6th Annual Colombian Student and Professional Conference

CIPA COLLOQUIUM

PERSPECTIVES FOR COLOMBIA´S ECONOMY IN A CRISIS ENVIRONMENT

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Cornell University
1. The World Economy: Resurgence of the Financial Turmoil

2. Latin-America in a Turbulent World Economy

3. Colombia’s performance during the financial crisis

4. Why has the Colombian economy performed well?

5. Colombian Economic Perspectives: The Downside Risks

6. Future Economic Challenges
THE WORLD ECONOMY: RESURGENCE OF THE FINANCIAL TURMOIL
The Euro Zone in the aftermath of the financial crisis

- The fiscal policy response to the 2007-2009 financial crisis increased already high public debt ratios.
- The debt service problem threatens the stability of the Euro economic system.
2011 registered a generalized decline in the world stock markets.

Even emerging markets were adversely affected.

There was also an increase in the VIX stock volatility indicator, although less pronounced than in 2008.
- Capital flows to emerging countries were translated into further appreciation of exchange rates to the US dollar.
- The role of capital controls as a potential remedy has been brought back to the policymakers discussions. Even the IMF has recommended them.
The IMF World Economic Outlook projections forecast a slowdown of the world economy.

The slowdown is expected to cover also the emerging economies.
1. Severe Income Disparity
2. Chronic Fiscal Imbalances
1. Major Systemic Financial Failure
2. Water Supply Crisis
3. Food Shortage Crisis
4. Extreme volatility in energy and agricultural prices
LATIN-AMERICA IN A TURBULENT WORLD ECONOMY
The increasing share of emerging countries is bringing a change in the world’s economic order.

Emerging markets growth mainly due to asian countries.
• The decline in GDP growth rates in advanced countries has been compensated with stronger growth in emerging nations: convergence.

• Emerging markets economies are different among and within regions.

• Latin-America shows increasing but modest annual GDP growth rates.
• Latin America’s economic history: booms and busts.

• External financial crisis have always had an adverse impact in Latin America’s economic performance.
Productivity and investment may be the source of the growth problem.

**Figure 1.5 Growth Accounting by Region**

- **TFP**
- **Labor Force/Population**
- **Physical Capital**
- **Human Capital**

### Breakdown by Region:

- **LAC-7 minus Venezuela plus Uruguay**
  - TFP: 7.2%
  - Labor Force/Population: 5.5%
  - Physical Capital: 1.8%
  - Human Capital: 2.9%

- **Rest of LAC**
  - TFP: 6.4%
  - Labor Force/Population: 5.1%
  - Physical Capital: 2.4%
  - Human Capital: 2.8%

- **Emerging Asia (w/o China)**
  - TFP: 14.9%
  - Labor Force/Population: 4.7%
  - Physical Capital: 2.9%
  - Human Capital: 3.3%

- **PCE**
  - TFP: 6.7%
  - Labor Force/Population: 5.6%
  - Physical Capital: 6.3%
  - Human Capital: 1.2%

- **China**
  - TFP: 47.8%
  - Labor Force/Population: 3.4%
  - Physical Capital: 23.5%
  - Human Capital: 3.3%

• Latin-America has not experienced important productivity improvements. Not even in periods of high economic growth (2000-2008).

• The growth gap with other emerging markets could be explained by this difference.
The slowdown of Latin-America´s major trade partners (USA, EU and China) will have an adverse impact in LATAM´S economic performance.

The global financial markets remain expectant to the EURO Zone financial solutions.

Commodity prices are expected to decline.

Financial contagion risk:
- European bank shares on LATAM´S banking assets: 25%
Monetary Policy:
- Some countries have reduced interest rates to stimulate economic activity as a response to the renewed international financial turmoil.

Fiscal Policy:
- Authorities may undertake countercyclical fiscal policies if economic activity declines.
- The European crisis showed that countries with large fiscal deficits may face capital outflows.

Financial Sector:
- The banking sector should be closely monitored.

The economic environment for the region is positive:
- The banking sector is solid.
- Monetary policies are adequate.
- The international reserves are high.
- Public Finances are solid.

The key issue is putting and maintaining in place adequate macro policies.
COLOMBIAN PERFORMANCE DURING THE FINANCIAL CRISIS
Colombia’s economic growth rates declined during the 2007-2009 international financial crisis.

