



## EPOG INTERNATIONAL MASTER'S COURSES

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# Policy responses in pandemic times to deal with the economic crisis in Colombia, what are the options?

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The Colombian economic crisis, in the recent context of the COVID-19 pandemic, can be seen as the endogenous outcome of an unstable development model based on energy commodity exports and capital inflows dependency. This policy brief will discuss options to deal with such fragilities.

### INTRODUCTION

The current economic crisis that Colombia is facing cannot be seen entirely as the result of an external shock caused by the outbreak of the COVID-19 pandemic. It is rather, at least partly, the endogenous outcome of an economic development model that builds up on oil and mining exports. The economic openness in Colombia that began in 1990 as a result from the Washington Consensus recommendations, and the boom in energy commodity prices have intensified the comparative advantage of the country towards this sector, diverting foreign capital flows away from manufacture and high-skilled labor-intensive industries.

Consequently, the economic cycles in Colombia turned out to be highly dependent on the movements of commodity prices. As it will be shown below, the rise in oil prices at the beginning of the 2000s and 2010s enabled high growth rates in the country, while economic recessions have been associated with a drop in oil prices. One of the effects of the outbreak of the COVID-19 pandemic in the first quarter of 2020 was the reduction of demand in energy, which significantly reduced oil prices and caused detrimental effects in the Colombian economy, such as capital outflows, depreciation of the local currency and output slowdown.

To face this economic crisis, the Colombian government has provided subsidies to families, has given debtors the possibility to redefine their loan terms, has reduced taxes for some economic sectors and has established three days in the year without VAT ([gov.co](http://gov.co), 2020). Nonetheless, Colombi-

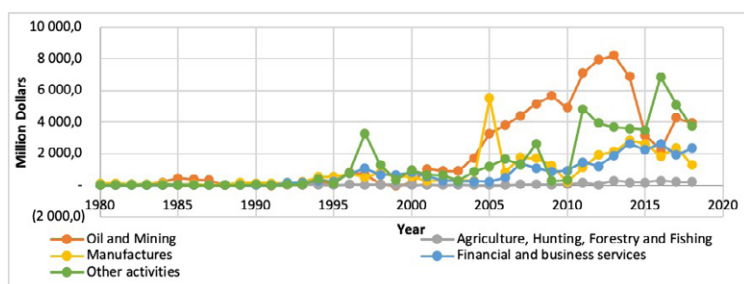
an policy makers have not taken any concrete action to decrease the dependence and the fragility of the Colombian economy, which stems from its integration into the world market. In fact, it was announced that the export-oriented energy-mining sector would continue to play an important role in the economy (Dinero, 2020) and that support to the construction sector would be granted (gov.co, 2020). This shows the lack of the Colombian government's willingness to move to higher-productivity and more labor-intensive sectors.

This policy brief aims to question the economic policies that have been taken to face the crisis. If the need to move away from the energy-mining sector and capital inflows dependency is straightforward, then why are policy makers not moving in this direction? Is this perhaps something not feasible?

## OUTBREAK OF THE COVID-19 PANDEMIC, SHEDDING LIGHT ON THE INSTABILITY OF THE COLOMBIAN EXPORT-LED MODEL

The boom of commodity prices at the beginning of the 2000s allowed an expansion of FDI, mainly in oil and mining sectors, see figure 1. This shows that capital inflows have a direct effect in structural change (Guevara and Combata, 2018).

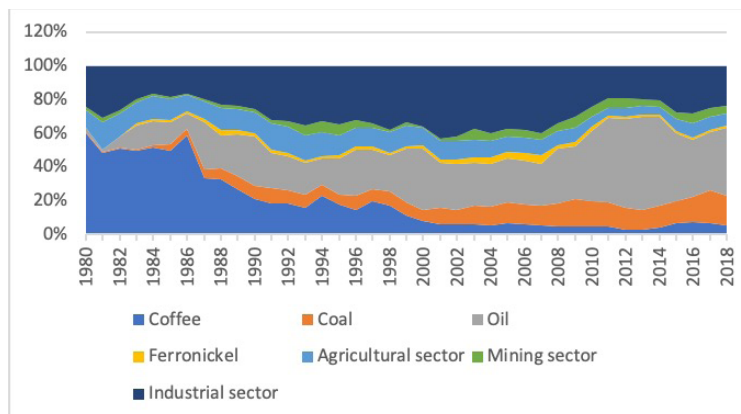
**FIGURE 1 - FIGURE 1: FOREIGN DIRECT INVESTMENT BY SECTOR, 1980-2018**



Source: Banco de la República; Departamento Nacional de Planeación; own elaboration

In fact, the concentration of FDI in energy and mining has been of such magnitude that the productive and export structure of the country has shifted significantly from manufacturing and agriculture to extractive sectors, see figure 2. Hence, the Colombian economy has gone through a deindustrialization process through which the share of industry in the country's GDP went from 20.8% in the 1990s to 10.9% in 2019 (World Bank, 2020).

