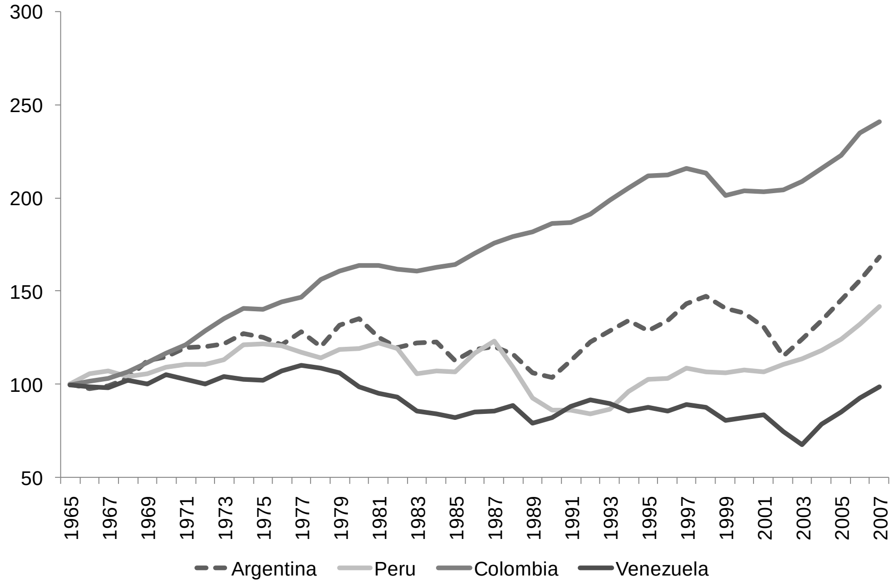
Something similar happened to Mexico between the beginning of the 1980s and the middle of the 1990s. Of course, Chile's remarkable growth in the last two decades stands out from the whole sample of Latin American economies, as has been widely documented. Colombia, though, displays the most stable pattern and exhibits milder contractions. When compared with the group of countries whose per capita GDP stagnated during the last four decades, the contrast is clear (see figure 11). Figure 12 shows that during almost 70 years, from the beginning of the 1930s to the end of the 1990s, Colombia displayed positive growth, averaging 4.55 per cent for the period. The fact that in a century of economic history, the economy experienced only three years of negative growth, reveals the remarkable stability of the Colombian economy.

Figure 10: Per capita GDP index for Brazil, Chile, Colombia and Mexico, 1965-2007



Source: World Bank, statistics for various years and author's calculations. Note: 1965=100

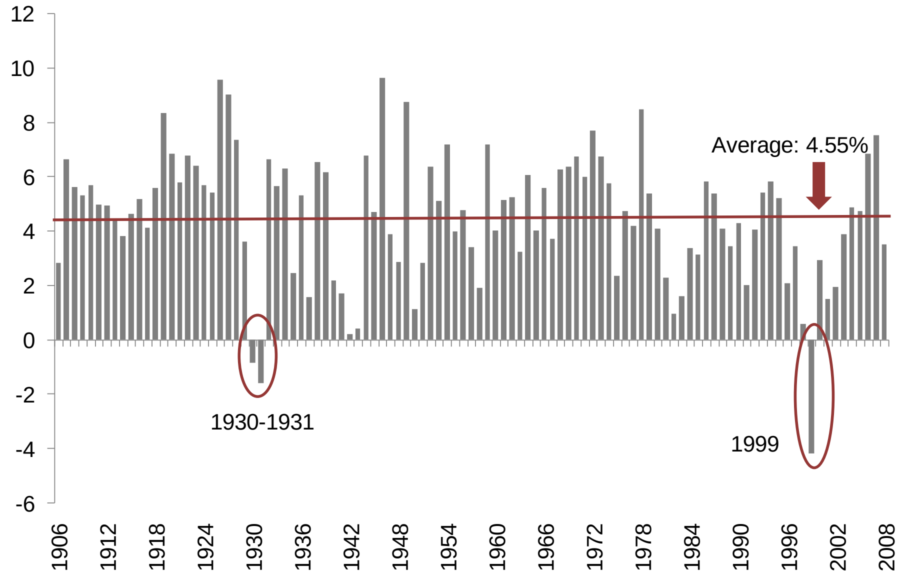
Figure 11: Per capita GDP for Argentina, Colombia, Peru and Venezuela, 1965-2007