There is a strong recovery of economic activity. GDP growth rates are returning to pre-crisis levels.

Recovery without overheating.
Mining is acting as the leading sector.

2011 showed a recovery in all economic sectors, including agriculture, which has been severely affected by floodings.
Colombia: a new mineral resource country
Annual GDP growth rates by economic sector. DANE

- Mining has been the most dynamic economic sector. Royalties associated with this development are expected to increase significantly.
- Both agriculture and manufacturing were adversely affected as a result of the international financial crisis 2008-2009.
CPI and monetary policy
Central Bank

2011 CPI inflation reached the upper level range set by the central bank, Banco de la República.

It reached 3.73% with a target range between 2% and 4%.

Colombian authorities maintain a tight monetary stance.

It was the first Latin American country to raise interest rates in 2012.
The unemployment rate declined to 9.3% in November.

Colombian unemployment rate continues being the highest in LATAM.

More than 2.4 million people are unemployed.
Imports increased 37% in 2011.

Automobiles imports were particularly dynamic (69%).

High commodity prices (oil, nickel, coffee, coal) increased export revenues.

Despite the appreciation of the exchange rate...
GDP growth perspectives are positive

- The international financial turmoil is expected to have a modest impact on economic growth.
- There are inevitable real and financial transmission channels. The main vehicle is the trade channel.

GDP Growth Projections Colombia 2012
Latin American Consensus Forecast
WHY HAS THE COLOMBIAN ECONOMY PERFORMED WELL?
Improvement in national security 2002-2011
Ministry of Defense

Illegal groups actions

The internal conflict of the last 40 years experienced a remarkable improvement.

Kidnapping

The internal conflict of the last 40 years experienced a remarkable improvement.
• Commodity Prices have risen since 2000.

• Food prices have increased 80% since 2000.

• However, commodity price volatility is very high.

Historically high commodity prices
IMF, World Economic Outlook, September 2011
Fixed Capital Formation
Annual percentage increases. DANE

Fiscal performance has improved
Ministry of Finance

Overall Fiscal Balance of the Consolidated Public Sector (% PIB)

Central Government Fiscal Balance GNC (% PIB)
Mineral resources boom impact our fiscal accounts

GDP Growth
MEGC, Forero and Rojas (2011)

- Base scenario
- Spending - Boom
- Saving - Boom
- Investing - Boom

Public debt (%GDP)

Accumulated effect on GDP until 2020

<table>
<thead>
<tr>
<th></th>
<th>Spending</th>
<th>Saving</th>
<th>Investing</th>
</tr>
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<tbody>
<tr>
<td>Accumulated</td>
<td>5.0</td>
<td>5.6</td>
<td>12.9</td>
</tr>
</tbody>
</table>

% GDP

2008 | 39 | 37
2009 | 39 | 37
2010 | 40 | 36
2011 | 41 | 35
2012 | 42 | 34
2013 | 43 | 33
2014 | 44 | 32
2015 | 45 | 31
2016 | 46 | 30
2017 | 47 | 29
2018 | 48 | 28
2019 | 49 | 27
2020 | 50 | 26

Annual growth (%)

2008 | 0.0 | 0.0 | 0.0
2009 | 1.3 | 0.5 | 0.3
2010 | 0.6 | 0.2 | 0.1
2011 | 0.5 | 0.1 | 0.0
2012 | 0.4 | 0.0 | 0.0
2013 | 0.3 | 0.0 | 0.0
2014 | 0.2 | 0.0 | 0.0
2015 | 0.1 | 0.0 | 0.0
2016 | 0.0 | 0.0 | 0.0
2017 | 0.0 | 0.0 | 0.0
2018 | 0.0 | 0.0 | 0.0
2019 | 0.0 | 0.0 | 0.0
2020 | 0.0 | 0.0 | 0.0
Colombia: Domestic demand has been dynamic
Annual growth. DANE

Households consumption
Direct Foreign Investment
Millions of USD. Central Bank.