**FIGURE 2 - EXPORTS BY ECONOMIC SECTORS, 1980-2018**



Source: Departamento Administrativo Nacional de Estadística; own elaboration

This deindustrialization process has led Colombia to import manufactured goods, increasing current account deficit and making necessary to accumulate higher capital inflows to equilibrate the balance of payments. This had not been problematic during the 2000s. However, the expansion of capital inflows and the flexible exchange rate regime allowed an appreciation of the national currency, which boosted imports and reinforced the current account deficit, see figure 3. Botta et al. (2014) described this phenomenon as "Financial Dutch Disease".

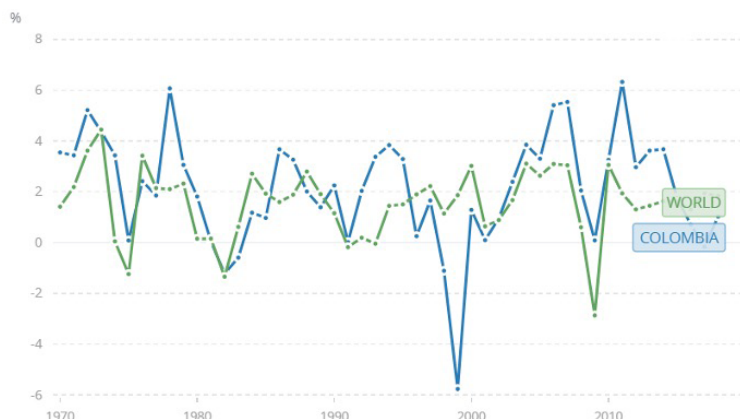
**FIGURE 3 - DEFICIT IN CURRENT ACCOUNT AS PERCENTAGE OF GDP, 2000-2017**



Source: Gandini 2017

The economic development model based on oil and mining exports allowed Colombia to enjoy high growth rates before and after the 2008 US financial crisis, see figure 4. Yet, a drop in commodity prices that threatens the profitability of this sector would have detrimental effects for the Colombian economy. This can be seen in the slowdown of FDI and GDP growth rates in figures 1 and 4 since 2014.

**FIGURE 4 – REAL GDP PER CAPITA GROWTH COLOMBIA AND WORLD TREND, 1970-2018**



Source: World Bank. Growth based on 2010 constant prices.

Nonetheless, it would not be until the outbreak of the COVID-19 pandemic that the instability of the Colombian export-led model would come to the fore. The impact of the decrease in oil demand and its prices has triggered a large capital outflow and demand for dollar, which caused a maximum historical value of this currency regarding the Colombian peso. At the beginning of this year, a dollar was worth 3.254 Colombian pesos, in March it reached a value above 4.000 Colombian pesos (Dinero, 2020).

Facing a deindustrialized economy that depends on the exports of oil and mining and on imports of capital goods to grow, it is no surprise that such depreciation had contributed to the greatest crisis in the Colombian's economic history. Exports dropped by 40% and imports decreased by 32% between May 2019 and 2020 (Kalmánovitz, 2020). Unemployment rates reached a historical maximum of 21.4% in May this year (La República, 2020). Similarly, the OECD predicted a slowdown in GDP of 6.1% for this year in the best-case scenario, in which there is no other COVID-19 outbreak (Semana, 2020).

## **FACING THE ECONOMIC CRISIS, APPLYING THE RIGHT POLICIES?**

The above has tried to show the unsustainability of the Colombian export-led model and the need to move away from it. Not only should the export and productive structure of the country diversify and move towards high value-added sectors, but also the design of monetary and exchange rate policies play an important role in contributing to greater stability in the economic cycles and the integration into international markets.

