COLOMBIA´S ECONOMY AT THE TURN OF THE CENTURY
Reforms and results of the free-market paradigm

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Contents

I. Foreword

In the late 1980s, many Latin American economies were heavily burdened by their external debts, and no longer competitive under a model of import substitution. Several countries undertook a series of radical economic reforms to strengthen their productive activities and to promote regional integration. Some of these reforms pursued to achieve greater macroeconomic stability, by reducing inflation rates and decreasing the fiscal deficit. Some others, which were more structural in nature, fostered free-trade policies, foreign investment, and the privatization of public enterprises. Other reforms introduced greater deregulation and a wide opening of the capital markets. These economic policies were coupled with an intense diplomatic activity aimed at establishing a variety of bilateral and multilateral trade and cooperation agreements. All of these endeavors caused a major

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shift in the region´s development pattern. In a context of increasing regional integration, the private and external sectors would become the new engines of economic growth.

Colombia´s structural reforms were in tune with domestic needs, but also geared to the emerging trends of economic globalization. In line with other Latin American countries, Colombia intended to modernize the general structure of the State, and to boost some of its key economic sectors. The ultimate goals were to improve the country´s social welfare in the medium and long terms, and to render its economy more competitive in the global markets. At the outset of the XXI century, these outcomes remain uncertain and the country faces an even more complex array of challenges.

This paper outlines Colombia´s recent economic performance, examining closely the free-market policies of the early 1990s, as well as their chief economic and social outcomes. Since most Latin American countries have followed a similar path –though the timing and scope of their reforms may have differed greatly, and as the social impact of economic liberalization is strongly felt throughout the region, it is reasonable to consider the Colombian *case study* as a typical example, from which to draw various lessons. The following section provides a brief description of Colombia´s structural reforms. Section III examines post-reform macroeconomic developments, and the related rearrangement of the productive structure. Section IV analyzes rising unemployment and the decline and concentration of income as the country´s most pressing economic concerns. Section V examines some of Latin America´s difficulties to become fully integrated to the global economy as well as various regional stances on hemispheric integration.

II. The Liberalization Policies of the 1990s

In the early 1990s, the free-market paradigm was defined as the new path to economic growth that would lead to the best allocation of resources in all sectors, promote competitiveness, stimulate the use of new technologies, and increase exports to new foreign markets. With these objectives in mind, Colombian policymakers introduced significant changes to the country´s trade, financial, exchange, labor, social security, and public finance systems. On the one hand, the goal was to liberalize the balance of payments; on the other, the objective was to open the labor and social security sectors to the market forces. Although a major purpose was to reduce the size of the State, so as to make it more efficient, decentralization policies turned the government responsible for a great variety of social programs. Thus, by the year 2000, the Colombian public sector was 80% larger than ten years before, and its financial sustainability began to pose serious concerns. The following paragraphs describe these reforms in more detail (box 1 summarizes them).

- **The New Trade System** In Colombia, the opening up process began in 1990 with a trade reform. Basically, prior-license requirements to imports were eliminated; the number of tariffs and their levels were reduced; trade operations steps were simplified; and new rules for the signature of international agreements were formulated. These policies were backed up with the establishment of : (a) a Foreign Trade Ministry; (b) a financial institution (*Bancoldex*); (c) an agency to control illegitimate trade practices and supply information about international prices (*Incomex*); and (d) an entity to promote exporting (*Proexport*). The average nominal tariff on imports went down from 49,4% at the beginning of 1990, to 11,7% by the end of 1991. Nevertheless, the uncertainties related to the new environment led, at first, to a very moderate increase in the level of imports.

- **Adjustments to the Financial System**. Colombia's Political Constitution of 1991 established an autonomous Central Bank responsible for maintaining the purchasing power of the currency (Law 31 of 1992). To meet this objective, the board of the Central Bank draws and implements the country's monetary, exchange rate, and financial policies. The main fiscal effect of the new Central Bank is its inability to make direct loans to the

Government (the Central Bank cannot purchase public debt instruments in the primary market). Moreover, the reforms ended the Central Bank's subsidized loans to specific sectors (agriculture and industry), and drew the legal and economic conditions under which commercial banks could become multi-banking institutions rather than specialized banks (Law 35 of 1993). Likewise, the new regulations eliminated obligatory investments for the banking system, and decreased the banks' required reserves in the Central Bank. Last but not least, the financial system was opened to foreign investment.

- **The New Exchange Regime.** Under the new regulations, the central bank no longer kept the monopoly to trade with foreign currencies. The market forces were left to determine the exchange rate as well as the allocation of the foreign trade resources. The exchange-control mechanisms were modified and they involved the financial institutions some more. Anybody could hold foreign currencies or assets, yet in limited quantities (Law 9 of 1991). Between 1991 and 1994, there was a transition period towards a system of exchange-rate bands, which was finally established in February of 1994. Throughout these years, the exchange authorities continued to announce on a daily basis the "official exchange rates" according to the crawling peg system. However, the bands system was dismantled in September of 1999, partly as a result of the speculative attacks associated to the Asian financial crisis. Subsequently, a free-floating exchange system was adopted (see details in Villar and Rincon, 2000).

- **Labor and Social Security Reforms**. In general, new labor regulations were designed to render the labor market more flexible. Until 1990, Colombian labor laws generated uncertainty and overburdened employers. The reforms made possible to contract workers for less than one year, and their annual salary-based benefits (locally known as *cesantías*) were no longer retroactive. The new labor policies were coupled with fundamental changes to the social security system. In essence, the law 100 of 1993 replaced the Government's social security monopoly with a dual system. The objective was to extend coverage and to secure pension payments to all current and future retired workers. Nowadays, such a dual system operates either through individual capitalization into private funds, or through deposits made into public agencies –which continue to function as before the reform.

- **The Decentralization Process**. The Constitution of 1991 reinforced a longstanding process of political and fiscal decentralization. From a fiscal expenditure standpoint, its main goal was to increase the provincial and municipal health and education allocations, and to maximize their benefits. Local governments were assumed to be better administrators of public revenues, because of their greater proximity to the communities. The law 60 of 1993 defines (a) the given amounts that the central government must transfer to the regions (provinces and municipalities); (b) geographic criteria for allocations; and (c) guidelines for allocations to different social programs. By the end of the 1990s, Colombia´s level of public expenditure allocated to regional levels ranked first after the two federal countries in the region (Argentina and Brazil). In the year 2000, nearly 36% of the country´s total public spending was executed by sub-national governments, against a regional average of 15%. Nevertheless, as these expenditure levels were not matched with tight budget constraints, they resulted in a never-ending fiscal imbalance coupled with an unprecedented number of tax reforms. There were, at least, eight national tax reforms between 1990 and 2000. They introduced constant changes to the Value Added Tax , and a tribute on financial transactions (more details in Lozano, 2001).

