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"LA ECONOMÍA POLÍTICA DE LAS REFORMAS ESTRUCTURALES: LECCIONES DE LA EXPERIENCIA COLOMBIANA 1989-1995"

(Informe final)

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THE POLITICAL ECONOMY OF STRUCTURAL REFORMS IN COLOMBIA[1]

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INTRODUCTION

On August 7, 1990, Cesar Gaviria became Colombia's constitutional president. During the next eighteen months he devoted himself to radically reform the economic and socio-political structure of the country. The economic reform plan included the relaxation of exchange controls, the liberalization of international trade and of financial and insurance markets, labor market flexibilization, tax system modernization, fiscal decentralization and independence of the Central Bank. The political reforms, an essential component of the overall strategy, included a new political constitution, bringing drug lords to justice and signing a peace agreement with the guerrillas.

From a comparative perspective, Colombia is an interesting case of a reform process. On the one hand, reform did not emerge from a situation of crisis, certainly not from an economic crisis. Second, key sequencing considerations were taken into account, something that many other reforming countries were unable to do. Third, reform was undertaken in a democratic setting, apparently having important differences with similar projects in other countries. Fourth, for a change multilateral organizations were highly influential. Finally, the President who led the reform process had actively campaigned as a reformist candidate. In his conclusions of a thirteen-country reform analysis, John Williamson (1994) refers to Colombia as the most atypical case.[2] Of course, Colombia shares many common features with other countries. The most important are the existence of

[2] Williamson (1994, pages 478-81) considers 14 hypotheses on the political economy of reform. He argues that Colombia exhibits the highest degree of non-conformance. Its experience does not fit 5 of those

powerful interest groups and the fundamental role played by "technopols" in the design and implementation of the modernization program.

The purpose of this project is to analyze Colombia's reform experience from a political economy perspective. Particularly, it pretends to shed light on what pushed Colombia to start this project; on how the different actors -political parties, the private sector, the labor movement, the military and, more generally, civil society- reacted; on how key players were compensated and on how the political and economic reforms interacted with each other.

We argue that Colombia is a case of an incomplete reform effort. In spite of some spectacular measures early on during the Gaviria administration, interest groups were able to block essential initiatives.3 In addition, the use of compensation mechanisms was so widely used, that several inconsistencies were introduced. In particular, decentralization and social security reform severely affected fiscal policy and, eventually, led to important macroeconomic imbalances.

The document is divided in five chapters. The first provides a brief discussion of the analytical aspects and main hypothesis found in the literature regarding the dynamics of economic reform. The second presents the context in which reforms were carried out in Colombia. It undertakes a description of the political system and of the initial social, economic and political conditions facing the Gaviria administration, as well as the most important players in the reform process. The third deals with the specific reforms that were carried out, particularly, trade reform, the abolition of exchange controls, reform of the

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hypotheses.

[3] Including privatizations, reforms to the social sectors and, more prominently, the reforms of the institutions

financial system and of the foreign investment regime, and the main economic implications of the new Constitution, in particular Central Bank independence and reform of the pension system. The fourth chapter explains, in great detail, the evolution of the reform process during 1990-1993. It describes and analyzes the conception of the reforms, key aspects of political strategy, the implications of dismantling exchange control legislation, and the reaction of opponents, especially in regard to trade liberalization. The fifth chapter sets out, by way of conclusion, the course followed by the reforms during the Samper administration and the challenges now faced by the government headed by Andres Pastrana.

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of the state.

CHAPTER 1. THE POLITICAL ECONOMY OF REFORM: ANALYTICAL ISSUES

During the last few years there has been a proliferation of works dealing with the political economy of reform. While some of them are analytical in nature, others are historical, and still others are of the "how to" type. The latter try to illuminate policy makers on the most effective ways of proceeding with economic modernization. Most of this literature has emphasized the role of interest groups, the media, initial economic and political conditions, and the role of the external environment. In this chapter we provide a very brief discussion of the most important aspects of this literature, and present a list of key hypotheses on the dynamics of the political economy of. In the rest of the book these hypotheses are confronted to Colombia's experience after 1990. The discussion in the chapter is deliberately brief, and concentrates on those issues that are particularly important for the analysis of Colombia's experiment with economic reform.[4]

Basic Issues

Traditional political economy approaches to economic reform in general, and trade liberalization in particular, have focused almost exclusively on distributive conflicts. The basic framework is based on some variant of the Heckscher-Ohlin theory of international trade, including Stolper-Samuelson and Ricardo-Viner models, and considers a finite number of actors in the reform process.[5] Some groups will be hurt by the reform and will

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[4] Readers interested in a more detailed coverage of the analytics of the political economy of reform should consult, for example, Williamson (1994), Haggard and Kaufman (1992), and Tommasi and Velasco (1996).

[5] In spite of their elegance, however, models based on the Stolper-Samuelson framework have a number of limitations. They assume that the interests of workers and capitalists are independent of the sector where

oppose it, while those that benefit will support it. This approach has been implicitly followed by Rodrik (1994) in his analysis of the political economy of trade reform, where he considers three groups of actors: (1) import substituting industrialists; (2) holders of import licenses; and (3) users of imports, including producers that rely on imported inputs. Depending on the underlying model of an economy (i.e., whether factors of production are industry-specific or not), it is possible to add to this list any number of groups with special characteristics, including: (4) agricultural producers, who often argue that food self-sufficiency is a matter of national security; (5) organized labor, especially those employed in import-competing industries; and (6) labor in the informal sector, which tends to be dispersed and disorganized, but with a large number of workers employed throughout Latin America, including Brazil, Chile, Colombia and Mexico. In this particular set-up the political support for the reform effort will be proportional to the difference between redistributed income and net efficiency gains from the reforms; what Rodrik (1994, 67) calls the "political cost-benefit ratio."

Reforms, however, are seldom restricted to one area of the economy. This means that in order to have a better understanding of the overall process, and in particular of the interaction between different interest groups, a broader constellation of players and sectors

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they operate initially, and they ignore important macroeconomic considerations, including the potential role of the exchange rate. Extensions of the basic Stolper-Samuelson framework, however, allow for additional actors, as well as for complex relationships between them. A powerful extension -- and one that has become very popular among political scientists working on the political economy of trade -- assumes that some of the factors (capital, say) are sector specific. In this case, capitalist interests differ depending on which commodities they are producing at the time the reforms are launched. That is, in this framework capital involved in the production of exportables, importables and non-tradables may (and usually will) have conflicting interests. Moreover, if the country in question is characterized by a semi-enclave traditional exportable sector -- oil in Venezuela, copper in Chile, coffee in Colombia -- there will be conflicting interests between this traditional sector and the rest of exportables.

should be considered.[6] For example, if financial sector reform is being considered, the role of banks, speculators and debtors should be incorporated into the analysis. Moreover, as long as privatization is a key component of the reform agenda, the role of state-owned enterprises (SOEs) in the reform process has to be considered explicitly. Commenting on the political economy of privatization, the World Bank (1995, 10) has argued that "the reform of SOEs can cost a government its support base, because reform almost invariably involves eliminating jobs and cutting long-established subsidies." Also, to the extent that a reform program includes the reform of public sector institutions, the role of public sector unions and the bureaucracy should be taken into account in an explicit fashion in the analysis. According to Haggard and Webb (1994, 13), "frequently, the most vociferous opposition to a change comes not from interest groups, legislators or voters, but from ministers and bureaucrats within the government."

Furthermore, Bates and Krueger (1993, 456) argue that one possible explanation for the failure of interest groups to prevent or shape economic reforms is that, "in the context of comprehensive economic policy reform, it is difficult for particular groups to calculate where their interests lie. Ideological struggles therefore can outweigh competition among organized interests as a determinant of policy change." In contrast, Fernández and Rodrik (1991) propose a theoretical model where uncertainty about the future benefits of reforms can produce a "status quo bias," thus inhibiting reforms. It is possible to argue, however, that the various components of policy packages can act as compensation mechanisms that can help reduce opposition and perhaps raise support for a program that includes trade

[6] This, of course, does not mean that the basic principles of international trade theory cease to be relevant. In fact, the extended general equilibrium framework sketched here, and favored by many analysts, continues to

liberalization. Moreover, political (even symbolic) compensation schemes can also be devised to tame opposition to reforms, such as offering political appointments to influential representatives of a particular interest group.

In recent policy discussions it has become customary to distinguish between "first" and "second" generation reforms.[7] First generation policy reforms represent a change in economic policies that alters some (very) basic aspects of the economic structure of the country in question. In addition to trade liberalization, these policies include fiscal reforms and adjustment, the elimination of exchange controls, financial liberalization, the implementation of minimal social safety nets, deregulation and some privatization. Understanding the way in which these different reforms interact among themselves is important from a political economy point of view. In contrast, second generation, or institutional reforms aim to drastically change the institutions of the state. These reforms are politically and technically more difficult to implement than the first generation reforms, because they entail changing the functioning of fundamental institutions, such as the judiciary and the civil service. Other second generation reforms include: reforming labor market institutions (including the relationship between unions, business and the government); reforming the way in which social services, mainly education and health, are provided; reforming social security; implementing administrative and political decentralization; implementing a major privatization program; and creating independent, professional and strong economic institutions aimed at providing simple, impersonal and clear rules of the game that will help reduce the costs of engaging in productive activities.

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be extremely powerful.

