

# Challenges and Opportunities for Colombia's Social Justice and Economy

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# Multiple Challenges facing Colombia today

- Managing its economy through the weak phase of a commodity cycle—a phase which may be prolonged
  - Contributing to weak economies of some of its major trading partners
  - Leading to concerns about current account deficits
- Highlighting standard problems facing natural resource economies—the resource curse
- Structural changes in the global economy suggest that the model for development that worked so well for so many countries—export led growth—may no longer work in the future

# Multiple Challenges facing Colombia today

- These problems—just beginning to be discussed—have now been compounded by the threat of a new era of protectionism, especially following the election of Trump
  - A new level of uncertainty about globalization
- Colombia has long been one of the countries with the highest level of inequality
  - But there is now heightened sensitivity to inequality
  - And to the full economic and social consequences of the lack of equality of income, wealth, and opportunity
  - Highlighted by the fact that the IMF has now put it at the center of its attention
- Peace brings to this “mix” new opportunities and new challenges
  - If matters are managed well, there could be a significant peace dividend

# The peace settlement presents unprecedented challenges and opportunities

- A long-standing conflict has finally begun to be resolved
  - Peace agreement with FARC has been signed and is being implemented
  - But just starting with ELN
- Such conflicts have enormous political and social consequences
  - Undermining economic growth both in the short run and the long, as well as economic stability
  - With adverse spill-over effects on others
  - That Colombia was able to do as well as it did during the long period of conflict is truly impressive
- While the conflict imposed large adverse economic costs throughout society, ensuring sustained peace, while hopefully bringing an overall peace bonus, will also impose fiscal costs, which the government must be ready to shoulder and will present both economic and institutional challenges

# Economic and institutional challenges of the peace

- Colombia has been running pro-cyclical monetary and fiscal policies—
  - end of commodity cycle weakening exchange rate,
  - leading to increased fears of inflation,
  - Leading in turn to higher interest rates;
  - and striving to maintain fiscal balance, government cutbacks have augmented downturn
- Meeting fiscal needs of peace should help encourage government to pursue countercyclical policies
  - Even fiscal “hawks” should be aware of balanced budget multipliers—increasing taxes and spending in tandem stimulates economy

# Reforming fiscal and monetary policies

- Some have suggested that Colombia needs a tax reform in any case
  - Taxes on land, especially underutilized land, could facilitate one of the more difficult parts of peace process—lowering price of land
  - Economists have long held that a land tax (as well as natural resource and pollution taxes) are among the best taxes
  - Elasticity of supply low, so low distortion
  - In case of pollution (carbon) tax, tax discourages socially destructive activities
  - Need for reform in Personal Taxes
    - Deliver too little revenue because of loopholes, exemptions, and inadequate enforcement

# Sustaining peace

Will require ensuring **land** and **jobs** for those affected

- Addressing underlying grievances within society—including excesses of inequality
  - More effective and effectively enforced progressive income tax
    - Fully taxing dividends
  - Need strong investment in the rural sector—promoting rural development
    - Reducing rural-urban divide
    - Promoting small holder agriculture
    - Land redistribution
    - With government reclaiming land with disputed title

- In good economic conditions, addressing conflict— what would normally have been a dampener on economic activity— leads to increased growth and employment
- But at this particular point in the commodity cycle and this particular moment in the global economy this “peace dividend” will only materialize with strong government actions
  - And coordination between monetary and fiscal authorities
  - Recognizing that the harm of mild inflation is far less than the benefits of having a strong economy able to respond to the new opportunity of peace

# Government Actions

- Ensuring a competitive exchange rate
  - Increased interest rates in US may make this easier
  - May require direct intervention
  - And will require monetary authorities to restrain interest rate increases
- Looser monetary policy will be of benefit in any case
  - Part of response to weak global economy (about to be described)
  - Realizing peace dividend will require investments,
  - Greater credit availability, at lower interest rates, will facilitate these investments

## Government Actions: Responding to the changes in the global economy

- Industrial policies aimed at economic diversification, employment creation and economic development (especially in areas formerly most in conflict), responding to global warming (anticipating future global carbon prices), including import substitution and export development—and especially in areas where Colombia can move up the “complexity” chain, advancing the potential of becoming a modern learning society
  - Industrial policies more than just expanding manufacturing
    - Go well beyond promoting “industry” to an active role in shaping the economy
      - But far different from the kind of “planning” of earlier decades
    - Inevitable consequence of policies (legal, infrastructure, education, other investments)
  - Perhaps better term: “active production policies”