Source: World Bank, statistics for various years and author's calculations. Note: 1965=100

What is the reason for this stable yet not exceptional growth? I contend that it is the result of a long-lasting tradition of economic policy 'gradualism'. This led to cautious economic management, the main goal of which was to avoid sharp economic fluctuations. Colombia has traditionally been a country with scarce natural resources, having scant oil or other mining reserves. The 20th century economy developed on the shoulders of coffee growers, and the main challenge then was how to dampen the external shocks stemming from the international coffee price. Indeed, at least until the mid-1980s, both the availability of foreign exchange – which was crucial for imports – and the evolution of domestic demand depended on the international price of coffee. Intermittently, policy-makers tried to adopt trade liberalization measures, but relied on import and exchange restrictions at any sign of a balance-of-payments crisis. This was paired with the conviction that the best development strategy for the country was import substitution, led by resourceful lobbies.

Figure 12: Colombian real GDP growth, 1907-2007



Source: Banco de la República and DANE and author's calculations.

As a result, the country's industrialization was contingent on the vicissitudes of international trade. In this sense, the most remarkable events determining the path that was followed were World War 1 and World War 2, the 1929 crisis and its aftermath, and the wave of protectionism and low FDI that characterized the world for most of the 20th century. Following the fashion imposed in Latin America by the Economic Commission for Latin American Countries (ECLAC) and dependency theory thinkers[17], Colombia adopted an import substitution industrialization strategy (ISI).

It is true that ISI helped to create agglomerations of new industries around the main population centers. However, it had several negative consequences as well:

1. It led to chronic shortages of foreign exchange
2. It determined a macroeconomic management directed to administer the scarce foreign exchange and dampen its sharp fluctuations. As a result, cumbersome monetary, fiscal and tariff instruments were necessary.
3. Distortions were imposed on the financial sector reserve system
4. A powerful institution was established, which was in charge of approving import licenses and managing the system of prohibited/licensed/free imports
5. Nationals were forbidden to hold foreign exchange
6. A myriad of instruments was devoted to promoting exports and directing Central Bank subsidized credit to arbitrarily selected economic activities.

[17] Raul Prebish, Fernando Henrique Cardoso, and like

7. Exchange rate management was administered to secure income for coffee growers

It is understandable that such a policy-making framework created strong incentives for lobbying and rent-seeking. One of the main roles of the state was to allocate rents to the most successful lobbyists via the set of policy instruments mentioned. Worse, this set of incentives typically led domestic producers to:

- Locate their production units away from the sea ports and around the inland cities
- Set in place small-scale units of production directed towards limited local markets
- Replace technology innovation with lobbying for protection
- Keep their firms as small, family-owned, low-capital enterprises

The sinews of Colombian capitalism atrophied greatly as a result of these developments. The situation impeded the emergence of internationally competitive firms, the pursuit of economies of scale and outward orientation. The cost of capital was high owing to low savings and high tariffs. With these barriers, FDI accrued to the country only to satisfy the tiny domestic markets and Colombia was never considered as a launch-pad for exports. As a corollary, the available labor was low-skilled. These circumstances condemned urban workers to low-productivity jobs that could not really confront international competition. Ironically, the anti-trade lobby has always argued that Colombian workers, infrastructure and financing are not ready to face international competition and trade liberalization. This argument confuses the cause and the effect.

The economy was managed in a way that defended its economic structure from foreign threats and avoided sharp fluctuations. In doing so, the Colombian elite opted for a low risk/low return development strategy. The country's economic fabric was weakened, but as compensation, the typical high borrowing/high expenditure fiscal indiscipline of developing countries was avoided. Consequently, the resulting type of development was one of mild fluctuations and mild growth.

With a growing urban population, increasing demand for foreign exchange, a widening technological gap vis-à-vis the developing Asian Tigers, and a lack of enough new leading economic sectors, the limits of ISI became apparent. Therefore, in the 1970s the country embarked on a gradual export-promotion drive and a house-building strategy. Favorable external circumstances promoted a boom in coffee prices in the mid-1970s, sparing Colombia the foreign borrowing epidemic contracted by its Latin neighbors and allowing it to circumvent the so-called 'Lost Decade' of the 1980s. However, the quality of Colombian capitalism had not really changed, nor its incapacity to face international competition.