In sum, recent analyses of the political economy of economic reforms have gone beyond pure economic issues and have emphasized five interrelated aspects: (1) distributive conflict among different groups, including exporters, industrialists and unions, among others; (2) the country's political organization and structure, including the system of checks and balances (i.e., executive branch discretion) offered by a country's constitution and the number and nature of political parties; (3) the role of the bureaucracy; (4) the role of ideas and of professional and intellectual groups; (5) external actors, including the international multilateral institutions, such as the IMF and the World Bank and, in some cases such as Colombia, the role of foreign governments (the United States, through the Justice Departments' Drug Enforcement Administration, DEA). This broader perspective, taken by Haggard and Webb (1994), Tommasi and Velasco (1996) and the World Bank (1997) among others, recognizes the relevance of a rich list of actors. Moreover, in this framework, both short- and long-run coalitions play an important function, as do politically-motivated compensation schemes.

The Dynamics of Reform

Each episode of economic reform is historically unique. Nonetheless, recent work on the political economy of policy reform have been able to detect some regularities in the phases followed by most reform episodes. A number of authors have argued, for example, that a major economic crisis almost always precedes the launching of a reform effort. In an early contribution Lal (1987, 274) argued that "the typical stabilization *cum* adjustment program

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[7] On the distinction between "first" and "second generation" reforms see Naim (1994, 1995).

is launched when the country is in a 'crisis,' usually an incipient or actual balance of payments crisis that necessitates a reduction in the level of current expenditures." Bates and Krueger (1993) are, possibly, the strongest advocates of this "crisis" view of reform initiation. According to these authors, "[t]here is no recorded instance of the beginning of a reform program at a time when economic growth was satisfactory and when the price level and balance of payments situations were stable. Conditions of economic stagnation...or continued deterioration are evidently prerequisites for reform effort (page 454)." Likewise, Rodrik (1994, 63) explains that, "the reasons for the free trade bandwagon are more or less unique and derive from the intense, prolonged macroeconomic crisis that surrounded developing countries during the 1980s... which overshadowed the distributional considerations...." After examining thirteen episodes of economic reforms, Williamson and Haggard (1994, 564) reach a more cautious conclusion: "Crisis is clearly neither a necessary nor a sufficient condition to initiate reform. It has nevertheless often played a critical role in stimulating reform."[8]

According to this "crisis hypothesis," in the midst of an economic crisis, highly trained social scientists, who in normal times have little or no political influence, are called by politicians and asked to help forge a way out of the crisis. All of a sudden, the incoming *technopols'* ideas -- usually based on the Anglo-Saxon economic tradition and consistent with the views of the multilateral institutions -- become highly influential.[9] As this contest

[8] For additional arguments in favor of the crisis hypothesis, see Drazen and Grilli (1993), Tornell (1995), and Bruno and Easterly (1996). For an skeptical view, see Rajapatirana et al. (1997), who show that historically many macroeconomic crises in Latin America have resulted in the "tightening" of trade policies.

[9] Domínguez (1997,7) defines *technopols* as follows: "Technopols are a variant of technocrats. In addition to being technocrats... technopols are political leaders (1) at or near the top of their country's government and political life (including opposition political parties) who (2) go beyond their specialized expertise to draw on

takes place in the marketplace of ideas, the proponents of the old, protectionist development strategy will try to dismiss the new approach as being foreign and/or imposed by the multilateral institutions. The *technopols* then try to persuade politicians and the public at large that their program is based on sound scientific principles and that it is supported by international empirical evidence. Ideas are not only important in formulating the reform plan, but also in implementing the actual liberalization program, because issues related to speed and sequencing become important. Moreover, at the implementation stage the *technopols* usually find out that the realities of politics conflict with the simple world of economics. Their ability to understand political trade-off's and to design sellable strategies may determine the success of the reform effort.

Although the actual way in which the reforms are implemented varies across countries, the early phases of the process are often concentrated on basic economic issues, and in particular on macroeconomic stabilization and trade liberalization. The coordination of macroeconomic and trade reform policies becomes crucial at this time. The political effect of these early reforms, particularly the support they will elicit from the population, will depend on a number of factors, including: (a) whether the government is able to put in place an effective public relations effort; (b) the performance of the economy -- if growth declines and inflation is slow in falling, political support will tend to erode quickly; (c) the government's capacity to put in place compensation schemes that will defuse opposition to the reforms; and (d) the government's ability to forge broad political coalitions.

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various different streams of knowledge and who (3) vigorously participate in the nation's political life (4) for the purpose of affecting politics well beyond the economic realm and who may, at times, be associated with an effort to "remake" their country's politics, economics, and society. Technopols so defined may operate in either authoritarian or democratic regimes." For a critical view regarding this definition see Toye (1994).

Reformist governments able to form broad coalitions and, more importantly, to compensate (potential) losers will be able to neutralize opponents, and will face an easier task in pursuing the reform agenda. As Haggard and Webb (1994) have argued, most successful compensation schemes have been rather complex, and have not been based on simple monetary transfers to those that are directly hurt by the reforms. Table 1 provides a description of five commonly used compensation schemes. The first one, called *direct compensation*, includes the traditional mechanisms used by governments to 'buy' the support of certain groups directly affected by the reform process. An example of this type of mechanism would be the distribution of shares in privatized companies to workers in those companies. The next three compensation schemes are more subtle, and are not as straightforward. *Indirect mechanisms* rely on making policy adjustments in areas unrelated to the reforms proper, in order to compensate (potential) opponents; *cross compensation* mechanisms, on the other hand, try to 'buy' the support of groups not directly affected by the reforms. This is usually done by transferring resources to these groups. *Exclusionary compensation* mechanisms try to deflect opposition by certain groups, by not including them among those affected by particular reform measures. The final category in Table 1 -- political compensation -- goes beyond the purely economic sphere and concentrates on political mechanisms, including the appointment of reform skeptics into key government positions. In a way, the reform government will try to co-opt (some) reform opponents, by allowing them to share into the trappings of political power.

Exporters are usually among the early supporters of reform-oriented governments. They benefit directly from the reduction of import tariffs affecting their inputs of production, and from the exchange rate depreciation that often takes place during the early

Table 1. The political economy of reform and compensation mechanisms

Compensation mechanisms	Main features and some historical examples
A. Direct Compensation	Groups directly affected by the reform policy are compensated through the transfer of cash or financial securities. In this way the authorities expect to see a reduction in the extent of opposition from that group to that particular reform. Examples of this type of compensation mechanisms include the distribution of shares of privatized firms to workers in that particular firm. The increase in take-home pay following a social security reform is another good example of this type of direct compensation scheme.
B. Indirect Compensation	This mechanism implies compensating (some of) the groups affected by a particular reform through the adjustment of a different policy that indirectly raises their revenues or reduces their costs of production. In some cases this type of indirect compensation is "automatic", and is the result of normal economic forces at work. In others it is the result of specific policy measures. One of the most important indirect compensation mechanisms is given by the real exchange rate (RER) adjustment following a trade reform. By devaluing the real exchange rate, import substituting sectors are partially compensated, while exporters experience an additional boon. Providing tax exemptions to sectors affected by deregulation constitutes another common form of indirect compensation.
C. Cross Compensation	This mechanism entails transferring resources -- either directly or indirectly -- to groups not directly affected by the reform, in order to obtain their political support. Transferring shares of privatized firms to the population at large -- as in Bolivia's capitalization program -- is a good illustration of this mechanism at work.
D. Exclusionary Compensation (i.e. Exemptions)	Entails excluding certain powerful groups from the effects of a reform, or implement policies that in effect exempt some sectors from the reform in order to diffuse their political opposition. By allowing these groups to maintain their old privileges it is expected that they will not become active antagonists. The special treatment given to the Chilean armed forces regarding that country's social security reform is a classic example of this type of compensation mechanism.
E. Political Compensation	This mechanism encompasses political "carrots and sticks." For example, the appointment of influential representatives of certain groups affected by the reforms to high government posts, often sends a signal to interest groups that their concerns will be addressed

Source: Edwards (1996).

stages of an stabilization program. Producers of import-competing goods are usually among the opponents of trade reform initiatives, but are often at least partially compensated by the real depreciation of the currency. In addition, losers of trade liberalization can also be compensated through other schemes. In particular, if the reform process is seen as a package, of which trade liberalization is only one component, some import-substituting groups may support the reforms if they perceive that they will directly benefit from privatizations or financial liberalization, for example. Unions representing the employees of state-owned enterprises are almost always among the most vehement opponents of economic reforms. Reformers often try to win them over, or at least to neutralize them by offering some participation in the newly privatized firm.

Support from the multilateral institutions -- either in the form of technical assistance or through the provision of funds -- may help the reform effort, once it has been launched. However, there is significant evidence that the multilaterals -- and mostly the IMF and the World bank -- have not usually played a fundamental role in the initiation of the reforms (see Edwards 1997). According to Lal (1997, 150), in order to encourage the reform government to undertake its tasks, "sweeteners which ease its fiscal problems, in the form of soft loans or grants from multilateral and bilateral foreign governments, may be desirable. Beyond that the role of foreign assistance seems limited." Moreover, Haggard and Webb (1994, 5) have argued that there are no recorded reform episodes since the mid-1970s that have failed exclusively due to a lack of financial support from the multilateral financial institutions.

How well the reform effort fares from a political economy perspective will also depend on the political structure of the country, including the degree of democratization, the nature of the party system, the degree of decentralization, the importance of the bureaucracy in implementing policies, and the degree of political polarization. For example, countries with a two party system and a low(er) degree of political polarization may find it easier to forge a national project and implement reforms with a long pay-off period, including the so-called institutional reforms, than those countries (such as Brazil) with a highly fragmented political system. More generally, countries with a high degree of political conflict may tend to get easily bogged down in political struggles. The sequencing and speed of reform also matter for the political economy of reform; they determine how fast the economy grows and whether it is feasible to compensate losers in an appropriate fashion. This issue is discussed in greater detail below.