Box 1. Structural Reforms in Colombia

Trade System:

- Removal of prior-license requirements to imports. Reduction of tariffs (in number and level).
- Easier trade operations. New rules for the signature of international agreements.
- Creation or reform of public entities: Foreign Trade Ministry; *Bancoldex* (financial institution); *Proexport* (promotes exporting), etc.

Financial System

- The Central Bank becomes autonomous.
- The Central Bank no longer provides subsidized loans to given sectors (agriculture, industry, etc.)
- Commercial banks become multi-banking institutions rather than specialized banks.
- Banks no longer have obligatory investments. Their required reserves in the Central Bank are reduced.
- The financial system is opened to foreign investment.

Exchange Regime

- The Central Bank no longer has the monopoly to trade with foreign currencies.
- Modification of exchange-control mechanisms. Financial institutions get more involved.
- Anybody can hold foreign currencies or assets, yet in limited quantities.
- The exchange-rate bands system operates between February of 1994 and September of 1999. Thereafter, a free-floating exchange system is adopted.

Labor and Social Security

- Workers can be legally hired for less than one year. Their annual salary-based benefits (locally known as *cesantías*) are no longer retroactive.
- The government's social security monopoly is replaced by a dual system (which allows capitalization into private funds, or the public agencies that still exist).

Fiscal Decentralization Process

- Aims at increasing and maximizing the benefits of allocations to the provincial and municipal health and education programs.
- Law 60 of 1993 defines the magnitude of transfers to the regions, geographic criteria for allocations, and guidelines for allocations to given social programs.

III. Colombia´s Post-reform Economic Performance

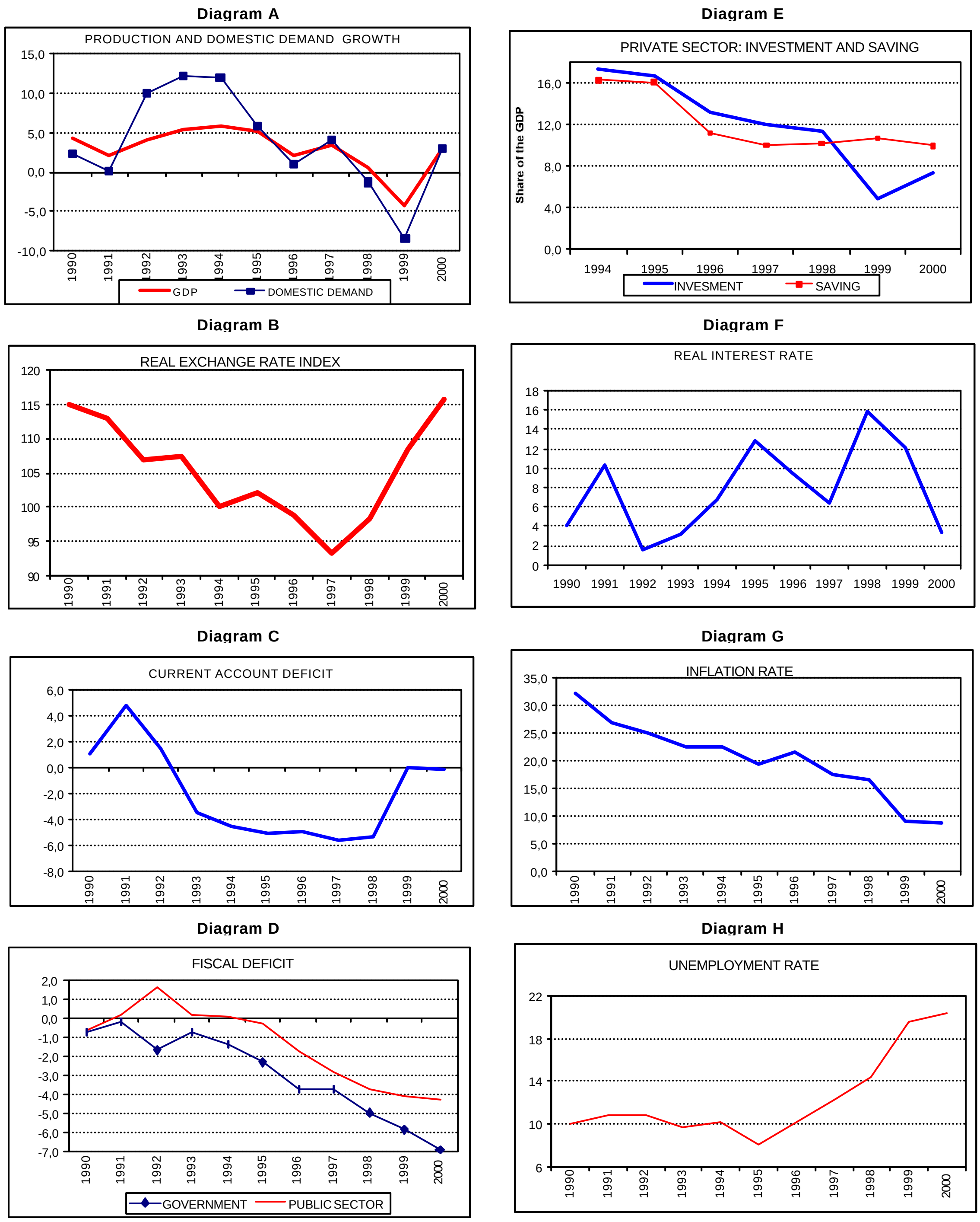
1. Chief Macroeconomic Developments

In the context of a global economy, national governments pursue a solid macroeconomic stability to attract foreign investment. Thus, macroeconomic policies play a significant role in the new development model. The following section outlines Colombia´s recent macroeconomic behavior and its relationship with the performance after a decade of liberal reforms (Graphic 1).