Several lessons can be extracted from this experience:

1. Any development strategy, be it ISI or urban housing, creates transitory wealth that can last for one or two decades; but eventually many of its components may impair adaptation to the demands of new international environments
2. Interest groups can become quite detrimental to the economic flexibility required by a globalised environment
3. The longer it takes to tackle the power of lobby groups, the stronger they become and the harsher are the social costs of necessary reform
4. What is at stake is the quality of a country's capitalism, its response capacity, and the risk-taking appetite of potential domestic and foreign investors

A reform agenda yet to yield its full potential

The 1990s was the decade of outward-looking reforms. As was mentioned in the introduction, the last two decades have witnessed a radical reformist agenda, following two different models. On the political and social fronts, decentralization, the deepening of representative democracy and the enactment of social aspirations into law were set as constitutional rights that can be demanded of the executive branch via rulings of the judiciary.

The new Constitution, enacted in 1991, also made provision for an independent central bank, and a fairly pro-market, pro-business framework for private entrepreneurship. Nevertheless, it comprises two different sets of ideological aspirations, one aimed at substantially increasing government expenditure for the social mandates, and the other allowing ample private sector participation (e.g. in the provision of public utilities) and the pursuit of the so-called neo-liberal agenda (Washington Consensus short-run policies and the long-run reform inventory of the multilaterals). Reconciling these conflicting ideological goals has become the biggest challenge of the new generation of policy-makers.

The economic liberalization agenda contained the following initiatives:

- Import tariff reduction
- Financial liberalization, allowing full foreign ownership of intermediaries
- Widespread concessions and the privatization of public utilities
- Individual capitalization accounts replacing the pay-as-you-go pension system
- Labor market flexibility
- The transfer of public subsidies to the poor from the supply side to the demand side

At the same time as this agenda was being implemented, Colombia discovered substantial oil fields. This created the false illusion of a new source of wealth and relieved the traditional budget constraints of a poor country. Hence, the intellectuals in charge of drafting the 1991 Constitution and its accompanying laws felt entitled to distribute the new wealth among several recipients: the regions (entailing a new generous system of transfers to municipalities); social needs (leading to an escalation in health care and education expenditure); and future generations (the new pension scheme bankrupted the pay-as-you-go system with the incredible fiscal costs projected for the next generation of Colombians).

The result of the apparent new oil wealth was an amazing increase in government expenditure above available revenues, a huge and permanent fiscal deficit, and public borrowing, the cost of which in turn worsened the fiscal situation (see figures 8 and 9). Apart from the unsustainable fiscal situation, the oil boom brought other unintended and pernicious consequences:

- ‘Dutch Disease’ affecting agriculture and manufacturing competitiveness
- Excessive household consumption and borrowing
- A real-estate boom and bubble
- A financial sector crisis resulting from the previous two aspects
- Macroeconomic vulnerability at the end of the 1990s, precisely at the moment when the Russian, Brazilian, and Southeast Asian economies were suffering their own crisis

In sum, Colombia created its own perfect storm. Ironically, the new oil fields were not the tip of an unprecedented iceberg of new wealth, but a once-in-a-lifetime event. Hence, the additional expenditure, rather than being fully financed, forced substantial public borrowing and several tax reforms during the following decade. The pension system, the cost of the internal conflict, increased social expenditure, and public debt all still hang above the heads of the next generation of Colombians. If GDP does not grow at a yearly rate of more than 4 per cent over the next 20 years, creditors of all types will try to cash their claims and there will not be enough resources to honor these.

In essence, the country has put itself in an awkward financial position. It has promised future pensioners, the current poor population, and public creditors, more than it can reasonably deliver. In order to honor these debts it has to solve its internal conflict, secure investor confidence and undertake necessary reforms in the productive sector. The latter implies a shift in the set of incentives created by the ISI development strategy. However, there are many interest groups that want to be compensated for the losses they are about to suffer owing to the new outward-looking, liberalized trade strategy. Otherwise, they plan to block this reform's passage through Congress. Consequently, politico-economic problems are piling up in the path of the reformists.