A question of particular relevance concerns the relationship between the extent of democratic practices and tradition and the political constraints faced by reformers. More specifically, do authoritarian regimes face political constraints, or do they essentially face a free hand? There is little doubt that in the absence of electoral competition a reformist government has more degrees of freedom. This does not mean, however, that reformers have a completely free hand in a dictatorship. In fact, even within a dictatorial regime there will be factions that will represent different interest groups. In this case the *technopols* still have to convince strongmen, usually high ranking military officers, that their policies are appropriate for the country. More specifically, the market-oriented perspective often clashes with the strongly nationalistic and state-centered views of the military. Moreover, the authoritarian government will still demand results -- although it may give the reformists more time to obtain them -- and would like to maintain some degree of legitimacy, while political repression will tend to be targeted to specific groups.[10] A related issue concerns the extent of freedom of expression under authoritarian regimes, which may limit the scope of the market of ideas.[11]

With time, and as the original crisis subsides, reform skeptics and opponents -- and in particular, those groups that have traditionally captured rents generated by government policies (including public sector unions) -- are able to regroup and to challenge the reform itself.[12] Their efforts to slow down the modernization process -- and even to reverse it -- can be successful if the reforms have failed to generate significant improvements in economic conditions, including higher real wages and lower unemployment. Such attempts to reverse the reforms will usually be present in both democratic and authoritarian settings. While in some cases nostalgia and the populist temptation are strong enough to bring the reforms to a standstill, in others the modernization forces are able to continue moving forward until the reform process is consolidated. The way in which a reformist government reacts to the populist challenge is also an important determinant of the fate of the modernization effort. For example, in order to regain some public support the authorities may reduce the pace of key reforms, or -- as is becoming increasingly common -- they may

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[10] For instance, a Chilean sociologist, Garretón (1985, 147), wrote that in the case of Chile, "we are... dealing with a program to lay the groundwork for a new social order... we must direct our attention to the capacity of diverse sectors in the dominant power bloc to achieve hegemony within it. The attempt to restructure society... can take several directions depending on the capacity of particular sectors to generalize these interests or to impose their own ideology within the victorious coalition." In fact, the general issue of "state autonomy" from economic and social interests has had a long trajectory in the social sciences. See, for example, the first, review chapter in Hamilton (1982).

[11] On a more general basis, and within the context of democratic regimes, there is no evidence linking economic and political reforms, or economic reforms and political parties (see Williamson and Haggard 1994).

[12] Nelson (1994) argues that in general it is more relevant to focus on the sustainability of reform than on its inception. The latter is generally facilitated by the so-called "honeymoon effect." The former is a much

relax the public sector budget constraint to face a political challenge, such as a mid-term election or a plebiscite in the case of an authoritarian ruler seeking to enhance its legitimacy.

Speed, Sequencing, Exchange Rates and Protective Structure

Recent discussions of the political economy of reform have focused on the tensions between "optimal" and "feasible" trade reform strategies. Much of this literature has focused on two issues: (1) the adequate speed of reform; and (2) the sequencing of reform. The role of "transition costs," and particularly of the unemployment consequences of trade liberalization, has been at the center of these discussions. For a long time analysts argued that a gradual liberalization was preferable to a big-bang approach (Little *et al.* 1970 and Michaely, 1986). According to these authors, gradual reforms would give firms time for restructuring their productive processes and, thus, would result in low dislocation costs in the form of unemployment and bankruptcies. These reduced adjustment costs would, in turn, provide the needed political support for the liberalization program. During the early 1990s, however, the gradualist position came under attack. It was argued that slower reforms tend to lack credibility, inhibiting firms from actually engaging in serious restructuring.

Lal (1997, 149-50) has argued that "once the crisis of the state seems to be manageable, there is no further incentives for the predatory state to continue with liberalization...This suggests that a 'crisis' provides an opportunity for liberalizers -- but it may be of short duration. A big bang may therefore be desirable..." (see, also, Rodrik 1989,

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more critical and complicated matter. More on this below.

Calvo 1989, and Martinelli and Tommasi 1995). Moreover, the experience of a number of countries during the 1980s and 1990s has shown that a gradual (and preannounced) reform allows firms negatively affected by it to (successfully) lobby against the reduction of tariffs.

The thinking on the speed of reform has been influenced by considerations of the short-run unemployment consequences of trade liberalization. To the extent that reform increases unemployment, there will be an active opposition to it. The strength of this opposition will largely depend on who becomes unemployed. It is not the same if those unemployed belong to a powerful union in the protected sector (including a privatized SOE) than if they come from the ranks of workers in the informal sector. According to the standard view -- based on specific-capital (Ricardo-Viner) models, with wage rigidities -- a gradual reduction of trade restrictions allows firms to reallocate capital out of the unprotected sector and into the export industries, without generating employment dislocations. At the end of the day, however, whether trade reform will generate an increase in aggregate unemployment is an empirical issue. A World Bank study on liberalization episodes in 19 countries (Choksi *et al.*, 1991) suggests that, even in the short run, the employment costs of reform can be small. Although contracting industries will release workers, expanding export-oriented sectors that are positively affected by the reform will tend to create employment opportunities. Edwards and Lederman (1998) have argued that in the presence of labor market distortions a trade reform may reduce the overall extent of overall unemployment, generating political support among some labor groups.

The *sequencing of reform* issue was first addressed in the 1980s in a systematic way in discussions dealing with the Southern Cone (Argentina, Chile and Uruguay) reform experience of the late 1970s and early 1980s, and emphasized the macroeconomic consequences of alternative sequences. It is now generally agreed that the fiscal accounts have to be (partially) under control at the time that a major structural reform effort is launched. Most analysts also agree that financial reform should only be implemented once a modern and efficient supervisory framework is in place. The importance of reforming the supervisory framework has become particularly evident in the aftermath of the 1994 Mexican currency collapse, and the 1997-98 East Asian currency crises. These episodes have clearly shown that a weak and unsupervised banking sector can generate a tremendous degree of vulnerability, transforming a run-of-the-mill external sector crisis into a major eruption with unforeseeable political ramifications.

One of the most hotly debated issue in the sequencing literature refers to the order of liberalization of the trade and capital accounts. The behavior of the real exchange rate is at the heart of this discussion. The central issue is that liberalizing the capital account would, under some conditions, result in large capital inflows and in an appreciation of the real exchange rate (McKinnon, 1991).[13] The problem with this is that an appreciation of the real exchange rate will send the "wrong" signal to the real sector, frustrating the reallocation of resources demanded by the trade reform. The effects of this real exchange rate appreciation will be particularly serious if, as argued by McKinnon (1982) and Edwards (1984), the transition period is characterized by "abnormally" high capital inflows that result in temporary real appreciations. If, however, the opening of the capital account is postponed, the real sector will be able to adjust and the new allocation of resources will be consolidated. According to this view, only at this time should the capital account be

[13] This would be the case if the opening of the capital account is done in the context of an overall liberalization program, where the country becomes attractive for foreign investors and speculators.

liberalized.[14] However, with specific reference to the cases of Chile and Colombia, recent work by Valdés and Soto (1996), Cárdenas and Steiner (1997) and Edwards (1998), has questioned the effectiveness of capital controls for avoiding situations of real exchange rate overvaluation.

Real exchange rate behavior has important implications for the political economy of trade liberalization. According to traditional manuals of "how to liberalize," a large devaluation should constitute the first step in a trade reform process. Maintaining a depreciated and competitive real exchange rate during a trade liberalization process is also important in order to avoid an explosion in imports growth and an eventual balance of payments crisis. Under most circumstances a reduction in the extent of protection will tend to generate a rapid and immediate surge in imports. On the other hand, the expansion of exports usually takes some time. Consequently, there is a danger that trade liberalization will generate a large trade account disequilibrium in the short-run. This, however, will not happen if a real exchange rate depreciation encourages exports and helps maintain imports in check. Moreover, as it was argued above, the depreciation of the real exchange rate constitutes one of the most important indirect compensation mechanisms (see Table 1). Many countries, however, have failed to sustain a depreciated real exchange rate during the transition. This has mainly been the result of expansionary macroeconomic policies that generate speculation, international reserves losses and, in many cases lead to the reversal of the reform effort. According to Choksi et al. (1991, 115-116), "in terms of economic performance and policies, liberalizing countries are characterized by a much faster growth

[14] Lal (1985) presents a dissenting view. Hanson (1995) has argued that under some circumstances the capital account should be liberalized early on.

of exports, generally lower budgetary deficits and (less clearly) budgetary expenditures, and clearest of all, long-term stability of the real rate of foreign exchange."

During the last few years, discussions on the political economy implications of the sequencing of reform have expanded their area of emphasis and have focused on a variety of markets. An increasing number of authors has argued that the reform of the labor market—and in particular the removal of distortions that discourage labor mobility—should precede the trade reform, as well as the relaxation of capital controls. As argued in Edwards (1988; 1995a, 122), it is even possible that the liberalization of trade in the presence of highly distorted labor markets will be counterproductive, generating overall welfare losses for the country in question. More importantly, perhaps, an early labor market reform has important consequences for the political economy of trade liberalization. For example, the easing of hiring and firing regulations is an important form of "indirect" compensation. Owners of capital that would otherwise oppose a trade reform, may support it if trade liberalization comes with more flexible labor market regulations. Edwards and Lederman (1998) have noted that this is exactly what happened during Chile's trade liberalization effort in the 1970s. On the other hand, unions in the formal sector will usually oppose labor market reforms that reduce their political and economic influence.

The sequencing between "policy"(or first generation) and "institutional" (or second generation) reforms also matters for the political economy of reform. As the terms "first" and "second" generations suggest, there is an implicit assumption regarding the sequencing of these two types of reforms. *Policy Reforms* are implemented earlier -- both for technical and political reasons --, while *Institutional Reforms* are usually postponed in time and are only attempted at later stages (Naim 1995, Tommasi and Velasco 1996, World Bank 1997).