# Industrial Policies

- Reflecting new thinking about the need for industrial policies (seen, for instance, in policies of CEPAL and CAF)
- Reflecting pervasive externalities and spillovers, including those associated with learning (reflected in my recent book *Creating a Learning Society*)
  - Increases in standard of living are more associated with learning than with just capital accumulation

# Industrial Policies

- Multiple reasons for new emphasis on industrial policies—beyond the recognition that in these areas markets typically don't work well
  - Need for resource rich countries to diversify, if they are to avoid resource curse
    - Not just high volatility of resource prices leads to high level of GDP volatility
    - Global economy may be entering a long term era of lower commodity prices
  - New era of protectionism
    - Limiting scope for export led growth
    - But providing new rationale for import substitution (with caution)
  - New recognition of the importance of moving up the complexity chain (Hausman)
  - Short sighted markets won't adequately anticipate need to respond to need for climate change adaptation and mitigation
  - Markets will underestimate externalities and social benefits of employment creation, and especially of economic development in the afflicted areas
  - Markets pay little attention to the economic and social consequences of inequality

# Industrial policies

Successful pursuit of these industrial policies will require

- Government/private sector/civil society/university cooperation
- Adequate finance—special facilities within existing development banks and/or new development bank
- Institutional development to ensure the identification and execution of strategies and projects

# A difficult moment for the world economy

- Colombia's transition occurs at a particularly difficult moment for the world economy, which will almost surely have adverse effects on Colombia
- The global macro-economy is likely to remain weak
  - Underlying problem: weaknesses of global aggregate demand
    - Underlying that: austerity in many countries (even in US); growing inequality; persistent eurocrisis; structural reforms throughout the world; and the slowdown in China
- Consequence is weak global commodity prices—which will affect Colombia

# Trump has added an unprecedented level of uncertainty to this scenario

- America first protectionism—seemingly willing to walk away from global trade agreements and the post World War II political and economic order which America worked so hard to create
  - Republican tax plan includes in effect a very high uniform tariff
  - Would almost surely not be WTO compliant
- Damage has already been done: undermining confidence in US and reminding businesses that borders matter
- If Trump succeeds in his agenda, global supply chains will be interrupted
  - Stagflation: costs and prices rise, as the global economy slows down
- Uncertainty itself will almost surely slow down investment—effects are already seen in some parts of world

# Political judgment: this part of Trump agenda unlikely to go through

- Would require acts of Congress (repeal of NAFTA, WTO)
- Would entail unprecedented absence of principles on part of Republican Party
- NAFTA negotiated by President Bush
- Open markets central part of traditional Republican platform
- America has always pursued its self-interest, but it has always pursued an *enlightened self interest*, realizing that economic and political stability of others is in America's interests
  - Trump views the world in zero-sum terms
  - Pursuing his strategies in ways which are negative sum
  - But globalization, if correctly managed, is positive sum

## America's experience has important lessons for the rest of the world—including Colombia

- One ignores the well-being of large fractions of one's citizens at one's peril
- Trickle down economics doesn't work
- While US GDP grew, large fractions of America's population saw their incomes decline and job opportunities shrink
- To the point where even health and life expectancy of the average American began to decline
- **There cannot be sustained economic prosperity unless there is shared prosperity**
- **Excessive inequalities often give rise to political and social divides, that manifest themselves in ways which are deleterious to the functioning of the economy and society**

# These challenges are especially serious for Colombia

Given its high level of inequality and given the ever present threat of the resource curse manifesting the symptoms seen elsewhere

- Lower economic growth
- More instability
- High level of inequality
  - Latter is especially surprising and disturbing, since resource wealth should be viewed as belonging to the country as a whole, and benefits should be directed at helping those most in need and in promoting overall development

# Post Conflict Societies

Face not only an economic challenge—

- Reintegration of the economy
- Finding employment for those previously engaged in conflict
- Rectifying distortions created by the conflict
- Addressing grievances that contributed to conflict

But also a broader societal challenge

- Restoring trust and a sense of national cohesion

# Concluding Remarks

- This is a time of true opportunity for Colombia
- But it comes at a time in which the country would have, in any case, been facing daunting economic challenges
- But addressing the challenges posed by the settlement of the conflict can actually help Colombia weather its way through these challenges
  - Doing so will require a *different* set of economic and social policies than have often been employed in the past and a strengthening of public institutions
  - If matters are managed well, there could be a significant peace dividend
  - Hopefully, this lecture will have provided some insights into what those policies might look like