



**Testimony before the  
Senate Foreign Relations Committee**

**“ECONOMY OF COLUMBIA”**

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**A Statement by**

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Thank you, Mr. Chairman, for this opportunity to discuss the economy of Colombia.

Colombia's economic performance is clearly crucial to that country's ability to deal with the crisis of the last decade. Colombians need security, but they also need to reverse the deteriorating conditions of life that afflict such a large part of their country's population. A major question is: how are they going to pay for what needs doing?

I have been following Colombian affairs closely for nearly 20 years. In the mid-1980s I was director of the Office of Andean Affairs in the Department of State and later when the struggle with the major drug cartels grew intense was Deputy Chief of Mission, and frequently Chargé d' Affaires, in the U.S. Embassy in Bogota. I was subsequently Deputy Assistant Secretary of State for South America when the reign of terror of Pablo Escobar was finally brought to an end. For the last several years I have been studying Colombia's plight and the U.S. response at CSIS.

At the outset let me make three assertions – points not always made by foreign observers when they talk about Colombia:

- While the country's institutions are failing to meet the needs of its citizens in many important respects, Colombia is not by any normal definition a failed state. It is capable once again of being one of the better performing countries in Latin America.
- While poverty, now affecting 60 percent of the population, requires urgent attention, it is not the primary cause of violence and disorder. In Colombia, it is conflict and corruption, fueled most importantly by narcotics trafficking, that best explain why a

country previously headed for success now suffers such misery and why its economy is unable to meet the basic needs of such a large share of its citizenry.

- Colombia's leaders must find the resources to overcome violence and corruption and simultaneously to support policies that restore hope in the future for millions of their fellow citizens. Without law and order the economy will not return to significant levels of growth; without economic growth the country's leadership will not have public support for the tasks required.

## **Historically Well Managed Economy**

For many decades Colombia was known as a well-managed economy. At the end of the 1960s when the U.S.-backed Alliance for Progress came to an end, Colombia was seen as a country taking the right path to modernity. At that point by most indicators it was not far behind Chile. It had, for instance, much admired housing and family health programs and insisted on following macroeconomic policies even more cautious than U.S. experts advised. In the 1970s it was able to begin diversification away from its dependence on coffee exports and was beginning to show signs of having a vigorous manufacturing export base. As late as the mid-1980s the income gap between the rich and poor was narrowing rather than widening as it was in most developing countries. Throughout the 1980s – normally referred to as the “lost decade” in the rest of Latin America, which experienced severe drops in income - Colombia was able to maintain modest levels of per capita economic growth and able, together with Chile, to avoid restructuring of its debt. Colombia was known as a country that

respected contracts, and it “played by the rules,” rolling over its debt, and not damaging the country’s credit standing.

For all that success in the 1960s and 1970s, in retrospect it is clear Colombian leaders neglected several fundamental national challenges. First, too little was done in the good years to overcome the daunting geography with highways and railroads to knit the country together. Second, not enough was done to improve life in the countryside. The signs are small and large. Today a country of vast grasslands imports cattle hides for leather manufacturing. More tragically, the instability of land tenure has led generation after generation to move, often forced, from rural subsistence to urban penury. Third, as that last example suggests, even before the rise of the powerful narcotics business, Colombia’s judicial system was notably weak.

## **The Price of Lawlessness**

Only a fraction of the immense revenue of drug trafficking returns to Colombia. Most drug money remains in the United States. Still, the impact of those ill-gotten gains has been enormous. Analysts at various times using different methodologies have estimated the total flow of earnings back to the country as low as \$1.5 billion and as high as \$3 billion, i.e., not much more than one percent of GDP, but all conclude that the net effect on the Colombian economy has been negative and disastrous. The rise in narcotics trafficking is closely related to the rise of criminality in Colombia and that of course was closely related to the rise in violence. One study points out that criminality leads to a misallocation of resources and a

drop in national productivity amounting to roughly one percent of the GDP. Other studies correlate the rise of violence with the drop of investment from 1980 onward and blame that for taking two percent points off GDP growth of the period.

Colombians themselves were slow to see the damage. But then the anecdotal evidence began to come in. As the narcotics traffickers sought to circulate their money into legitimate commerce, honest businessmen became alarmed when they saw murder and extortion become common business practice. The coffee zone, where small efficient farms were the rule, began to see land bought up for showplace *fincas* ill suited for making honest profits or quality coffee.

The most severe damage was, of course, on the government's own ability to enforce the law. The already weak justice system was for a time nearly crushed under the threats from the Medellin cartel. It was not long before it was recognized that not just common criminals but even the supposedly political guerrillas were using information obtained from the banking sources and the court system to target kidnapping and leveraging other moneymaking schemes.