Recent experiences increasingly suggest, however, that the adherence to this linear sequencing may be counterproductive, costly and inefficient. The postponement of institutional modernization until the first generation reforms are firmly in place could, in fact, generate unwanted -- and even negative -- economic effects. This was the case, for example, in Chile in the 1970s and early 1980s, where the liberalization of the financial sector without the creation of an adequate supervisory structure resulted in a major financial crisis. Likewise, the liberalization of international trade in the absence of the modernization of labor market institutions, will in many cases generate unemployment and high dislocation costs. An inefficient -- and worse yet, corrupt -- judiciary system will increase the transaction costs associated with private initiative, and will result in sub optimal investment levels. And privatizing utilities without putting into place an appropriate competition policy will result in monopolistic pricing and distortions.

The postponement of institutional reforms will not only affect the efficiency of the economy, but is also likely to generate undesirable distributive effects. These could include, among others, the appropriation of rents by private operators of newly privatized utilities, the reduction of the level of employment in certain sectors affected by labor market rigidities, the erosion of the real (expected value) of pensions for the poor, and the delivery of low quality social services to the less fortunate groups of the population. A large number of Latin American countries have been affected by many of these problems in the last few years. All of this, of course, suggests that in order for the modernization reforms to truly bear fruit and be successful, an effort should be made to implement institutional reforms early on in the process-- ideally alongside with the economic reforms proper.

Table 2 presents a summary of the main hypotheses on the political economy of reform discussed in this chapter. As will be seen throughout the rest of the book, most of the issues identified in this discussion as important -- speed, sequencing, unemployment consequences, and real exchange rate behavior, among others --, played a major role in the unfolding of the Colombian reforms. What is particularly interesting is that, in the end, both the policies as well as their effects were significantly different from what the Colombian policy makers -- and some outside observers -- had anticipated. It is worth mentioning that most of the literature on the political economy of reform gives little, if any consideration to the precise content of the reform package itself.[15] As we shall see, in the particular case of Colombia that omission could easily lead to incorrect interpretations regarding the influence of political factors in derailing or in retarding the reform effort.

[15] The Williamson (1994) volume is a good example of this fact.

Table 2. Eleven key hypotheses on the political economy of market oriented reform

Hypothesis	Comments
1. Crisis Hypothesis	A market-oriented reform is usually initiated in the midst of a major economic crisis.
2. Technocratic reform team leads the modernization effort	The reforms are designed and implemented by a team of technocrats – the *technopols*.
3. Ideas Matter	The *technopols* have a clear ideology. The design of the reforms, and their outcome, are affected by this ideology. The reform process goes beyond purely distributive issues. In some cases the political leader does not have a reform ideology at the beginning of the process; in others, he hides his ideology from voters, the so-called *voodoo-economics* hypothesis
4. A strong public relations effort helps increase the support for the reforms	The average citizen has mixed feelings about the reforms. In the midst of a crisis he is willing to experiment with new policies; on the other hand, he is apprehensive about new ideas. A strong marketing effort will help him understand the true nature of the reform program
5. Compensation schemes can help reduce the opposition to the reform effort	The reforms have profound effects on income distribution. Naturally those groups hurt by the reform will oppose them. The use of broadly defined compensation schemes, that usually go beyond the economic sphere, can effectively help deflect this opposition.
6. Sequencing matters	The order in which reforms are undertaken has economic and political consequences. It affects the nature of the distributive conflict, and the authorities ability to implement effective compensation schemes
7. Speed matters	The speed at which the reforms are implemented has important political effects. There usually is, however, a trade off between *credibility* and *adjustment* costs. A gradual reforms will have lower adjustment costs, but will tend to have a low degree of credibility. To the extent that there is a "honeymoon period" a more rapid reform during the initial months of an administration may be effective
8. Political institutions are important	The nature of political institutions matters. Some of the most important aspects are the degree of decentralization, the strength of the executive, and the degree of independence of the judiciary and the central bank.
9. External support may be important at certain junctures	Support from the multilaterals -- IMF and World Bank, for example – may help launching the reforms. In some cases technical advise can also be useful. The importance of external actors tends to be exaggerated in the popular media.
10. Coalition building can ease the political costs of the transition	Forging a broad coalition -- or a national project -- around the reform effort will greatly reduce the political opposition and facilitate the transition. By their own nature, however, broad political coalitions are fragile and may break easily. This suggests that an effort should be made to make progress while the coalition holds in place.
11. The opposition to reform tends to grow through time, as those negatively affected by it regroup	As the sense of urgency created by the initial crisis subsides, the appeal of reforms declines. Opponents see an opportunity to regroup. The extent and success of this opposition will depend, among other things, on the performance of the economy. If growth is fast, wages increase and unemployment is down, the support for reform will be sustained

Source: Edwards (1996).

CHAPTER 2. POLITICAL BACKGROUND, INITIAL CONDITIONS AND MAIN ACTORS

This chapter provides some background on the Colombian reforms, setting the stage for the political economy analysis undertaken below. Emphasis is placed on three issues: first, we briefly mention the salient features of the political system. Second, we evaluate the initial social, political and economic conditions faced by the Gaviria administration. Third, we provide a discussion on the most important actors in the reformist effort. This analysis is based on the general framework discussed in the previous chapter, and recognizes that, while distributive issues are important in defining the course of a reform effort, they are not the only factor. In addition, ideas and politics -- in a strict sense -- matter.

A. Political and institutional background

This section provides a characterization of Colombia's political environment since the late 1950s. We show that, for the most part the post-1960 era has been one of power sharing between the two historical parties. Second, we argue that the polity has been an important factor explaining the lack of extreme positions regarding economic policy. This background is useful in showing that the introduction of a reform program was an achievement in itself.

Three decades of power-sharing. Colombia is, together with Mexico, possibly the country where the party system has least changed in the Western Hemisphere. According to Dix (1990, 100), "what does distinguish the Colombian case is the failure of the country's political institutions, and notably its party system, to manifest changes comparable in magnitude to the new levels of social mobilization." On average, during the 1945-86 period the two traditional parties (Conservative and Liberal) commanded over 97% of the vote for the House of Representatives. Only once (in 1970) did this percentage fall below 90. Between 1931 and 1982 only 12% of municipalities switched party allegiance. Almost without exception, every time dissident factions appeared, they invariably went back to their original partisan allegiance.

The non-emergence of a third party is surprising in light of the fact that since the late 1950s the two traditional ones have converged in terms of policy and ideology.[16] If anything, Colombia's poor distribution of income and wealth made it an ideal place for the emergence of a class-based party. However, the workforce has not been heavily employed in sectors that are prone to produce a militant, class-oriented activism. Quite the contrary, coffee, the country's main product, is grown on thousands of small, family-operated parcels. According to Dix (1990), this has fostered conservative, individualist values rather than radical or collectivist ones. On top of that, coffee is entirely owned by nationals, as have been other key industries. This might explain the lack of nationalistic attitudes, frequent breeding grounds for popular movements.[17]

Following Dix (1980), since 1958 Colombia can be characterized as a case of a *consociational democracy*, unique in that its subcultures do not originate in religious, ethnic, or class differences.[18] In regard to the two traditional parties, their exclusionist

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[16] This description does not hold after the enactment of a new Political Constitution in 1991. More on this topic below.

[17] Nelson *et al* (1971) mention as an additional element the organizational weakness of labor federations and "the hierarchical difference between them and the entrepreneurial class."

[18] Lijphart (1977, 1) distinguished a consociational democracy as one in which "centrifugal tendencies inherent in a plural society are counteracted by the cooperative attitudes and behavior of the leaders of the different segments of the population." By means of proportionality rules, grand coalitions and mutual vetoes,

nature and their familial and communal roots mark them as the functional equivalent of subcultures.[19] Historically, the two traditional parties have been composed of notables bound together through clientelistic relationships, with weak organizations and almost no programmatic content. They are, nonetheless, effectively multi-class, as the elites have sought popular support in their partisan competition for government perks. Furthermore, the relative openness of the regime –in terms of elections, division of powers and freedom of the press— granted it reasonable legitimacy among all social groups.

The stronghold on power of the two traditional parties was enhanced in the late 1950s, through a political coalition (National Front or *Frente Nacional*). After several years of party violence, the leaders of the two traditional parties reached an arrangement by which both would share power for 16 years. The agreement was facilitated by several factors: (i) the usual conflict between the parties was being superseded by much higher stakes, as the masses were becoming increasingly resentful; (ii) the repressive actions of the military and their political ambitions became more uncomfortable than a coalition with a partisan foe; (iii) the Liberal's acceptance that Colombia was a catholic country; (iv) agreement that the military would not be persecuted and that the Minister of Defense would come from their ranks.

The main provisions of the National Front were: (i) the presidency would be alternated for the duration of the coalition; (ii) all seats in Congress, departmental

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leaders of different subcultures are able to provide reasonable stability to an otherwise polarized society. Other analysts have referred to Colombia as a "modified democracy", using qualifications such as "controlled", "oligarchic" or "bipartisan elitist." Some have even called it a "formally authoritarian democracy" or a "constitutional dictatorship" (Hartlyn, 1993).