- *A sharp domestic consumption cycle*. In the early 1990s, reforms to the capital market and a relaxed monetary policy foster the expansion of available resources. Thus, a swift increase in the domestic consumption patterns, both private and public, took place. Some analysts associate this consumption boom to three variables: (a) price changes related to the opening up process; (b) the relaxation of liquidity constraints; and (c) a foreseeable income increase (Urrutia and López, 1994; Echeverry, 1996). The growth rate of the aggregated demand, which was governed by consumption, went up from 0,1% in 1991, to 12% in 1994. Thereafter, a more conservative monetary policy, and its resulting interest rates, reversed the consumption cycle, even though it had short periods of relaxation. In general, such monetary policy was a result of the external and public deficits as well as the speculative attacks of financial investors (Diagram A).
- *A fast-growing external deficit in the early 1990s*. The large inflows of foreign capital, particularly into the financial and oil sectors, as well as the privatization of public assets, had an impact in the exchange rate appreciation. At the same time, a higher internal consumption and the lower prices of imports resulted in their fast increase, while the elimination of the protection barriers, left exporters in a very vulnerable situation. The outcome was a fast- growing external deficit which attained 5,5% of the GDP in 1997. In the second half of the 1990s, this deficit was adjusted, particularly because the domestic demand fell, and so did imports. The exchange rate depreciation after 1998 also contributed to this adjustment (Diagrams B and C).

- *A steady public-finance imbalance.* The new role assigned to the State by the Political Constitution of 1991 brought about the expansion of social programs, manly through fiscal decentralization, as well as a substantial reform to the social security system. Likewise, the judicial system and other public agencies stood a radical transformation. These reforms caused a dramatic increase of the public spending levels, which amounted to near 4,2% of the GDP. Because the government´s tax revenues did not parallel such spending trends, despite the various tax reforms, a permanent and fast-increasing fiscal deficit settled in, becoming a most serious source of macroeconomic instability (Diagram D).
- *The imbalance of private accounts.* In the early 1990s, most private investment came from inflows of foreign capital, which were allocated into the oil, banking, and construction sectors. The establishment of an integrated financial market, made possible through the liberal reforms, facilitated this trend. Between 1991 and 1994, private investment in Colombia grew from 8,4% to 12,5% of the GDP, and then it dropped. Nevertheless, through the 1990s, private saving decreased steadily. Between 1990 and 1995, it fell from 14,1% to 8,6% of the GDP, and then it continued dropping even more. A recent article (Hernández and Lozano, 2001) stated that in the second half of the nineties, the credit requirements of the Central Government absorbed a significant portion of the private saving (Diagram E).
- *A high external vulnerability led to changes on the exchange control mechanisms.* Like many other emerging economies, Colombia was not immune to international financial crises. Because of speculative attacks, and following the Brazilean and Chilean example, in September of 1999, the Colombian Central Bank replaced the exchange band system with a free floating scheme. Yet, it lost a substantial amount of foreign reserves in the process.

GRAPHIC 1
COLOMBIA: CHIEF MACROECONOMICS DEVELOPMENTS



Source: Banco de la República - CONFIS - DANE - DNP.

Between the late 1997 and the mid 1999, the Colombian Central Bank sold approximately US$ 2.4 million of its external reserves.

- *The acute economic depression of the late 1990s*. By the end of 1996, both the real business cycle and the real rate of domestic consumption reversed their trends. The Colombian economy plummeted into a deep recession, reaching a growth rate of –4,3% in 1999. Throughout this period, the domestic real interest rates were consistently high, and Colombian policymakers faced the perils of political instability and a sharp financial crisis at once. Nevertheless, by the year 2000, the economy reentered the path of positive growth (2,8%). It is worth mentioning that the autonomy of the Central Bank, mandated by the 1991 Constitution, brought about an steady decrease of inflation rates, from 32,4% in 1990 to 8,7% in 2000, thus meeting the Bank´s inflation targeting scheme (Diagrams A, F and G).

2. A New Paradigm of Economic Development

Colombia, along with many other third world countries, has been gradually entering into a new paradigm of economic development. In such new model, the services sector (banking, telecommunications, government, commerce, personal services) has a large share of the country´s aggregate output, while there is a decrease of the activities related to the production of goods --agricultural and industrial. This trend has been displayed even by the so-called emerging economies (Graphic 2).

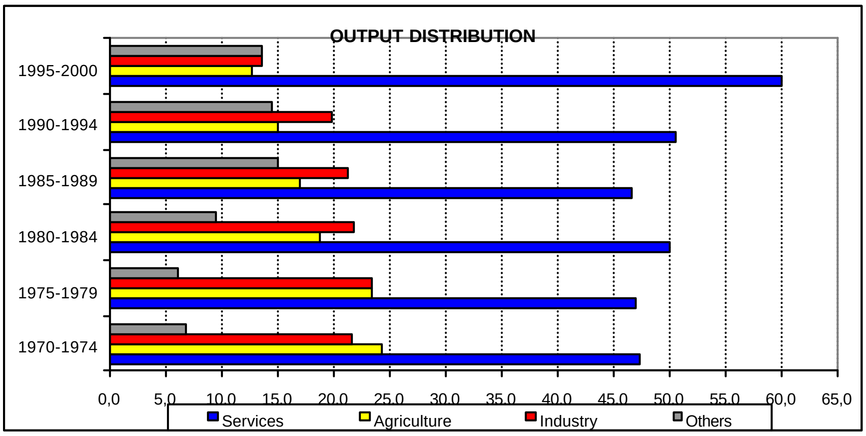
In the 1970s, the Colombian agricultural sector explained one fourth of the productive activity; ever since, it has registered a decreasing participation. Before the free-market reforms, many agricultural activities were protected and subsidized. Once the reforms took place, many traditional agricultural business began to face serious challenges. Some of them disappeared completely, others strove to become more competitive.

From the 1980s, the Colombian industrial sector has shown very little signs of progress. Currently, the production of non-durable consumption goods, which is low intensive in technology and knowledge, is the leading industrial activity. On the contrary, the production of capital and semi-manufactured goods, which is traditionally associated to technological progress and human capital development, registers a declining participation on the country´s aggregate output. Nowadays, the agricultural and industrial sectors together explain 26% of the country´s output, while at the early 1970s they explained more than 46% (Diagram A).

The services sector (in particular banking, government, transportation, and commerce activities) has displayed a more dynamic behavior, explaining more than half of the total output in recent times (60%). Although this sector is labor intensive, usually the workers demanded have relatively low human capital, and the majority of them are enrolled in informal jobs, with very low value added.