### **Finding the Way Out**

Colombia is in a maze - with no easy way out. The low cost answers to its predicament have so far been found wanting. It has tried and failed to negotiate peace first with drug mafias and

then with the guerrillas. Peace with some of the paramilitaries groups may still be possible, but, if that were to happen, the government now recognizes it will not be cheap. The Colombian public has been tempted to believe – as many foreign observers are – that the country could overcome the violence by adopting more generous social policies and a more decentralized style of government. After experiencing disappointment with all the easy answers, Colombia seemed to accept peace would be costly and elected a president dedicated to law and order.

Liberal social policies introduced in the early 1990s did help reduce poverty for a time, but eventually fiscal policy spun out of control, sovereign debt rose precariously and the country suffered its first recession in nearly 70 years. In 1999 the economy contracted by more than 4 percent, wiping out the gains earlier in the decade. Unemployment climbed to a record 20 percent. Adding to the country's woes, coffee prices plunged to historic lows, at 64 cents a pound less than half the price of just 10 years before. Coffee is no longer among the top Colombian exports when measured by value (at 7 percent of total exports it is now less than oil, coal, flowers and apparel), but it generates more employment (with some 560,000 directly employed and another 2 million in related activities) than extractive industries and is more than geographically concentrated than manufacturers.

When President Alvaro Uribe came to office fourteen months ago, he inherited a weak economy and a government struggling to deal with burgeoning expenditures and a heavy load of debt (equivalent to 53 percent of GDP). He adopted an orthodox approach to government finance – even to the extent of broadening the application of the unpopular value added tax -

and sought to rein in expenditures. For example, because of the decentralization, much of the government's income was flowing out to inefficient and poorly supervised regional and local governments. Much was also spent on a generous pension program. Uribe is known internationally for his law and order agenda, but in Colombia he is recognized for being on the road continually seeking to make government work, but fewer resources.

While the Colombian president was trying to constrain spending he was also determined to give more support to the armed forces and police. It is often remarked that a nation supposedly at war such as Colombia was spending hardly any more than other countries in Latin America on security. (For the decade of the nineties with a rising level of violence military spending in Colombia was just 2.6 percent of GDP as compared to 3.1 percent in Chile and 1.9 percent in Bolivia and Ecuador.) Uribe decided to finance increased spending on the security services with a one-time tax on the wealth of the upper tax brackets that brought in the equivalent of 0.7 percent of the GDP. His government projects that defense spending will rise to 5.8 percent of GDP by the end of Uribe's term in office in 2006.

Raising taxes and cutting expenditures is not the usual formula for stimulating an economy, but Uribe had little choice if he was going to give the police and military the support he promised while at the same time keeping the country from falling once again into a damaging recession. He is attempting to make government give better service within tighter budgets. The assumption of his policy, not often openly expressed but clear, is that an improved security climate will lead to improvement of public confidence and a consequent increase in

domestic consumption and investment. Similarly, there is an expectation that better security will attract foreign investment

To a degree, Uribe's approach is working. People are more secure by most measures – though throughout much of Colombia the ominous threat of violence remains. International markets reacted well to the new president's determined economic management, and spreads on Colombian debt fell by more than half (though they have moved up marginally in recent days following the defeat of the economic items in the referendum last weekend). There are signs investors from abroad – clearly many of them Colombian – are increasing both direct and portfolio investment. Energy companies – both oil and coal – increased their stakes in Colombia early this year. Unemployment continues to fall. And exports are rising.

## **A Role for Trade**

Exports may, in fact, play a large part in Colombia's exit from its current economic conundrum. Manufacturing exports are still less important than those of the agriculture and extractive industries. But Colombia's manufacturing sector has long shown the potential for take-off. Colombia is the most active trader in the Andean Pact and it has taken more advantage than the Andean countries of the trade preferences first granted by the United States in 1992. The Colombian government has estimated that the first Andean Trade Preference Act created some 150,000 permanent Colombian jobs and the new Andean Trade Promotion and Drug Eradication Act will stimulate another 200,000. (It is useful to note that these are many more than the 80,000 people estimated to be involved and facing displacement

drug cultivation.) Early this year reports indicated that Colombian exports were showing a healthy 3.8 percent rise overall, with products eligible for Andean preferences recording a twenty fold increase.

Colombia will, of course, best reach its export potential when the world as a whole liberalizes its trade regime. Colombia negotiators have been active and positive in both the Doha Round and Free Trade Agreement of the Americas talks. Those agreements promise low barriers to new markets around the globe. But Colombia's most important market is the United States, the destination of 40 percent of its exports. Colombian officials have a skeptical eye on the end of 2004 when the Doha and FTAA negotiations are due to conclude. They even fear those talks will not produce results before the Andean preferences come to an end in 2006. Wanting to lock in the full benefits of trade by giving investors the prospect of long-term gain, they think the United States should place Colombia at the head of the line for a free trade agreement.

Colombia and the United States are close partners in the struggle against drugs and violence. My own sense is that the struggle can be won, but only with persistence by both governments, both peoples. Eventually, the U.S. security role will wind down. The key to success then will be, even more than it is now, on the strength of the Colombian economy. A mutually beneficial free trade agreement would be an important step toward a new, more optimistic stage in our relations.