[19] Writing in the early 1970s, Nelson *et al* (1971, pp. 218, our emphasis) suggested that "the traditional style of Colombian politics invokes an emotional, moralistic, *and tenacious attachment to hereditary loyalties.*"

assemblies and municipal councils, and all cabinet and government offices, as well as Supreme Court positions, would be divided in a 50-50 fashion, to the exclusion of all other parties; (iii) non-procedural decisions in all elective bodies required a two-thirds majority. Though it might be criticized for having impeded any real social change, the National Front must be credited with having achieved a steep decline in inter-party violence and the return to barracks of the military.[20] The two parties stopped quarreling for the control of the state, while reaping the gains of its impressive growth (Hartlyn, 1993). The resulting policies fostered stable growth and relatively low inflation, without openly discriminating against any particular activity.[21] According to Hartlyn (1993), coffee sector interests were always favorably addressed, and to a lesser degree so were those of other business organizations.[22]

The National Front formally ended in 1974, but several of its provisions were extended for four years.[23] Informally, the coalition lasted much longer, with all the presidents that followed until 1990 being bred within its ranks, while Congress continued to be dominated by the two traditional parties. A referendum held in 1990 mandated the convening of a popularly elected constituent assembly which drafted a new constitution, which facilitates the creation and consolidation of new political movements, empowered

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[20] Recent violence has occurred outside of any power dispute between the traditional parties, although many of its causes can be traced back to the exclusionist nature of the National Front. On these matters, the essays collected in Leal (1995) are very relevant.

[21] According to Reveiz and Pérez (1986), during the National Front heads of business associations began to occupy, in a rather large proportion, positions in the executive branch.

[22] In sharp contrast with this interpretation, Bates (1997) argues that being electorally very important, coffee producers have been highly influential in those periods in which party competition has been significant, but have been subjected to the government's redistributive purposes when there was no partisan competition in national elections (i.e. the National Front years).

[23] A 1968 Constitutional amendment prolonged parity in cabinet and administrative positions for four years

citizens, and advanced political and fiscal decentralization. Though many analysts have been skeptical of its practical implications, the power-sharing schemes of the National Front did, for all practical purposes, end in 1991.

Some implications of the polity. The characterization of Colombia as a consociational democracy, in which since the late 1950s, and at least until 1991, two parties have explicitly or implicitly shared power, can go a long way in explaining the economic policies that were implemented until the late 1980's. According to Haggard (1994, 238), Latin American countries with high inflation histories have been those in which the "urban popular sector" and labor groups have been incorporated into populist parties, within the context of relatively polarized party systems. In turn, the political difficulties of implementing macroeconomic adjustment programs have been less severe where decision making has been centralized and less subjected to rent-seeking pressures.

There are two aspects that differentiate Colombia from the typical Latin American country, as characterized by Haggard: (i) the most influential business group produces an exportable (coffee) not linked to import substitution; (ii) export promotion has been the cornerstone of policy since 1967. Post-1967 Colombia seems to fit in Haggard's assessment of Asia in the sense that in that region it has been important "to maintain realistic exchange rates and to shift toward the promotion of manufactured exports" (pp. 241).

According to Urrutia (1991), in Colombia there has generally been no "economic

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and established that after this extension the other party other than that of the President would receive "equitable" cabinet and administrative positions.

populism", at least not in the sense of Dornbusch and Edwards (1991). Macroeconomic policy has generally been conducted with the purpose of providing some minimum stability deemed necessary to promote growth, rather than with redistribution purposes. This has been made possible not by "populism", but by "clientelism", which has given politicians an important say in the distribution of the national budget, while at the same time allowing them to reap the benefits of stability, produced by a seldom politicized macroeconomic decision-making process.

As Archer and Soberg Shugart (1997) and Soberg Shugart and Nielson (1997) show, Colombia's electoral rules –in which members of Congress are elected by proportional representation rules applied on each district on factional, rather than on party lists-- provide incentives for politicians to pursue personal, service-related votes instead of party-oriented votes.[24] Voters are tied to individual legislators and their vote depends heavily on the elected official's delivery of government services. In addition, parties have almost no control over the composition of their delegations in Congress. Some three decades ago, Nelson *et al* (1971) argued that National Front political practices were supplementing the inter-party political and ideological debate with the politics of pressure groups.

To be sure, in spite of the strong bipartisan coalition, politics does not take place in a vacuum. Different regions hold different interests, and those interests are better served by different powers within the state. As a first approximation, it is interesting to differentiate between the (mainly Andean) coffee-growing region and the rest of the country. The

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[24] The 1991 Constitution maintained this rules for the lower house of congress. To facilitate matters for

former is heavily dependent on a primary export; the latter has a much more diversified economic base. Table 3 shows the regional origin of the heads of three key economic institutions: the Ministry of Finance, the Central Bank and the National Planning Department. The first is involved with all types of economic matters, the second primarily with exchange rate policy and monetary policy, and the third with long-term planning and fiscal policy. The coffee-growing region, with less than one fourth of population and GDP, has provided 40% of the Ministers of Finance and Governors of the Central Bank, but only 22% of the Directors of the National Planning Department.

As was just pointed out, until 1990 both houses of congress were apportioned by proportional representation. Table 4 shows that, as a result, the regional origin of senators and representatives was very similar to the regional distribution of the population. However, the 1994 senate elections were based on proportional representation at the national level. The last two columns of the table indicate that the Caribbean region became over represented in the senate, at the expense, among others, of the coffee growing and pacific regions. Table 5 contains information regarding abstention during the 1990 elections. For the presidential election, abstention in the coffee-growing region was in line with the national average, and much lower than in the Caribbean region. However, in congressional elections abstention was much lower in the Caribbean region than in the country as a whole. It can be argued that the Caribbean region is a very active political actor in congressional elections, whose outcome is crucial in the formulation and distribution of the budget, but much less important in presidential elections, whose outcome is critical in

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political minorities, Senate seats are now assigned by proportional representation rules applied in a *national* electoral district.

Table 3. Regional origin of policy-makers

Región	Finance Minister[a]		Central Bank Governor[b]		Head of Planning Department[c]		Population 1993	GDP 1992
	Number	%	Number	%	Number	%	%	%
Antioquia	11	20			3	13	13.1	14.5
Atlántico					2	9	4.9	4.1
Boyacá	4	7					3.5	2.8
Caldas	9	16	1	25			2.8	2.1
Cundinamarca	16	29	2	50	13	57	19.7	27.4
Magdalena	1	2					3	1.6
Nariño					1	4	3.9	1.5
N. Santander	1	2					3.1	1.8
Quindío	1	2	1	25			1.3	1.5
Risaralda	1	2			2	9	2.3	2.4
Santander	4	7					4.8	5.5
Tolima	1	2					3.4	3.0
Valle	2	4			2	9	10	11.6
N.A./Others	4	7					24.2	20.2
Coffee growing region	23	42	2	40	5	22	22.9	23.6

[a] 1930-1998

[b] 1969-1998

[c] 1958-1998

Source: Own claculations based on Meisel(1996) and Yanovich(1997).

Table 4. Regional composition of Congress

	1974	1986	1990	1994	Population Distribution (1993)
Number of Senators	112	114	114	100	
Regional composition (%)					
Caribbean region	22.3	21.9	21.9	25.0	21.2
Antioquia region	21.4	21.1	21.1	17.0	19.5
Pacific region	18.8	18.4	18.4	15.0	18.0
Central region	28.6	28.1	28.1	34.0	30.6
Santander region	8.9	8.8	8.8	9.0	8.0
Other regions	0.0	1.8	1.8	0.0	2.8
Coffee growing region	25.9	25.4	25.4	20.0	22.9
Number of Representatives	199	199	199	163	
Regional composition (%)					
Caribbean region	20.1	20.1	20.1	21.5	21.2
Antioquia region	21.6	21.6	21.6	18.4	19.5
Pacific region	18.1	18.1	18.1	16.0	18.0
Central region	29.1	29.1	29.1	26.4	30.6
Santander region	8.5	8.5	8.5	7.4	8.0
Other regions	2.5	2.5	2.5	10.4	2.8
Coffee growing region	26.1	26.1	26.1	21.5	22.9

Source: Own calculations, based on Yanovich (1997) and Dane.

Table 5. Abstention in the 1990 elections
(as percentage of potential voters)

Region	Presidential Election	Congressional Election	
		Senate	House
Total 1/	56.4	43.9	44.8
Coffee growing region 2/	56.7	45.2	45.0
Caribbean region 3/	66.5	36.1	37.2

1/ Excludes Amazonas, Arauca, Casanare, Consulados, Guania, Guaviare, Putumayo, San Andrés, Vaupés and Vichada.

2/ Includes "Viejo Caldas" (Caldas, Quindio, Risaralda), Tolima y Antioquia

3/ Includes Atlántico, Bolivàr, Cesar, Córdoba, Guajira, Magdalena y Sucre.

Source: Own calculations based on Registraduría Nacional del Estado Civil.

the design of overall macroeconomic policy. There is no doubt that all regions and economic interests are concerned with all types of economic policies, from the more technical issues of monetary and exchange rate management, to the more political aspects of fiscal policy and structural reforms. However, tables 3-5 give some support to the idea that certain regions and economic interest are more concerned with certain types of policies, and are therefore more interested in politically capturing the institutions that undertake them.

Economic stability and institutional continuity. Within the Latin American context, Colombia has been characterized as the least volatile economy. Table 6 provides information on inflation and growth for the region's largest economies. In all sub-periods, Colombia had the third lowest inflation rate. In terms of volatility, except during 1960-69, it had the most stable rate of inflation. A similar pattern emerges in the case of the rate of growth. The table indicates that Colombia's relative *stability* occurred in the context of macroeconomic results that were not particularly impressive. Economic volatility depends on several factors, prominent among them external conditions (i.e. terms of trade and capital flows) and economic policy. For a slightly different set of countries, Table 7 shows that with regard to the terms of trade, Colombia's "external environment" has not been particularly stable. Instead, during 1970-92 Colombia had by far the most stable economic policy of the region's 22 countries under analysis by the IDB (1995). It is in the context of this relative economic and institutional stability that an ambitious structural reform program was introduced. At least in economic terms, far removed from a situation of "crisis."