GRAPHIC 2
COLOMBIA: CHANGES IN THE DEVELOPMENT PATTERN

Diagram A



AGRICULTURE

Diagram B

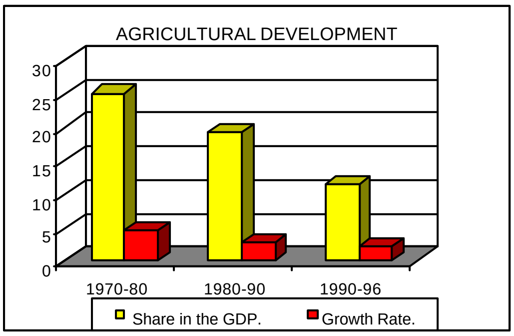


Diagram C

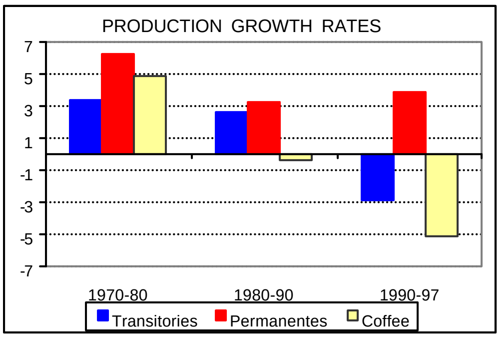
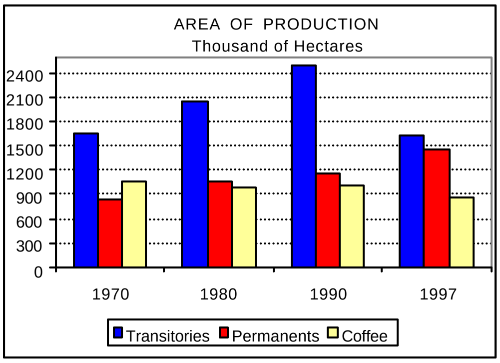


Diagram D



INDUSTRY

Diagram E

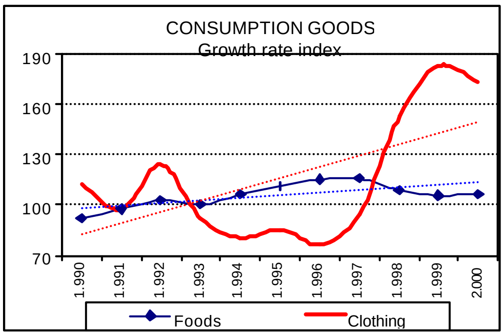


Diagram F

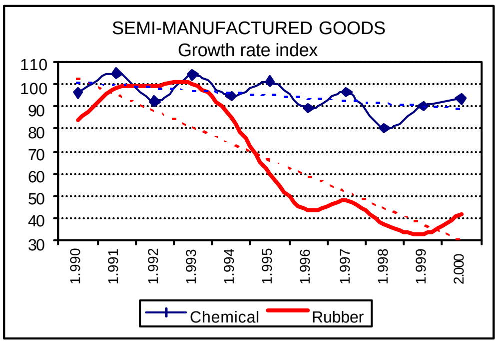
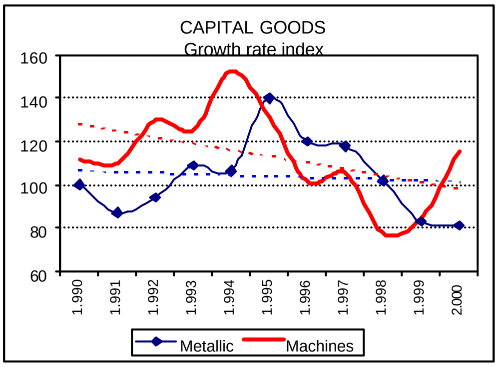


Diagram G



Sources: DANE, Agricultural Ministry, Balcazar (2001)

Recently, the output composition changes described above have been coupled with very large unemployment rates, as well as decreasing income levels for the workforce. In this context, Colombia has little advantages to participate effectively into the world´s globalized economy.

a. Agriculture loses its predominant role

In recent times, Colombia´s agricultural development had been promoted through a series of subsidies and protection measures such as: (a) high and discriminatory tariffs to imports; (b) quantity restrictions to imports; (c) subsidies related to prices guaranteed by the State; (d) subsidies associated to financial loans; and (e) in the case of export crops, subsidies linked to the State´s payments to producers. In addition, the international coffee agreement, which was in force between 1962 and 1989, played a key role in the country´s coffee production --Colombia´s leading agricultural activity.

Between the 1960s and the 1990s, agriculture and cattle raising activities were a dynamic field. In the 1970s, the real production of these sectors grew at 4,6% per year; however, by the 1980s, this figure dropped to 2,9%. Between 1990 and 1995, agricultural and cattle raising activities continued to grow at 2,2% per year; yet, between 1996 and 1999, their growth rate was virtually null, or even negative for some periods. Consequently, the share of these sectors in the country´s aggregate GDP went down from 25% in 1970, to 11% in 1996. Such a sharp decrease was particularly evident as of 1992 (Diagram B). There is not question that the opening-up process of the early 1990s, which meant the elimination of most protection mechanisms, greatly contributed to such a decrease.

Moreover, the elimination of the international coffee agreement in 1989 worsened this trend.

In the 1990s, the contraction of the agricultural sector resulted in a re-composition of the production activities away from the tradable goods, which had been so heavily protected before the reforms. The use of agricultural resources as well as the sector´s income distribution would never be the same.

- **The coffee-production crisis**

Coffee production, Colombia´s chief agricultural activity until the 1990s, developed significantly under the international coffee agreement (1962-1989). Initially signed by 54 countries (32 producers and 22 consumers) whose commercial activities explained 95% of the international coffee trade (exports and imports), the agreement intended to balance the international coffee markets by setting prices and production quotas.

Under the international coffee agreement, Colombia became the world´s second producer of coffee, with nearly 11 million bags per year. Until 1992, coffee production rendered considerable profits to the country´s economy, and was a significant source of employment. This was particularly true during the second half of the 1970s, when the external coffee prices registered a dramatic increase. Between 1976 and 1980, the average price of a pound of Colombian coffee was US$ 1,9 --almost five times the average price registered in the 1960s (Avella, 2000) . Such a high price had a positive impact on the overall economy of the country, which grew approximately 5,3% per year.