Two final problems that remain to be addressed effectively are poverty and income distribution.[18] Colombia and the Latin American region in general are regarded as having particularly unequal income distributions. During 2001, a very high proportion of Colombia's population (75 per cent) earned less than 4 minimum wages (MW).[19] Half the households had incomes of between 1 and 3 MW, and 10 per cent had salaries smaller than 1 MW.[20] In Colombia, the richest 25 per cent of the population enjoy incomes that are 30 times higher than those of the poorest quartile. Colombia has been one of the few countries where this distribution deteriorated towards the end of the 1990s.

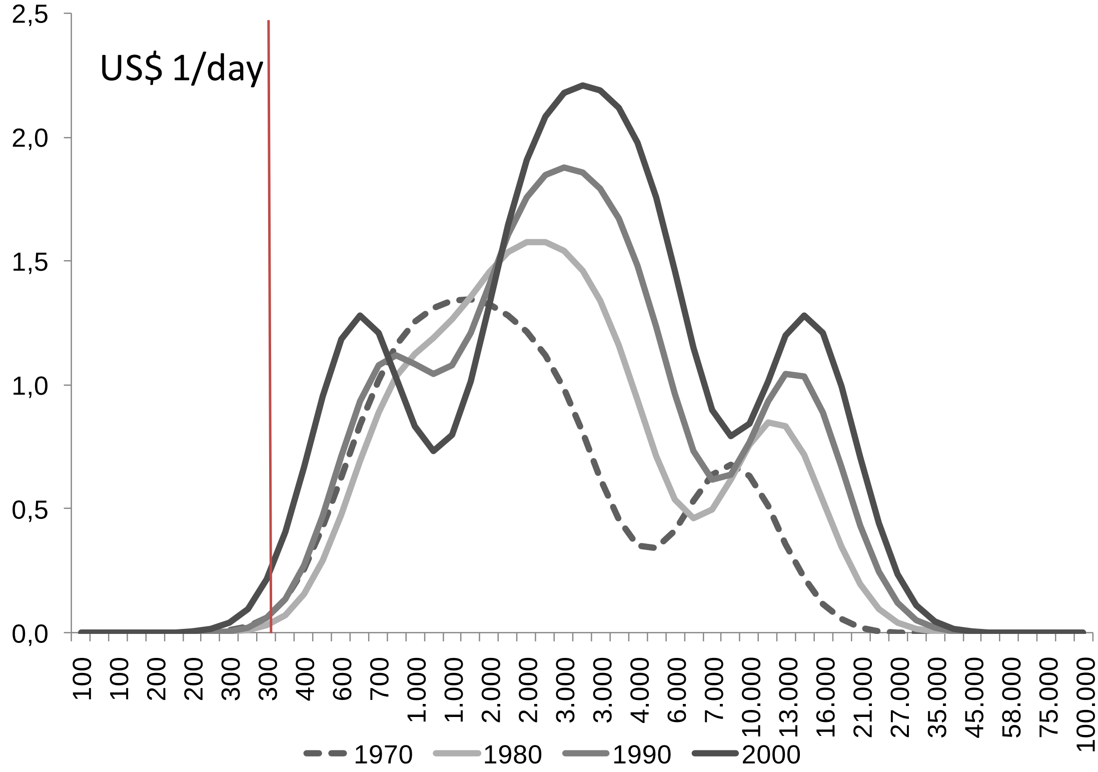
This pattern of inequality is illustrated by figure 13 – the income distribution of Colombia. In 1970 the graph exhibited a two peaked mountain, with the area at the left of the vertical line shows the percentage of the population in absolute poverty. This shape evolved towards a 'ghost pattern' of income distribution in 2000: the three peaks being the arms and head of the 'ghost'. The head is the middle class, while the two arms represent the working and the affluent classes. This pattern is not usual in the distributions of other middle-income or even low-income countries, although it is frequently found in Latin American countries. It indicates that social mobility has been difficult during the last three decades, and such difficulty has probably increased, exactly the opposite of what is desirable.