Table 8 shows the different phases of central banking in Colombia. The central bank

Table 6. Inflation and growth in Latin America*

Country	Variable	1960-69	1970-79	1980-89	1990-96
Argentina	Inflation	22.9	132.9	565.7	361.3
	*Ranking: level***	4	5	6	5
	c.v.	1	5	6	6
	Growth	4.04	2.66	-0.75	4.85
	*Ranking: level***	1	2	1	5
	c.v.	6	5	1	3
Brazil	Inflation	45.9	30.5	319.6	1329.6
	*Ranking: level***	6	4	5	6
	c.v.	3	2	5	5
	Growth	9.19	8.01	3.11	1.60
	*Ranking: level***	6	6	4	1
	c.v.	5	3	3	6
Chile	Inflation	25.1	174.6	21.4	14.7
	*Ranking: level***	5	6	1	1
	c.v.	4	6	2	3
	Growth	4.51	2.22	3.67	6.83
	*Ranking: level***	2	1	6	6
	c.v.	4	6	5	1
Colombia	Inflation	11.2	19.3	23.4	24.9
	Ranking: level*	**3**	**3**	**3**	**3**
	c.v.	**5**	**1**	**1**	**1**
	Growth	4.92	5.77	3.40	4.14
	Ranking: level*	**3**	**4**	**5**	**4**
	c.v.	**1**	**1**	**2**	**2**
Mexico	Inflation	2.7	14.7	69.1	21.6
	*Ranking: level***	2	2	4	2
	c.v.	2	4	3	4
	Growth	7.16	6.48	2.26	2.60
	*Ranking: level***	5	5	3	2
	c.v.	2	2	4	5
Venezuela	Inflation	1.2	6.6	23.0	52.2
	*Ranking: level***	1	1	2	4
	c.v.	6	3	4	2
	Growth	5.64	5.19	0.2	3.12
	*Ranking: level***	4	3	2	3
	c.v.	3	4	6	4

* Annual percentage change in CPI and in GDP, respectively.

** An entry of 1 (6) indicates the lowest (highest) level of the variable and of the coefficient of variation (c.v., computed as the ratio between the standard deviation and the mean).

Source: Author's calculations based on IMF.

Table 7. Terms of trade in Latin America

Country		1960-69	1970-79	1980-89	1990-96
Argentina	Coefficient of Variation	0.16	0.20	0.21	0.14
	*Ranking**	6	3	3	6
Brazil	Coefficient of Variation	0.07	0.09	0.13	0.12
	Ranking	2	1	2	5
Chile	Coefficient of Variation	0.08	0.26	0.09	0.04
	Ranking	3	5	1	3
Colombia	Coefficient of Variation	0.11	0.22	0.31	0.03
	Ranking	**4**	**4**	**6**	**2**
Mexico	Coefficient of Variation	0.14	0.18	0.22	0.03
	Ranking	5	2	4	1
Venezuela	Coefficient of Variation	0.04	0.43	0.25	0.10
	Ranking	1	6	5	4

* An entry of 1 (6) indicates the lowest (highest) level of the variable or coefficient of variation.

Source: IMF, "Supplement on Trade Statistics", Supplement Series, 15, and World Bank, "World Development Indicators on CD-Rom", 1997.

Table 8. Central banking phases in Colombia

Period	Nature of the board	Main objective
1923-1951	Private and independent from government	Price Stability
1951-1963	Private and independent from government	Price stability and economic development
1963-1991	Official and dependent from government	Monetary, exchange and credit management
1991-	Official and independent from government	Price stability

Source: Meisel (1996)

Table 9. Governor tenure at the central bank of Colombia

Starting Date	Name	Tenure (years)
15/Dec/1960	Eduardo Arias	8.8
22/Oct/1969	Germán Botero	8.8
24/Aug/1978	Rafael Gama	4.0
26/Aug/1982	Hugo Palacios	3.1
26/Sep/1985	Francisco Ortega	7.4
22/Feb/1993	Miguel Urrutia	
Average tenure		**6.4**

Table 10. Turnover rate of central bank governors

Country	Turnover rate [1]
Argentina	0.93
Honduras	0.13
Costa Rica	0.58
Chile	0.45
Colombia	0.20
Mexico	0.15
Panama	0.24
Brazil	1.33
Uruguay	0.48
Venezuela	0.30
Averge rate	**0.48**

[1] Average changes per year
Source: Cukierman (1992)

was established as private and autonomous entity in 1923, and it remained so until 1963. Up to 1931 Colombia adhered to the gold standard. It then maintained a fixed (and stable) exchange rate until 1949. In 1951 the central bank's objectives were expanded, to include not only price stability but also "economic development." In the early 1960s the central bank was nationalized and in 1963 the Monetary Board was created. Conformed solely by members of the government and by the government-appointed governor of the central bank, the Board was given control of monetary, credit and exchange rate policies. The 1991 Constitution completely overhauled the central banking regime (see below). The Banco de la República was organized as an autonomous state institution, independent from the government, with the sole objective of achieving price stability. Its Board of Directors is in charge of monetary, credit and exchange rate policies. It is composed of seven members: the Governor of the Bank, the Minister of Finance and five full-time members, appointed for a fixed term by the government, in a staggered fashion.

In 1967 Colombia adopted a "crawling peg" exchange rate system. Whatever is said regarding stability in Colombia's key economic variables has to take into account the fact that since 1967, and at least until 1991, it maintained the same exchange rate regime.[25] The stability of the exchange rate regime has coincided with notorious institutional stability. Table 9 shows that since 1960 the central bank has had only 6 governors, with an average tenure of 6.5 years, well above the regional average suggested in Table 10, borrowed from (Cukierman, 1992). If the tenure of the central bank governor has been notorious, it pales in comparison to that of the General Manager of the National Federation

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[25] It is revealing to note that in 1987 the central bank organized a very well attended international seminar to

of Coffee Growers (Fedecafé, for Federación Nacional de Cafeteros). Since 1937 Fedecafé has had only three general managers!!

B. Initial Conditions

Colombia was one of only two major Latin American countries that was not devastated by the 1980s debt crisis -- the other was Chile. Throughout the 1980s Colombia exhibited a positive rate of growth of GDP per capita, did not reschedule its foreign debt and was able to maintain inflation under (relative) control --see Table 11 for the evolution of some key economic variables. Moreover, during the 1970s and 1980s most social indicators in Colombia exhibited major improvement. The Gini coefficient showed a declining trend, poverty was reduced, and regional disparities narrowed significantly (Londoño 1995, Cárdenas and Pontón 1995). It is not an exaggeration to say that Colombia was one of Latin America's best -- if not the very best --performer during the 1980s.

Colombia's achievements during this decade were not, however, the result of "good" policies, but rather the reflection of the country's ability to avoid major crises. By keeping out of trouble, Colombia had historically been able to avoid the stop-go cycles that have plagued the Latin American economies. As was discussed above, starting in the mid 1960s Colombia followed a "pragmatic" economic policy based on selective but firm government intervention, that neither fully choked the private sector with over-regulation, nor did it allow it to flourish. This hybrid policy stance led Díaz-Alejandro (1985, p. viii) to argue that "[s]ocial scientists have had a difficult time fitting Colombian experience of

commemorate the 20 years of the *Estatuto Cambiario*, the 1967 piece of legislation that laid the foundation for the crawling peg system.

Table 11. Colombia: Main economic indicators 1980-1990

	1980-85	1986-90
Real GDP growth	2.6%	4.6%
Inflation	23.1%	25%
Public Sector Balance as percentage of GDP	-5.7	-1.1
Current Account Balance as percentage of GDP	-5.1	0.5
Investment (gross) as percentage of GDP	19.7	19.7
Gross National Savings as percentage of GDP	14.6	20.2
Unemployment	11.0	11.5

Source: The World Bank

Table 12. The extent of protection in Colombia 1980-88

	1980	1984	1988
Average Nominal Tariffs	26%	57%	27%
Average Effective Rates of Protection	43%	na	na
Percentage of Imports Subject to Prohibitions or Licenses	31%	99%	62%

Sources: The World Bank.

the last thirty years into fashionable categories such as monetarism, structuralism, bureaucratic-authoritarism and such." According to Urrutia (1989) this "pragmatic" stance permitted Colombia to avoid populist outbursts, to pursue a stable macroeconomic policy aimed at avoiding real exchange rate overvaluation -- through a crawling peg exchange rate regime --, and to follow a largely progressive public expenditure policy.[26]

During the late 1980s, however, and in spite of what some considered to be an adequate performance, the Colombian economy had increasingly become more and more regulated. Government intervention grew significantly and red tape increasingly stood in the way of private investment. Some of the more clear distortions included the following:

- By 1985 Colombia had one of Latin America's -- and the world's, for that matter -- most distorted trade regimes: average nominal import tariffs were 74%, the average rate of effective protection exceeded 60% and more than 75% of imports were subject to prior import licenses.
- Labor legislation was antiquated and generated severe costs to the private sector. In an effort to protect employment, labor regulations discouraged job creation and tended to generate informality.
- The financial sector was highly distorted. Banks had forced credit allocations and interest rates were controlled by the authorities. For many years real interest rates were negative and credit allocation was highly distortive.
- Since 1967 Colombia had an extensive system of massive exchange controls.

[26] Urrutia credits four features of Colombia's political and social system with these results: a strong political system based, since at least the 1960s, on a two-parties system; a decentralized social arrangement built on "clientelism"; a professional and efficient technocratic class; and a free press.