The collapse of the international coffee agreement in 1989 brought about the fall and volatility of external prices. Consequently, coffee production and its contribution to the total value of exports decreased significantly (from 50% in 1985, to 21% in 1998). In 1997, the real income of coffee producers was 33% lower than in 1991.

- **The Re-composition of Agricultural Production**

Agricultural products may be classified as *tradable* or *non-tradable*. In turn, tradable products are *permanent* (coffee, banana, flowers, sugar, African palm) or *transitory* (sorghum, cotton, corn, barley, rice). Permanent products have an agricultural cycle much larger than transitory goods. In Colombia, many tradable products, and particularly the transitory ones, were negatively affected by the economic opening. In some cases (sugar, rice) the government kept some protection policies, however most tradable crops grappled with the new open-market conditions. Non-tradable products (fruits, vegetables, tubercles and legumes), which had never profited from protection measures, fared much better through the free-trade reform (Diagram C).

Productivity and production areas. Through the 1990s, Colombia´s agricultural land registered a sharp decrease of more than 700,000 hectares. Such a reduction was particularly evident in the case of transitory goods, whereas some permanent goods registered some increase. The areas traditionally devoted to coffee production decreased nearly 150,000 hectares (Diagram D). Despite this phenomenon, in this period, both the quantity and the value of the country´s agricultural production registered increases. This could be interpreted as a raise of agricultural productivity, particularly when productivity is measured as the production value by hectare (Balcazar, 2001). However, such increases could also be explained by the higher relative prices gained by the producers of non-tradable goods after the free-market reform.

Although in recent times many Colombian crops have increased their productivity by hectare, for the international standards, the country´s marks lag behind significantly. In the late 1990s, Colombia produced 4,36 tons of rice by hectare, while China produced 6; 2,1 tons of barley, while the European Union countries yielded 6; 1,7 tons of corn, while Chile rendered 9; 2,2 tons of wheat, against 3,5 produced by France.

Prices, Margins, and Quantities. Once protection policies were eliminated, the relative prices of tradable products fell. Since 1993, an exchange appreciation trend stimulated imports, and furthered low export prices. Such a price behavior had a negative impact on the profitability and production of tradable goods, particularly the transitory ones. On the contrary, the relative prices of non-tradable products increased, and thus their production and margins of profit. As a whole, Colombia´s agricultural sector grew 4,6% per year in the 1970s; 4,4% during the second half of the 1980s; and 1,3% between 1990 and 1997. Between 1993 and 1996, the country´s dynamic internal demand made possible the absorption of imports as well as a higher production of non-tradable goods.

- **The New Allocation of Agricultural Resources**

In general terms, the free-trade reforms meant for the Colombian agricultural sector a sharp regressive adjustment, with a substantial loss of production, employment, and income. A case in point, the land no longer used for agriculture was devoted to cattle raising activities which are very low intensive in capital and labor resources.

Between 1992 and 1997, the Colombian agricultural sector lost nearly 130,000 employees. This figure comes from a decrease of 155,000 employees in the production of transitory goods, and 230,000 employees in the coffee crops. The remaining agricultural activities displayed an increase of only 253,000 employees. By 1999, the participation rate of the rural labor force reached 56,2%. Thus, rural unemployment went up from 4,2% in 1991 to 6.4% in 1996. By the end of 1997, nearly 380,000 rural workers had no employment. This figure is associated to the coffee crisis. In 1997, coffee-production activities generated 137,000 jobs less than in 1991.

Between 1991 and 1995, the per capita income of Colombia´s rural population decreased at 2,13% per year. Interestingly enough, while in 1995 the richest decile of this population was making only 40% of their 1991 income, the two poorest deciles registered an income increase of 7,3% per year. Thus, the Gini coefficient on the rural income went down from 0,57 in 1991 to 0,44 in 1995. Such a positive trend on the rural income distribution reversed the trend of previous years (between 1978-1991, the Gini coefficient raised from 0,49 to 0,57), and it could be related to the higher production of non-tradable goods (which are cropped by a larger number of farmers). Nevertheless, nowadays, Colombia´s agricultural sector remains deeply troubled by a gross income inequality and a marked concentration of the land.

b. The Setbacks of the Industrial Sector

In the late 1980s, Colombian policy-makers had important reasons to propose a sharp economic reform. Economic growth was slow; the imports-substitution model was no longer effective; and neighboring countries were introducing free-market policies as recommended by the World Bank.[1] Moreover, there was broad consensus on the fact that protection mechanisms, such as high tariffs and quantitative restrictions to imports, were not necessarily strengthening the country´s industrial sector. On the contrary, heavily protected industries not always had enough incentives to become more competitive in the global markets.

Due to these reasons, between 1990 and 1991, the Colombian government eliminated all quantitative restrictions to imports, and reduced tariffs by more than two-

[1] In 1989, a study from the World Bank recommended that the Colombian economy relied more on its external/exporting sector (than on its internal market) as a new strategy for economic development.

thirds (in average, effective tariffs for manufactured products fell from 66.9% in 1990 to 21,5% in 1992). These policies were coupled with the signature of regional trade agreements, and additional reforms to foreign investment regulations.

During the first half of the 1990s, the expansion of the internal demand as well as the lower cost of imports (including row materials, equipment, and machinery) had a positive impact on the manufacturing industry –and particularly on the production of consumer durable and non-durable goods, which became the most dynamic industrial activity throughout the liberalization period.[2] In fact, the production of semi-manufactured goods (steel, iron, oil, textile, and paper industries), which had developed considerably over the previous twenty years, soon lagged behind the production of consumer goods, both durable and non-durable. By 1996, 51% of Colombia´s aggregate industrial production was explained by consumer goods (processed-food items alone represented 20,3%; and beverages, 7,4%). By contrast, the share of the country´s textile industry had fallen to 7,2%, from a healthy 14,9% registered in the late 1970s.

After 1996, a sharp decrease in the domestic aggregate demand caused severe problems to the whole manufacturing sector. By 1998, the situation became critical, and only one year later, the country´s industrial sector fell into an unprecedented recession with a negative growth rate of –12,5%. Such a dramatic setback, went hand in hand with the closing of all kinds of business that had begun as early as 1992. By then, a great variety of industries began to face serious liquidity problems, thus becoming unable to cover their operational costs. Many of them declared themselves in bankruptcy. Taking into account small, medium, and large firms, in 1993, there were 12 such cases --affecting approximately one-thousand workers. In 1995, there were 57 such cases --affecting more than eleven-thousand workers. Altogether, between 1990 and 1996, there were at least 183 enterprises in bankruptcy, affecting nearly thirty-thousand employees. Of these, at least 93 had closed operations for good by November of 1997 (Garay et al.1998).