[18] The following paragraphs are based on Echeverry et al. 2006

[19] One minimum wage per month (MWM) was equivalent to US$ 135 in 2001

[20] Jaramillo and Silva 2001

Figure 13: Income distribution of Colombia, 1970-2000

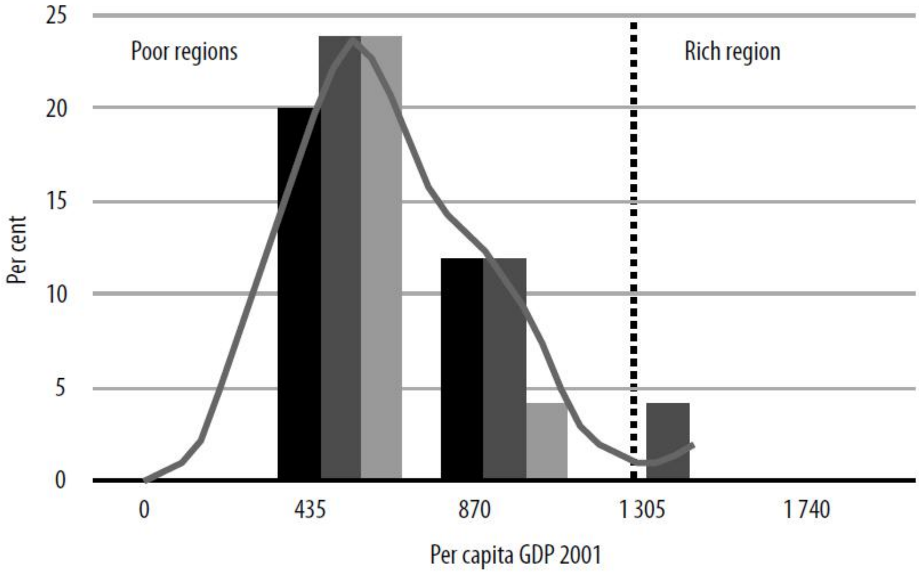


Source: Sala-i-Martin 2002 & 2006 and author´s calculations.

The shape is important, as it is a consequence of two distinct elements. The first one is pervasive inequality, a frequent claim by civil society organizations (labor unions, think-tanks, etc). During the 1990s, the trade-liberalizing reforms and the development of services led to higher demand for highly skilled urban workers in relation to low-skilled ones; this worsened income distribution and increased inequality. The second element is the incidence of poverty traps, which prevent a considerable number of poor people taking advantage of the economic prosperity accruing to the rest of the country. The positive evolution of emerging economies during 2003-2007, of which Colombia was no exception reduced poverty (four million people surpassed the poverty threshold in Colombia). However, the 2008-2010 international crises poses a new challenge to these positive trend.

Economic, social and institutional infrastructures vary widely by region across Colombia. A similar situation occurs in other Latin American middle-income countries. Figure 14 shows the distribution of per capita regional GDP in Colombia during 2001. The regions are divided into two different groups: poor and rich, with a larger concentration of regions in the poor cluster and a wide gap in the income between the two groups. Additionally, Colombia’s most prosperous economic region and its most depressed area, Bogotá, the capital, and Chocó, in the eastern Pacific coast, respectively, are located at the extreme right and left of the distribution.

Figure 14: Income distribution of Colombia: Per capita GDP of the regions, 2001



Source: Aguirre 2005

An partial explanation for the 'ghost feature' discussed above is the fact that urban areas are connected with the global economy and thereby more able to reap the benefits of international trade, direct and portfolio capital flows, labor force training and flexibility, and economies of both scale and scope in businesses. In contrast, distant and under-provisioned regions find themselves trapped in poverty with little potential for advancement. In general, accesses to what economists call 'the markets' is distinctly different for these two demographic types.

Several lessons can be extracted. First, and foremost, the *Zeitgeist* of the last half century has greatly influenced economic policy-making in Colombia. The 1950s saw the fashion of the role of the state in the economy: public property; overregulation; import substitution based on cumbersome tariff systems; and public banking institutions providing subsidized credit to predetermined economic sectors, based on monetary creation. The 1990s brought the hegemony of market-oriented reforms, as well as disappointment at the overwhelming presence of the state with its myriad inefficiencies created by decades of bureaucracy and labor unions. The latter fashion was labeled as conforming to the 'Washington Consensus', but we need to look beyond the so-called first wave of reforms; later, microeconomic and 'institutional' reforms came in. However, the failure to yield high growth and better income distribution led to a confusion that now permeates most discussions regarding long-term growth.