Originally this system had been devised as a way of allowing the central bank to carry out a nominal exchange rate policy based on frequent mini devaluations. The purpose of this exchange rate policy -- which at the time of its inception was considered to be extremely creative -- was to avoid real exchange rate overvaluation and to maintain exports competitiveness. With time the mini devaluations policy became the staple of Colombia's policy making. Ironically, perhaps, economic agents came to believe that it was a fundamental determinant of Colombia's (relative) economic stability. By the late 1980s the Exchange Controls Statute had become an institution universally revered in the country.

- Direct foreign investment was subject to a surrealistic array of controls. The legislation governing DFI had its origins in the Andean Pact infamous Article 24 which, from all practical purposes, was aimed at cutting the Andean nations off the world economy.
- The tax system was seriously distorted. Inflation eroded tax assessments, distributed earnings were subject to double-taxation, evasion was rampant and a number of sectors had been able to obtain significant exemptions.
- The public sector played an important -- both at the national and decentralized levels -- role in the productive process. Even though state-owned enterprises were not as important as in other Latin American nations, they still covered some of the key areas, including telecommunications, power and oil.

Although Colombia did not suspend payments to foreign creditors during the 1980s, the international financial community drastically reduced its Colombian exposure after 1982.[27] In Ocampo's (1989) words, Colombia was the victim of a "neighborhood" effect -- it suffered the consequences of being a Latin American nation -- and experienced a severe decline of net resource transfers from the rest of the world. Moreover, during the early 1980s Colombia faced a significantly negative terms of trade shock, as the price of coffee -- the country's main export -- declined significantly in the world economy.

As a result of these two external shocks -- the cut of external financing and the worsening in the terms of trade -- Colombia was forced to implement a major adjustment in the first half of the 1980s. This was based on the implementation of a real exchange rate depreciation -- through an acceleration of the pace of mini devaluations --, a timid fiscal correction, and a major hike in the degree of protection. Average (nominal) import tariffs (including tariff surcharges) were hiked from 32.5 % in 1980 to 61% in 1984. More important yet, import licenses increased very significantly during this period: while in 1980, 30% of imports required a license, by 1984 99.6% of imports were either prohibited or required prior licenses! (see Table 12).

By 1984 it had become evident to many observers -- including Colombian academics and the staff of the multilateral institutions -- that this high degree of protectionism was suffocating the economy. In 1984, the World Bank initiated discussions with the authorities on the need to implement a trade reform program that would reduce

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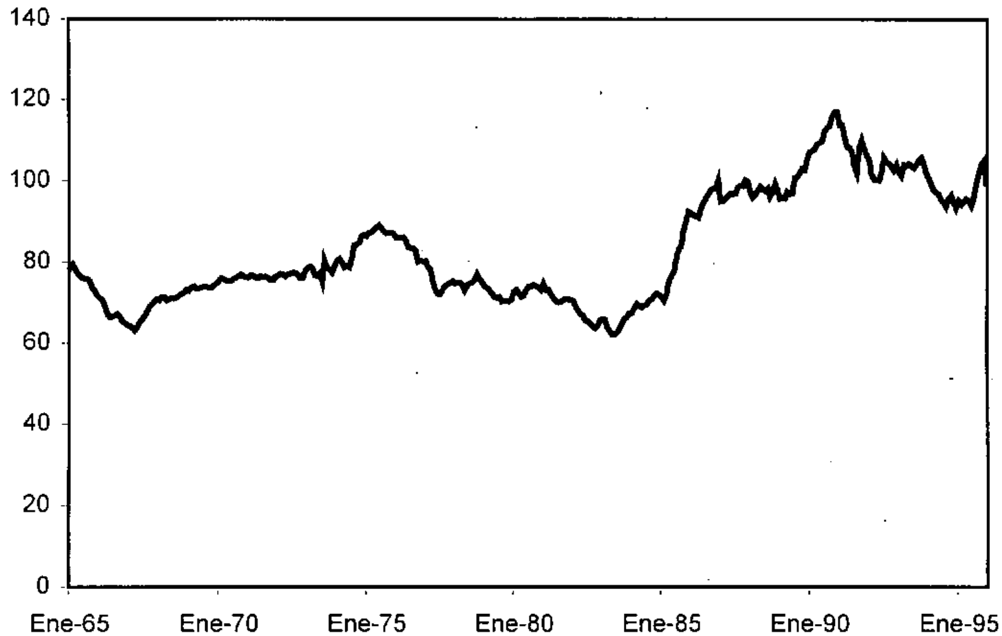
[27] Interestingly enough, during his brief tenure as Finance Minister in the Barco administration César Gaviria took the strong position that, in spite of the costs involved, it was essential for Colombia to remain current in its international debt payments. This view was contested by others, including a number of economists close to Ernesto Samper, a leading figure in the Liberal party. He was to serve as Minister of Industry during the first part of the Gaviria administration, eventually becoming his successor in the presidency.

Colombia's staggering degree of protection. A World Bank report on agriculture policy date April 20, 1984, and later published as Thomas (1986) argued, in characteristically guarded Bank language, that "[a] reversal of the recent restrictive measures would be desirable ...Liberalization may need to proceed in stages in order to ameliorate adjustment costs ...[A] major liberalization while the exchange rate is appreciated can be problematic from the point of view of the domestic industry (p. ix)." In May 1985, and after extensive discussions with the Colombian authorities, the World Bank approved a Trade Policy and Export Diversification Loan whose main purpose was to assist Colombia move towards a more open trade system. This operation was followed by a second trade-related loan -- the Trade and Agriculture Policy Loan -- approved by the World Bank's board of directors in 1986. While the first loan was considered to be a major success, the second ran into difficulties and many of the policies that it contemplated (explicitly or implicitly) were either postponed or not undertaken. The delay in the implementation of these policies generated serious strains between the World Bank and the Colombian authorities until mid-1990 (Cepeda 1995, Urrutia 1994).

By 1988, and as a result of the World Bank-sponsored reforms, Colombia's trade regime had become less restrictive, but still maintained a considerable degree of discretion, mostly in the form of very high coverage of import licenses -- see Table 12. A particularly important achievement of the trade liberalization effort initiated -- albeit timidly -- in 1985, was that it had been carried out at the same time as a real exchange rate depreciation was achieved (see Figure 1). In fact, since at least 1967 one of the most important concerns of

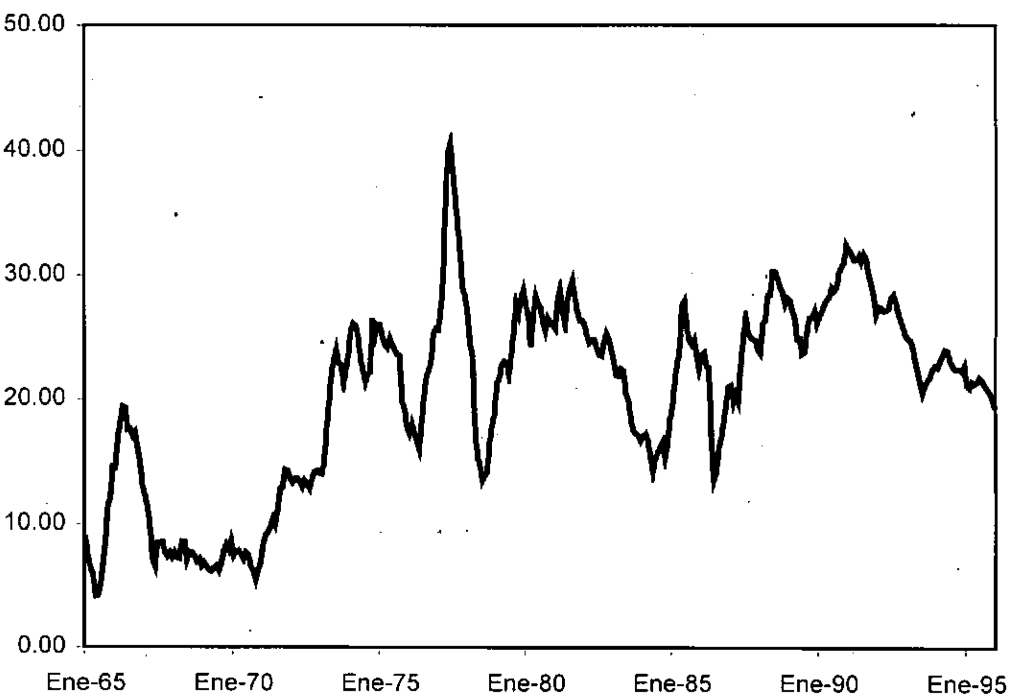
Figure 1. Real exchange rate

(Dec. 1986=100)



Source: Banco de la República and author´s calculations

Figure 2. Annual rate of inflation



Source: Dane

Colombian policy makers had been to avoid real exchange rate overvaluation.[28] During the second half of the 1980s inflation -- which had traditionally been rather mild by Latin American standards -- became more and more entrenched. Indexation mechanisms -- both formal and informal -- became generalized, and efforts to return the country to (relative) price stability systematically failed. By the late 1980s inflation had acquired a significant degree of inertia, and seemed to be stuck at around the 25 percent annual mark. Although most economists agreed that reducing inflation was important, this was not perceived as a major priority by the public at large. The proliferation of indexation mechanisms -- both formal and informal -- had eliminated the urgency to reduce inflation. Figure 2 displays the evolution of inflation in Colombia from 1965 through 1994.