Employment figures for the industrial sector parallel the aforementioned trends. Between 1991 and 1993, the industrial demand for labor grew in average 3,6%. Later on such a demand dropped, and by 1995-1996, it was already displaying negative rates of –3.1% and –4.1% respectively. In the following years, unemployment figures raised dramatically, partly because of the sharp industrial recession, but also due to the higher labor costs introduced by the social security reforms.

Despite the government´s visible efforts to promote research and development activities through the 1990s, (by the creation of a *National System of Science and Technology,* and the promotion of *Technological Development Centers*), the Colombian industry, as a whole, showed no significant technological progress in the period. The country manufactured a great deal of consumer goods (low intensive in knowledge and human capital), but failed to produce capital and semi-manufactured goods (traditionally linked with a higher technological complexity) --Diagrams E to G. Even the country´s imports had low levels of sophistication. By 1996, Colombia´s public investment in research and development activities remained remarkably low, at only 0,25% of the GDP. Countries as diverse as Cuba, Costa Rica, Canada, and the U.S. were investing a healthy 1,5%, while Korea devoted 2,5% of its GDP to these activities.

IV. Staggering Unemployment and Income Distribution –Chief Concerns at the Turn of the Century

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[2] The growth rate of the industrial sector as a whole went up from 1,2% in 1990 to 6,3% in 1993.

The deep crisis that the country´s key economic sectors (both agricultural and industrial) endured right after the free-market reforms had an extremely negative impact on Colombia´s labor market. In addition, neither the services sector nor the mining or construction activities were able to absorb all of the displaced workers from other sectors, or to generate employment for the new labor force. After 1995, Colombia´s rates of unemployment have increased relentlessly, reaching staggering levels of 20% in the cities, as well as the largest unemployment rate of the hemisphere. Informal activities have become the only source of income for thousands of people, with all of the negative effects related to this phenomenon.

Concomitantly, as of the second half of the 1990s, income levels across all social sectors began to display a decreasing trend, while the country´s wealth remained highly concentrated. After Brazil, Colombia has the most uneven income distribution in the region (although its levels are remarkably close to those of Bolivia, Chile, Guatemala, Honduras, Nicaragua, and Panama). These economic circumstances have greatly contributed to the country´s fragile political stability and weak social cohesion (Ocampo, 2001).

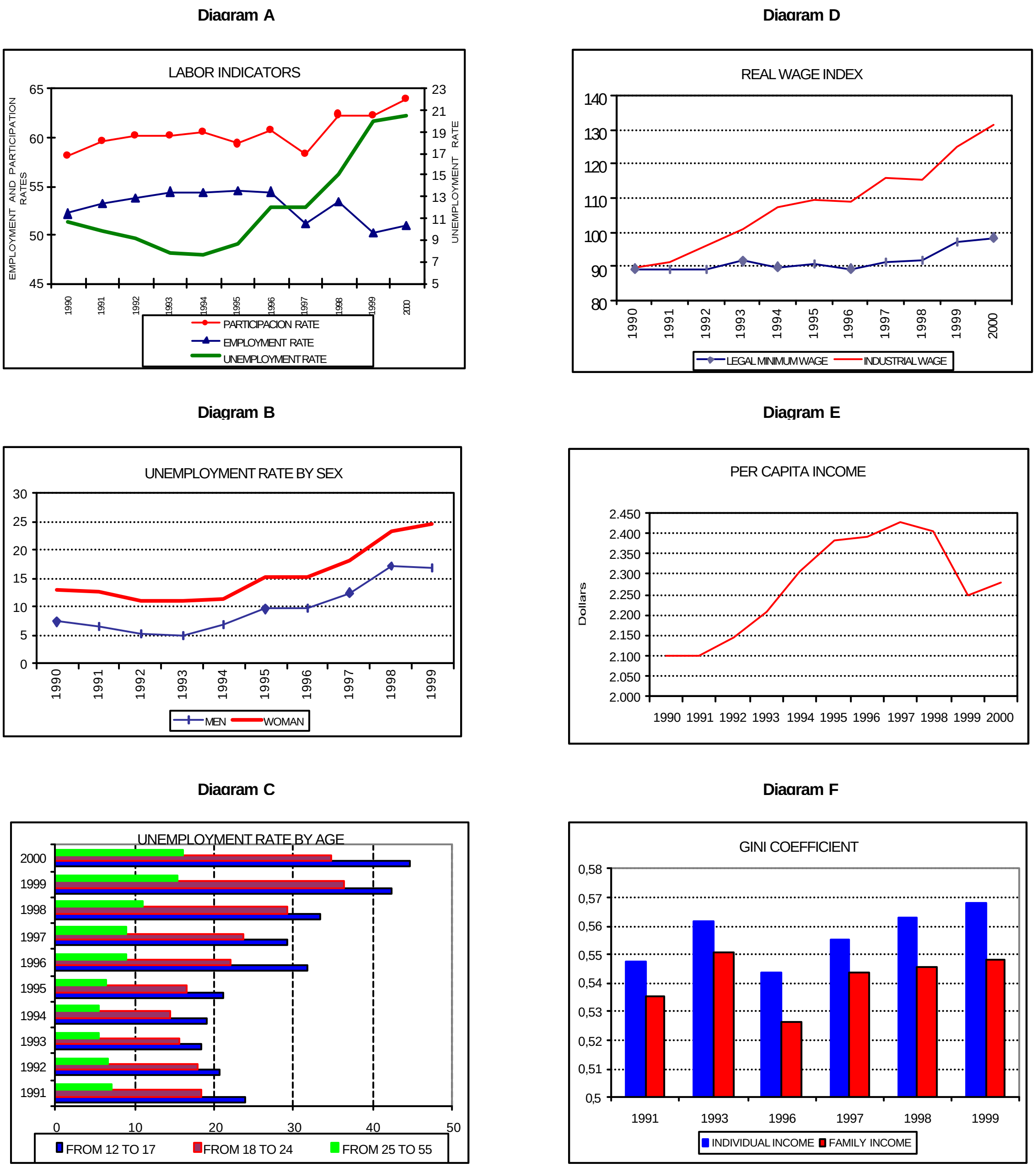
The following paragraphs describe the main features of the Colombian labor market in the 1990s, examining the links of unemployment with (a) the real business cycle, (b) labor supply aspects, and (c) the decline and concentration of income (Graphic 3).