In Colombia the events of the 1990s were characterized by severe 'Dutch Disease', the relaxation of budget constraints, and the adoption of many reforms with huge fiscal costs – leading to an exaggerated trust in productivity and growth effects. The international environment also became quite complicated and the economy's vulnerability increased with the simultaneous opening of current and capital accounts. Politicians, who had traditionally been conservative in terms of public expenditure, believed they could fulfill the social aspirations written in the new Constitution – but ended up promoting inflexible and unrealistic budget frameworks that became part of the problem. Finally, there were the actions of scattered guerrilla groups paired with the protection needs of emerging illegal drug businesses. The linkage between these two forces has proved to be the biggest challenge for Colombian institutions and political and economic stability. At the end of the 1990s these events proved too much of a burden for the country – with the consequence that economic performance suffered the first negative growth in 70 years (see figure 12).

Nonetheless, the country has found new political alternatives to restore the people's confidence, and has regained momentum in its economic activity. However, big challenges have piled up for the future. Within a real GDP growth range above 4 per cent, the country, broadly speaking, is economically and fiscally viable. At a real GDP growth rate below 3 per cent, it enters the 'twilight zone', where many negative dynamics conspire against economic and fiscal stability. This is why international crises like the one unfolding since 2008 pose considerable challenges for these type of economies. Finally, social demands need to be met for both the poor and working classes, in order to avoid the events that occurred in Venezuela, Bolivia and Ecuador in the last decade – whereby middle- class income and wealth were slowly eroded and extreme political alternatives gained the favor of the voters.

Anna Karenina in the tropics

In the last decade there has been a debate on the fundamental determinants of long-run growth. At least four intellectual trends have fought for supremacy. The first, which has been championed by Nobel Prize-winning economist Robert Lucas[21], supports the primacy of technological diffusion, learning-by-doing and international catch-up. This version gives paramount importance to technological progress and its diffusion across borders.[22] A second stream of literature defends the primacy of typically capitalistic institutions, like the rule of law, the enforcement of property rights, restrictions on excessive executive power and the pre-eminence of a system of checks and balances that promotes entrepreneurship and risk-taking.[23] A third branch of academic literature stresses geography as the key determinant of long-run growth, via the influence of initial endowments of natural resources, climate and diseases, and environmental challenges faced by countries and continents (which would, for instance, greatly differentiate the Eurasian area from Africa and Latin America).[24] Finally, a fourth group of researchers emphasize trade and economic integration.[25]

Rodrik and his colleagues empirically evaluated the merits of three of these four approaches. Their conclusion was that 'institutions rule' and are basically the crucial determinant of long-run growth.[26] Personally, I consider that the critical issue is not which of the determinants of long-run growth dominates the other, but how each of them could deter economic progress at different moments in time. Indeed, in different historical circumstances the 'binding constraint' of growth could shift among these four alternatives. The form in which the four 'deep determinants' of long-run development exchange their supremacy across time would determine a nation's advance or stagnation. A constructive way of thinking about their interplay comes from Jared Diamond, who proposes what he calls the 'Anna Karenina Principle'[27]. This dictum revolves around circumstances in which several conditions have to be met

[21] Lucas 2002
[22] See also Mokyr
[23] See North 1990; Acemoglu et al. 2001
[24] See Sachs 2001; Diamond 1997
[25] Frankel and Romer 1999
[26] Rodrik et al. 2004
[27] Diamond 1997

simultaneously.[28] In the current context, the principle would be: 'Prosperous nations are all alike, while every non-prosperous country is non-prosperous in its own way'. I think this is a constructive way of considering the discussion about the four determinants of long-run growth surveyed above.

Analyzing some of the facts of Colombian history, the 'Anna Karenina method' would lead us to evaluate which of the four indispensable conditions of growth – technological diffusion, capitalistic institutions (including an effective, viable political system), overcoming geographical challenges, and openness to trade – were not met at different moments in time. Table 2 is an attempt to identify the periods in which each of those constraints could have been in place as the most important obstacle to growth. In other words, the table presents a narrative of non-prosperity in Colombia.