![Bar chart showing Direct Foreign Investment from 1994 to 2011. The chart displays a significant increase in investment from 2005 onwards.](chart-image)
Colombia: An attractive site for foreign investment
Doing Business 2012, IFC

• 2012: Achieved the 42 place as best country for doing business (it improved five places since 2011).
ECONOMIC PERSPECTIVES: THE DOWNSIDE RISKS
The adverse impact of an international financial crisis

- Colombia is not immune to an international financial crisis.
Exchange rate appreciation

- Capital inflows appreciate the exchange rate.
- It has been an across the board impact on all emerging economies.
- Colombia has to learn how to survive with a strong peso.
Household debts have reached unprecedented levels.

Households debt / Disposable income (%)

1994: 15.7
1995: 17
1996: 17.4
1997: 19.2
1998: 18.9
1999: 16
2000: 12.2
2001: 11.3
2002: 10.5
2003: 10.3
2004: 10.1
2005: 11.1
2006: 13.6
2007: 16
2008: 16.3
2009: 15.9
2010: 17.2
2011: 18.7
Inflationary Pressures

Rango meta BanRep  Var anual IPC

2006 2007 2008 2009 2010 2011 2012
La inversión debe estar encaminada hacia la disminución de la brecha en infraestructura (Sustaining Latam’s transformation, IMF)
El riesgo de que se despilfarren los recursos es importante.
Podríamos perder nuestra oportunidad de oro.
High structural unemployment rate

- Highest unemployment rate of the region.

Unemployment rate projections 2012
Latin American Consensus Forecast

- Colombia: 9.9
- Venezuela: 7.6
- Argentina: 7.5
- Perú: 7.5
- Chile: 7.5
- Ecuador: 6.6
- Uruguay: 6.3
- Brasil: 6.2
- Paraguay: 5.9
- México: 4.9
- Bolivia: 4.3
- Grupo Andino: 8.6
- América Latina: 6.5
- Mercosur: 6.5
More than half of the employed populations is working on the informal labor market: without social protection.
Poverty and inequality

Fuente: BID.
Internal insecurity: Are we going to achieve peace?

Ministry of Defense

Number of terrorist attacks

Security and defense expenditure (%GDP)
FUTURE ECONOMIC CHALLENGES
Managing the natural resource boom

• Natural resources curse:
  – Countries with natural resources abundance usually lack good political and economic institutions.
  – Colombia has approved a new law on the use of royalties. It can lead to misuse of public resources

• Dutch disease: The negative impact of exchange rate appreciation on other exports and employment.

• How to use wisely the forthcoming resources:
  – Saving and reducing external debt
  – Efficient public expenditure
  – Investing on productive projects with high social rates of return (education, infrastructure, R&D).
Fiscal Reform and the Reduction of Inequality

- The government is preparing a structural tax reform to be submitted to Congress.

- It will introduce a more progressive tax structure.

- Exemptions, deductions and other tax benefits will be reduced.

- The value added tax in Colombia is regressive. Poor people have a higher tax burden in relation to their income than the richer population.

- The target is to use the tax system and a more redistributive public expenditure policy in order to improve income distribution in Colombia.

- According to a recent World Bank Report, Colombia is the seventh most unequal country in the world and the second in Latin America.
The Colombian Government has announced that it will present to Congress a draft bill on pension reform.

It will contain two major sets of proposals: One directed to introduce retirement benefits BEPS for lower income individuals who are not in capacity to obtain even a minimum wage annuity in the formal system.

It shall benefit nearly 9 million colombians who actually earn less than the established minimum wage and have not been able to contribute to the pension system.

The second is a reform of the actual dual pension regime and is guided to modify pension parameters such as ages, and the possible establishment of a pillar system.

The political economy of pension reform is particularly complex.
Final remarks

• “Honey moons” don’t last forever:
  – International liquidity in the markets
  – Low interest rates
  – High commodity prices

• We should get prepared for bad times
  – Managing the mineral resource boom
  – Fiscal and pension reform
  – Infrastructure investment
  – Achieving peace and domestic security

• If the appropriate policies are not adopted, the income and social gaps won’t be closed.
References


• Ministerio de Hacienda, Colombia: Credibilidad y Sostenibilidad, Seminario Anif-Fedesarrollo, Febrero 2012


• World Bank, Fiscal Policy in Colombia: Tapping its potential for a more equitable society, March 30 2012.

THANK YOU