Unemployment and the real business cycle

- Right after the free-trade reforms, some economic sectors (services, construction, several agricultural and manufacturing industries) increased their labor demand, in about 4,7 points between 1991 and 1995 (Ocampo, et al. 2000). However, all of the sectors negatively affected by the liberal policies (mainly the providers of tradable products) decreased significantly their labor requirements, reaching rates of –3,9 points during the same period. Overall, by 1995, the country´s urban aggregate unemployment had dropped to 8,1%.

- The second half of the 1990s brought with it a severe reversal of the real business cycle. It was a period of sharp macroeconomic imbalance, a deep fall in domestic consumption, industrial recession at large, and even the dramatic collapse of the construction sector (in itself a major source of direct and indirect employment). International financial crises as well as turmoil in the country´s financial sector (with a consequent hardening of monetary policy) deteriorated the economy even more. Colombia´s growth rates went from 5,2% in 1995 to –4,3% in 1999 --the year when urban unemployment climbed up to an all-time high 19,5% (Diagram A).

GRAPHIC 3
COLOMBIA: UNEMPLOYMENT AND INCOME CONCENTRATION



Source: DANE. World Bank

Unemployment and labor supply

- Between 1989 and 1996, the participation rate of the labor force remained in average

59,5%. Thereafter, such indicator increased from 58,3% in 1997, to 64,7% in 2001. Since the country´s demographic growth has decreased progressively in the last decades (from 31,5 per one thousand between 1951-1964, to 18,4 between 1985-1993), the availability of a larger labor force is explained by the fact that more people are seeking employment. During the economic recession, nearly 37% of the country´s households have lost income, as one or more members of the family group have lost their jobs. Consequently, nowadays, it is a common trend that not only the household heads seek employment. In addition, a vast rural migration into the cities, largely related to the country´s armed conflict, has raised even more the high number of workers available.

- Young, non-skilled workers, both male and female, are the group hardest hit by unemployment. Currently, one of every four youths (18 to 21 years of age) is unemployed, and females are more severely affected. By the late 1990s, the Colombian average unemployment rate for women, between 15 and 25 years of age, more than doubled the Latin American average: 40% vs. 17% (Diagrams B and C). Likewise, the poorest households are the most negatively affected by unemployment. By quintiles, in 1999, the first three had raised their labor participation by 63%, as a large group of youngsters dropped out of school. In the first two poorest quintiles, the percentage of children dropping out of school increased about 13,8% and 12,5% respectively.

Unemployment and the decline and concentration of income

- Through the 1990s, Colombia´s skilled work force experienced a steady income raise of 3,9% in average. Such an increase had a negative impact on the demand for skilled labor and rendered the job market very rigid. Yet, as labor productivity figures were way below, skilled workers registered accumulated earnings of 32%. By contrast, unskilled workers remained at minimum wages --which were barely adjusted to inflation rates every year. Such a wide income gap between the skilled and unskilled workers greatly explains the country´s very high income concentration rates (Diagram D).

- Since 1985, Colombia´s per capita income level (by then at US$1,840) began to register a steady growth. In the early 1990s, such a positive trend was evidenced by the already mentioned expansion of the country´s aggregate demand. However, by 1998, the situation reversed completely, and Colombian´s income rate was at the level registered six years before (Diagram E). Currently, Colombia´s per capita income is very similar to times lower than Chile, Mexico, and Brazil´s; nine times lower than Italy and ; and fourteen times lower than the U.S.´
- Income inequality and a steep concentration of wealth have been a constant throughout Colombia´s economic history. Much of the country´s internal conflict is directly related to the fact that the ownership of land, financial assets, real state, has been the privilege of very few. There is little information available on wealth distribution for recent years, however, Gini coefficients provide a clear picture of income inequality. Although individual and family income levels remained stable during the first half of the 1990s, their levels (at 0,5510 and 0,5376, respectively) were not very promising. Between 1996 and 1999, Gini coefficients relative to individual income went from 0,5436 to 0,5683; and those relative to family income went from 0,5264 to 0,5483 (Diagram F). These figures mean that by 1999, the poorest decile of the population got 0,4% of the total income, whereas the richest decile got 45%.

V. Latin America´s Difficult Path to the Global Economy

Globalization has been defined as a complex phenomenon fostered by both a series of technological developments and major changes in international relations. From an economic perspective, globalization and the establishment of free-trade policies worldwide have become synonymous. The recent expansion of international trade (whether it is of manufactures or services), as well as the development of capital markets, evidence the extraordinary dynamism of economic globalization. Through the 1990s, international trade grew 7% per year –a figure that represents the world´s production growth two-and-a-half times. Latin American exports grew an unprecedented 9% per year, although the regional share of the world´s market remained quite modest –at barely 3,7% by 1990.

Clearly, globalization trends have transformed the world´s economic make-up, rendering it more interdependent and volatile. Likewise, domestic economies have endured drastic adjustments, which include the role and functions of the State itself. In a global economy, a country´s productive and financial structures are not always ruled by the regulations, and they become increasingly sensitive to the sways and pressures of international markets. The impact of the Asian financial crisis on Latin American economies during the second half of the 1990s is a case in point.

In most economies, certain activities greatly profited from the establishment of free-trade policies, while other sectors lost relative privileges, and even protection mechanisms. Many Latin American governments, including the Colombian one, tried to restore economic balance by launching a series of social programs, well-intentioned in essence, yet extremely costly for their strained budgets. Not surprisingly, by the end of the 1990s, those same governments were facing serious fiscal sustainability crises.

The outcomes of free-trade policies were remarkably similar in many Latin American countries: (a) Initial macroeconomic imbalance (particularly in the foreign sector) was counteracted with a conservative monetary policy. (b) Initial enthusiasm was followed by a tighter domestic expenditure. The resulting high interest rates attracted foreign capitals, but decelerated exports. (c) Economic systems became divided into highly competitive sectors and non-competitive activities. A whole new pattern of economic development slowly emerged. (d) Unemployment figures raised swiftly. (e) Economic integration and the establishment of regional trade agreements became a foreign-policy priority. In this context, national governments found themselves with the double challenge of opening markets, and taking care of the consequences (Fazio, 1997).