One policy goal could be the active interventions in the foreign exchange market by Colombian economic authorities. Meaning that, during an expansion of capital inflows, the central bank could accumulate reserves,

so that a strong depreciation of the national currency can be managed. In this vein, Ocampo (2011) explains that dependency of capital inflows is most likely to lead to procyclical behavior, that is, in boom and bust phases economic policy authorities tend to reinforce the cycle rather than to smoothen it. For example, in the boom, where there is currency appreciation, it is better to get into debt than in a bust when foreign currency is more expensive. Similarly, in periods of crisis, interest rates tend to rise to avoid capital outflows. This creates “the need to enhance the space for countercyclical macro-economic policies” (Ocampo, 2011, p.17). Likewise, Guevara and Martínez (2020) highlight the importance of capital controls to avoid capital flights that destabilize the value of the national currency.

Another policy goal to deal with the instability of the Colombian model is to depart from the dependency of the energy-mining sector. Botta et al. (2014) suggest that capital accumulation in the country should not entirely rely on foreign investment but also on productive initiatives of local actors. At the same time, they argue in favor of the diversification of the export base, such that labor-intensive high-skilled sectors have a higher share. This should allow accumulating human capital and investing in more innovative production techniques in Colombia.

The policy options to reduce the instability of the Colombian economy is more or less clear. The experience of this economic crisis in the context of the COVID-19 pandemic should provide an opportunity for the country to depart from dependency on oil and mining. Nonetheless, Colombian policy makers are not moving in this direction. Indeed, it seems that the measures they are taking are rather reinforcing the current development model and actions to transform the productive structure seem to be far away. The answer to the crisis has consisted on the grants of some subsidies to families and the declaration by the government of three days in the year without VAT (gov.co, 2020). Considering the deindustrialization of the country, these measures are most likely to increase consumption and therefore imports, rather than fostering a reindustrialization process.

Similarly, in the middle of the year, the government announced the sectors that would be leading the economic recovery; priority will be given to construction (gov.co, 2020) and the oil and mining sector will continue to play an important role. The government even announced the will to advance on fracking projects (Dinero, 2020). Again, these measures are far away from promoting the accumulation of human capital.

It is also worth noting that different political streams have proposed different actions to cope with the crisis. While right wing and conservative parties have come up with reverse mortgage and reforms to the pension system, left wing parties have tried to bring into discussion the possibility of a basic income. Similarly, the need to undertake a green transformation has been discussed, but still there is not a clear plan of action to do so, not even an understanding of what a green transformation means and implies. Also, there has not been yet a discussion regarding exchange rate management or capital controls.

## CONCLUSION: CHALLENGES TO MOVE AWAY FROM THE EXPORT-LED MODEL

The COVID-19 pandemic presents a challenge for Colombia to cope not only with the economic crisis but also with the ecological one. Colombian policy makers should direct their efforts in shifting the productive structure towards the production of high value-added goods with the capacity to mitigate and adapt to climate change. Perhaps Colombia's role as provider of energy goods in the last decades and the need to move to renewables could present a crucial opportunity. This would not be an unrealistic goal since there are already initiatives that integrate private, public and international efforts to boost technology and innovation in the country (Icesi, 2020), one example could be ecotourism. Additionally, it is important to take into account the social and armed conflict that Colombia is going through, so a structural change should be supported by a strategy that guarantees compliance with the peace agreements signed in 2016 and greater social participation by society.

However, a question remains to be answered: if the fragility of the current economic model is clear, why have not policy makers tried to cope with it? Why have not capital controls, countercyclical macroeconomic policies, exchange rate and foreign reserves management been applied? Even, why have the Colombian authorities been so insistent in keeping the dominance of the oil and mining sector? My assumption is that these policies are not so easy to apply in a context of neoliberal globalization. International investors are interested in injecting capital to Colombia because of the possibility of making a short-term profit or to benefit from resource extraction. If Colombian authorities impose low interest rates, exchange rate and capital controls, would investors still accept to invest in the country? Similarly, would developed countries be willing to invest in the diversification of Colombia's productive base, even when this implies that Colombians will reduce their imports and that opportunities to extract natural resources will be threatened?

To sum up, one of the reasons that explains why Colombian policy makers have not taken measures to depart from the commodity-energy-export-led model could be the fear of losing the external financing on which the country is so dependent. An alternative to this would be to gradually allocate capital inflows in the diversification of the productive and export base. A more reformist strategy would be to promote alliances between social movements in the global north and south to pressure local governments and international investors to guarantee an economic development model that is stable, and at the same time achieves environmental and social justice.

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