Table 2: Constraints to long-term growth in Colombia, 1830-2006

Unmet condition	Period	Why it constrained growth and its reform
Capitalistic institutions	1830-1900	Endless fighting stopped owing to power-sharing reforms in 1905-1910
Geographic challenges	1830-1920	Scant infrastructure kept regions isolated from each other and from the world; key events for overcoming this: Railroads between 1880 and 1930 Airplane communication after 1920 Cable communication after 1915 Roads network after 1920
Technological diffusion	1830-1920	Coffee exports allowed imports of capital goods after 1920
Openness to trade	1930-1965 1976-1991	Import-substitution industrialization imposed high and cumbersome tariff system Imposition of import restrictions for combating inflation ended a period of openness
Technological diffusion	1930-1965 1950-2008	Endemic shortage of foreign exchange impeded imports of capital goods Multinationals came to Colombia to supply domestic market and not to export. Low production scale and technological sophistication

[28] The first sentence of the novel *Anna Karenina* by Leon Tolstoy is 'Happy families are all alike; every unhappy family is unhappy in its own way.' Diamond 1997 (p.157) uses it to explain the domestication of big mammals: 'Domesticable animals are all alike; every undomesticable animal is undomesticable in its own way.'

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Appendix: Timeline of economic policies in Colombia, 1950-2008

Table A1: Timeline of economic policies in Colombia, 1950-2008

Period	Commercial Policy	Exchange Rate Regime	Monetary and Fiscal Stance
1950-1966	Import-substitution industrialisation: reduced exposure to fluctuations in primary commodity prices via increased industrialisation.	Fixed exchange rate with drastic discrete devaluations.	Economic reforms aimed at maintaining one digit inflation and reducing unemployment and government expenses.
1966-1976	Export promotion: a change of regime in Latin America first implemented by Colombia. Unilateral and regional integration measures that sought to develop industry through exchange rate incentives and a combination of tax discounts, tax returns and credit facilities. A tax rebate scheme, Plan Vallejo, was one of the primary measures	Crawling peg exchange rate scheme - a system of frequent mini-devaluations aimed at maintaining real exchange rate competitiveness and thus promoting exports (Decree Law 444, 1967). The central bank was granted a foreign exchange monopoly.	Inflation rose from one digit levels before April 1971 to more than 20% at March 1973. Inflation fluctuated between 20% and 30% over the next 25 years - an extraordinary case of the stability of a moderately high inflation rate.
1976-1981	A substantial coffee price boom and an increase in petro-dollar capital flows slowed the export diversification process and encouraged imports.	Mini-devaluations decelerated and a real appreciation took place which affected trade.	A significant increase in Public expenditure, principally in the mining and power generation sectors. A fiscal imbalance was created.
1982-1986	The Latin American debt crisis did not affect Colombia as much as other countries due to lower levels of external debt. However a severe balance of payments crisis developed, and was confronted with tighter trade barriers, including a counter trade scheme.	In 1985 a significant devaluation was sought to confront the balance of payments crisis. The policy was successful in balancing external accounts. The peso depreciated by 50% in one year without any major change in the rate of inflation.	Financial sector regulation reforms were introduced – deposit insurance, establishment of a guarantee fund and re-privatisation of nationalised banks. Colombia is the only major Latin American country which did not have to reschedule its external debt during

			the debt crisis.

Table A1: Timeline of economic policies in Colombia, 1950-2008 (continued)

Period	Commercial Policy	Exchange Rate Regime	Monetary and Fiscal Stance
1986-1990	A trade liberalisation process began. Trade levels benefited from a coffee, coal and oil export boom – as well as that of illegal exports.	The crawling peg scheme was aimed at maintaining competitiveness along the lines of Purchasing Power Parity (PPP) with a basket of foreign currencies.	Fiscal reform is passed. Fiscal adjustment is focussed on cutting public investment, increasing Central Government revenue29 and reducing the Central Government deficit significantly.
1991-1994	Internationalisation - the reduction and elimination of non-trade barriers and export subsidies. Average tariffs[30] and tariff dispersion were lowered, several regional integration agreements were signed (most importantly the G-3 agreement with Venezuela and Mexico) and foreign investment was liberalised. As with all emerging economies, Colombia received important capital inflows. Short term capital inflow controls were enacted.	Adoption of an exchange rate band regime, whose slope was set along PPP lines. However, there was a real appreciation which triggered imports of consumer goods.	Market-oriented financial sector reform: simplification of foreign capital entry and exit regulations, adoption of an almost universal banking scheme, reduction of intermediation taxes, tighter regulation, re-privatisation of financial institutions. New Central Bank Law provided greater autonomy to monetary authorities.
1995-1998	Substantial increase in oil exports.	Exchange rate turbulence triggered by a contagion of the international crisis in the emerging markets, as well as political and monetary policy factors.	Inflation targeting adopted. Increase in capital inflows. Excessive fiscal expenditure and borrowing.
1999-2008	Imports decreased significantly, while exports were enhanced	Introduction of a Flexible Exchange Rate regime.	Adjustment program with IMF. Pension and regional