- **Latin American Stances on Hemispheric Integration**

In Latin America, Mexico and Chile exemplify the successful implementation of neo-liberal policies. Though neither country is free from the evils of wealth concentration and income inequality, both nations enjoy vigorous economies and political stability, and thus large foreign investment rates. Mexico´s structural reform began as early as 1985, yet the country reached a milestone in 1994, when it joined the North American Free Trade Agreement (NAFTA). Chile began implementing free-market policies even sooner, by the early 1980s, and to this day, it keeps high expectations of becoming NAFTA´s fourth member. Not surprisingly, both Mexico and Chile are strong supporters of the establishment of a Free Trade Area of the Americas (FTAA) by the year 2005. Since Chile has already signed free-trade agreements with Mexico and Canada, either NAFTA or the FTAA are highly attractive to reach the U.S. market. (Annex 1 provides general information on the regional economic blocks).

By 1991, South America´s largest economies, Brazil and Argentina, along with their neighboring Paraguay and Uruguay, established MERCOSUR, the world´s fourth largest trade block. As key members of this community, Brazil and Argentina are adopting different positions regarding the FTAA. While Brazil wishes to strengthen MERCOSUR as a negotiating unit within the FTAA (and expects clear U.S. policies concerning agricultural subsidies and anti-dumping practices), the Argentinian authorities hesitate between adopting Brazil´s position or taking a more bilateral stance.

The Central American republics pioneered regional integration when they signed the Central American Common Market (CACM) in 1962. Nevertheless, the region´s well-known political turmoil during much of the 1970s and 1980s, hindered economic growth and social development. Civil wars in Nicaragua, El Salvador, and Guatemala killed more that half a million people, and brought about the exile or internal displacement of nearly two million more. Billions of dollars in property and other economic assets were lost. In 1987, the *Esquipulas II* agreement brought peace to the region, and economic integration was once again on the agenda. In fact, by 1991, the region established a system of integration known as the Protocol of Tegucigalpa. Ever since, the Central American countries adopted an "outward looking" development model, and the establishment of additional free-trade agreements (either individually or collectively) became fundamental. Consequently, Central America as a whole is looking forward to the establishment of the FTAA in 2005 (Solis and Solano, 2001).

Compared to all of the regional free-trade agreements already mentioned, the Andean Pact has been the least active and cohesive, despite its twenty years of existence. Although formally signed by Venezuela, Colombia, Ecuador, Peru, and Bolivia, only the first three countries have been active participants of the agreement --with a rather low trade value, despite a notorious increase in recent years.[3] The chief characteristic of the Andean Pact members is an evident disparity in their levels of economic development. Ecuador´s per capita income (at US $1,310) is three times lower than Venezuela´s. Nevertheless, all of the Andean countries have followed the trends of economic liberalization, and recently, Ecuador even opted for the dollarization of its economy.

Colombia has not enjoyed great success with the free-market model, despite the State´s great efforts in this regard. The country´s severe armed confrontation has caused a significant decrease in foreign investment, and the various trade agreements signed by the early 1990s have failed to strengthen the external sector as expected.[4] Regarding the establishment of the FTAA by 2005, Andean countries are no less disparate. While Venezuela openly objects it, arguing the lack of social programs to counterbalance inequality, Colombia fully endorse it, proposing an open U.S. market as the best remedy to the country´s social, political, and economic maladies.

VI. Closing Remarks

The extraordinary dynamism of the world´s economic globalization has prompted much of Latin America´s structural reform. Nonetheless, and despite its great efforts, the region as a whole faces serious obstacles to become fully integrated to the global economy. On the one hand, Latin America´s exports are little diverse (mostly agricultural and primary goods), and the region keeps a very modest share of the world's trade (barely 5,4% in 1999). On the other hand, the liberalization of the international markets has been incomplete and asymmetric. Incomplete, as the industrialized countries have kept trade barriers and subsidies to both agricultural products and manufactured commodities which are labor intensive. Asymmetric, as the liberal policies have covered only those sectors that represent advantages to the developed nations. Not

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[3] However, as this paper was being written, the leaders of the five Andean countries held a meeting in Valencia, Venezuela, after which they announced a set of aggressive policies to achieve greater regional integration.

[4] Colombia has signed agreements of partial scope with Argentina (1993), Brazil (1993),Paraguay (1987), Uruguay (1993); Chile (1994), and Mexico (1988). Likewise, it has signed free-trade treaties with the following countries: Mexico and Venezuela (1994 - the Group of Three); Peru, Venezuela, Ecuador, Bolivia (1980 - the Andean Community); with various Caribbean countries (1994 - Caricom).

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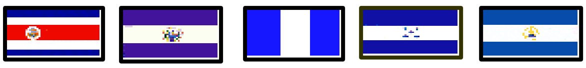
ANNEX 1

The North American Free Trade Agreement

NAFTA				
Data / 1999	**Canada**	**México**	**U.S.A.**	**Total / Bloc**
Population (Millions)	30,5	97	278	405,8
Per-capita Income US$	20,140	4,440	31,910	
International Trade				
Exports (US millions)	277,451	148,979	1´030,400	1´070,000
Imports (US millions)	259,039	154,784	1´131,600	1´428,000

MERCOSUR					
Data / 1999	**Argentina**	**Brasil**	**Paraguay**	**Uruguay**	**Total / Bloc**
Population (Millions)	37	168	5	3	213
Per-capita Income US$	7,550	4,350	1,560	6,220	
International Trade					
Exports (US millions)	27,753	79,659	1,771	3,744	74000
Imports (US millions)	32,568	87,925	2,825	4,076	83000

ANDEAN PACT						
Data / 1999	**Bolivia**	**Colombia**	**Ecuador**	**Peru**	**Venezuela**	**Total / Bloc**
Population (Millions)	8	42	12	25	24	111
Per-capita Income US$	990	2,170	1,360	2,130	3,680	
International Trade						
Exports (US millions)	1,444	15,414	7,049	7,629	22,484	53,000
Imports (US millions)	2,249	16,887	4,902	8,823	15,738	40,000



The Central American Integration System

SICA						
Data / 1999	**Costa Rica**	**Salvador**	**Guatemala**	**Honduras**	**Nicaragua**	**Total / Bloc**
Population (Millions)	4	6	11	6	5	32
Per-capita Income US$	3,570	1,920	1,680	760	410	
International Trade						
Exports (US millions)	8,108	3,100	3,458	2,316	772	
Imports (US millions)	7,127	4,612	4,986	3,061	2,040	

Source: www.worldbank.com , www.imf.org, www.comunidadandina.org