[29] This was achieved principally via the 1983 tax reform, which imposed VAT on most goods.
[30] These fell from 34% in 1990 to 12% in 1991.

	by an increase in oil price levels. Free trade with Venezuela became critical for manufacture sales.	transfers reforms. Plan Colombia and Seguridad Democrática increased the Defense budget.

Table A2: Leadership, catalysts and constraints in three phases of Colombian economic development

Phase	Content of reform	Leadership	Catalysts	Constraints
1966-1981	The mid-1960s saw the introduction of a new model, which promoted exports, but maintained the distortionary regulations and lobbyism of import-substitution. Urban areas grew, the domestic markets increased and a new working class developed. The government encouraged currency stability through mini-devaluations, and the financial system developed, providing better conditions for savings and credits.	The President and the Coffee Growers Federation led the reforms and economic policy design, thereby ensuring that the coffee growers benefited from the changes made.	Import-substitution failed because firms in the cities were located far away from ports; prices of imported inputs increased; small plants constrained the exploitation of economies of scale; low exposure to international competition technological advance; and poor education system. At the same time, there was a dilemma between an agrarian reform aimed at distributing land to peasants, and emigration flows to urban areas attracted by higher productivity and employment opportunities. There were three significant devaluations in 1963, 1966 and 1968.	Coffee exporters resisted through the National Federation of Coffee Growers lobbyism aimed at avoiding nominal appreciation. Powerful urban industrial confederations also played an important role in maintaining the burdensome import-substitution regulation that distorted prices and quantities (quotas, directed credit). The central bank distorted quantities via money creation for specific sectors.

Table A2: Leadership, catalysts and constraints in three phases of Colombian economic development (continued)

Phase	Content of reform	Leadership	Catalyst	Constraints
1982-1995	Opening up of the economy. Capital controls were relaxed. Significant oil wells were discovered. A new constitution was written, which created a new system of regional transfers that decentralized public expenditure. There were pension, labor and financial reforms. The central bank gained independence.	Reforms were led by the President, partly inspired by the Washington Consensus. According to Steiner and Edwards (2008), multilateral corporations played a key role.	In the mid-1980s, the Latin American debt crisis closed access to external funds and the government lost control of its fiscal accounts.	The housing market boom created a strong confederation of mortgage financial institutions which resisted financial sector reforms. Dependence on natural resources for attracting foreign investment. Worsening of violence and conflict situation.
1996-2008	The economy was opened still further. Oil and manufactured and agribusiness exports increased. An adjustment programme with the IMF led to fiscal and financial reform. Plan Colombia (a US backed security strategy) and Uribe's Seguridad Democrática increased the defense budget. The conflict's intensity decreased and the government recovered an important part of the national territory. Pension, labour, tax and regional transfers reforms were enacted.	The reforms were led by presidents Pastrana (1998-2002) and Uribe (2002-present). During this period the consensus for fiscal discipline and structural reforms regained importance. This gave technocrats a key role, especially in the Finance, Economic Planning and Defense ministries.	The first half of the 1990s were years of financial largesse for households, firms and the government. By 1996 it became clear that the indebtedness levels were too high; there was a real state price bubble, mortgages hiked; the peso became unsustainably strong; and government's deficit widened.	The biggest constraint during this period was low growth, accompanied by high unemployment. At the same time, the armed conflict threatened the financial and security situation. Business associations inhibited the scope of tax reforms. The unions did the same with labor and pension reforms; and mayors and governors with regional transfers reform.

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2009 Latin America Emerging Markets Forum