This plan to open the economy to international competition was to be supplemented by a series of measures geared at reducing the extent of government control and modernizing Colombia's economic institutions. According to Cepeda (1994) the Barco administration went a long way in trying to persuade the population -- and especially the most influential pressure groups -- that this proposed opening up had not been imposed by the multilateral institutions, and did not follow a "foreign" pattern (see also Alarcón 1994). Urrutia (1994) has argued that this reform effort was in part the result of a sense of inevitability; since the Barco economic team recognized that liberalization and market-orientation had become a powerful global trend, that could not be opposed: If you cannot

[28] Among others, Díaz-Alejandro (1976) and Wiesner (1978) have argued that the main purpose of the Exchange Controls Statute -- the *Estatuto Cambiario* -- adopted in 1967, was to allow for a crawling peg exchange rate regime that would protect the real exchange rate from the erosion of inflation. A recent analysis of the political economy of exchange rate policy in Colombia can be found in Jaramillo, et al (1999).

fight them, join them.[29] There is little doubt, then, that during the second half of the Barco administration, a reform process was initiated. Plans were designed, programs were drafted and some specific measures were implemented. Overall, however, these efforts were timid. They were in fact timid both in relation to what the Gaviria administration would do during its first two years, and they were timid when compared with the reform frenzy that at that time was beginning to engulf many of the Latin American nations.

The absence of a major balance of payments crisis has led some analysts, such as Williamson (1994), to argue that the initiation of the Colombian reforms does not conform to the "crisis hypothesis' discussed in Chapter 1. This view misses, however, two fundamentally important issues. First, the Colombian reforms during the Gaviria administration went well beyond the economic sphere. In fact, the administration's intention was to introduce major changes in the political, narcotics and economic fronts. Second, although the economy was not in dire straits, the country was indeed facing a major political and social crisis. Drug trafficking -- which for a long time had only been considered an annoyance -- was becoming severely entrenched. Violence was spreading rapidly and, in spite of some successes in the effort to forge a peace agreement, the guerrilla movement continued to operate with quasi-impunity in vast regions of the country. The political system had also entered into a deep crisis. congress had increasing trouble passing meaningful legislation, the relationship between the provinces and the national government were tense, and voters showed considerable apathy.

Many observers, have indeed argued that in the late 1980s Colombia could be

[29] See, however, the memoirs of Barco's Minister of Finance Luis Fernando Alarcón (1994).

characterized as a "blocked democracy". Many considered that the institutional arrangement through which the Conservative and Liberal parties shared power -- formally from 1958 to 1968, and then informally -- had been exhausted. During the 1970s and 1980s several efforts were made to get over the political impasse through a reform of the 1886 Constitution. The latest of these efforts had taken place in 1988 during the Barco administration. At that time César Gaviria, then Minister of Government, had led the government's strategy to obtain the required support to go through with the reform. The last attempt to reform the Constitution failed, in part, because members of Congress tried to include a constitutional ban on the extradition to the United States of Colombian nationals accused of drug trafficking. Under those prospects, the government withdrew the reform.[30]

On August 15, 1989 Senator Luis Carlos Galán the founder and leader of the *Nuevo Liberalismo*, and the indisputable front runner in the liberal party's primary campaign was assassinated by gunmen hired by the Medellín drug cartel. Galán had been a relentless proponent of the modernization of Colombia's political system, and had argued with great vehemence that the government should use an extremely hard hand when dealing with drug dealers. In many ways Galán had become the candidate of morality and anti-corruption. In terms of economic policy, for a long time Galán had followed the Liberal Party's tradition of supporting import substitution and a high degree of government intervention. However, starting in 1987, and after returning to Colombia from a year in the U.K., Galán's views on the economy began to change. Increasingly he called for modernizing the economy and opening up international trade to international competition (Vargas 1993, 51).

In his effort to become a presidential candidate that would unify the liberal party,

[30] On the economic significance of drugs in Colombia see Steiner (1998).

Galán had asked former minister César Gaviria, who did not belong to the *Nuevo Liberalismo* wing of the party, to become his campaign manager (*Jefe de Debate)*. In this position Gaviria not only gave the campaign a sound organizational base, but also helped Galán develop a reformist view regarding the economy. Vargas (1993) has argued that as the campaign proceeded Galán and Gaviria grew closer and closer, and that the latter economic ideas slowly started to have an increasing importance in Galán's views.

On October 20th 1989, Galán's elder son -- who at the time had barely turned 17 years old -- surprised the *Nuevo Liberalismo* leadership when at his father's funeral he publicly, and emotionally, asked Gaviria to take over as the movement's leader. A few days later Gaviria officially joined the Liberal Party's primaries as the front runner. In March 1990, and after a campaign marred by threats from the drug cartels, and conducted mostly through TV and radio, Gaviria defeated his two liberal rivals -- Ernesto Samper, that would eventually succeed him as president in 1994, and Hernando Durán Dussán --, and started his campaign for the presidency.

The months that followed Galán's assassination were particularly bloody and reflected, with all its terror, the deep institutional, social and political crisis that the country faced. In the last four months of 1989 alone, close to 90 bombs exploded in Colombia's major cities; the headquarters of a leading newspaper were destroyed; banks and corporate buildings were subject to terrorist acts; a powerful bomb went off in the security forces headquarters killing 63 people and wounding more than 600; and an Avianca plane was bombed killing more than 100 people.[31] When the 1990 presidential elections were finally over on May 27th, 1990, three presidential candidates had been assassinated – Galán, Bernardo Jaramillo Ossa, from the left wing UP, and Carlos Pizarro from the former guerrilla movement M-19. Additionally, Ernesto Samper, one of the leading Liberal Party candidates had been seriously wounded in an attack aimed at the communist leader José Antequera. When Cesar Gaviria Trujillo, the 43 years old economist with a baby face, became Colombia's constitutional president on August 7th 1990, Colombia was facing one of its worst crises. The economy may have been doing rather well, but the sense of institutional disintegration was evident to perceptive analysts and, clearly, to almost everyone living in the country.

C. Actors

Traditional political economy models of reform tend to distinguish between two main actors -- owners of capital and labor. As argued above, however, reality (and in particular Colombia's reality), is significantly more complex than what these crude models suggest. For instance, capital in different sectors has different interests, labor in different industries has heterogeneous views, the military has a saying, the bureaucracy has its own turf to protect, and ideology (including ideas) plays an important role in determining the course of policy. Colombia has traditionally had a unique way of organizing its social, political and economic relationships. Urrutia (1991), for instance, has argued that what best characterizes the country is a relationship of "clientelism" between social and economic actors and powerful institutions. Martz (1993) and Bushnell (1993), among others, have

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[31] See Silva (1997).

pointed out that the country's two party arrangement -- based on power sharing -- has generated a highly underdeveloped democratic system. In contrast with other large countries in the region labor unions are relatively weak -- except for public sector unions, and, what is perhaps more perplexing to the uninformed observer, the military has played a reduced political role since the 1960s.

The purpose of this section is to deal with the main (broadly defined) actors that participated in Colombia's reform process. We make a distinction between internal and external actors. In discussing the different actors, we follow the framework delineated in Chapter 1 and discuss the way in which each group positioned itself with respect to the different reforms that were considered by the Gaviria administration. Table 13 contains a systematic discussion of the most important internal actors in Colombia's economic life, including a brief commentary on their general position regarding economic modernization, as well as a detailed discussion on the way these different actors viewed specific aspects of the reforms agenda. As may be seen, Colombia's socio-economic landscape is extremely complex, and full of land mines that any reformist government has to face with extreme care. The table also shows that some groups favored certain measures while strongly resisting others. When taking over power, the Gaviria administration faced the difficult task of forging a reform path that would maintain support at a minimal level and -- perhaps more importantly -- would minimize active opposition to the reform agenda.

Two comments regarding Table 13 are in order. The first point is related to the business sector pressure groups, or *gremios*. For a long time there has been the idea that these groups have had a significant degree of influence in Colombia. In the preface to his extensive study on the *gremios*, Urrutia (1983) points out that already in the 1960s the guerrilla priest Camilo Torres argued that the *gremios* had become increasingly influential, and were yielded a tremendous (indirect) power. Moreover, the founder of the *Nuevo Liberalismo* faction of the liberal party, Luis Carlos Galán argued in 1981 that the *gremios* power had increased so much that it had even surpassed that of congress.[32] Although the *gremio* formed by coffee producers (FEDECAFE) is the better known, as Table 13 shows, there are a number of other highly influential *gremios*. Urrutia (1983) lists 106 active *gremios* in 1980, up from 51 in 1960, and merely 22 in 1950. The long list of prominent *gremios* in Table 13 illustrates, with remarkable clarity, that what in analytical models is generically referred to as "owners of capital" is, in most historical instances, a highly heterogeneous group. In fact, many of these *gremios* had antagonistic views regarding important aspects of the reform program.

The *gremios* have traditionally exercised their influence in a number of ways: they lobby in a way similar to their US counterparts, they directly help finance political campaigns for members of congress, and they finance think tanks that develop the intellectual rationales for their positions. Traditionally most Colombian *gremios* have focused on short term economic issues affecting their members. They have tried to influence legislation, and in the pre-1991 era they lobbied for obtaining import licenses and other rents generated by the state. According to Urrutia (1983) *gremios* have had two interesting characteristics. First, most gremios -- with the possible exception of the banking *gremio* ASOBANCARIA -- have traditionally opposed the government. In that regard, a particularly interesting historical episode refers to the vehemence and force with which the

[32] See Urrutia (1983, 15-16).

ANDI opposed the trade liberalization reform attempt of 1979-80.[33] And second, and in contrast to popular belief, according to Urrutia (1983), once everything has been done and said the *gremios* real power has been somewhat limited; so much so that he refers to them as "paper tigers."

The second important aspect of Colombia's political economy captured by Table 13 refers to labor. Broadly speaking, Colombia's labor movement does not appear to be very important. While in 1965 close to 16% of the labor force belonged to a labor organization, that number dropped to 9.3% in 1984 and to only 7.8% in 1990. Affiliation numbers are small, and have barley increased (Table 14). In 1990 the economic activity with the highest percentage of workers belonging to a labor union was "utilities" (at that time, basically "public utilities"), with an affiliation rate of 42%. Affiliation rates were as low as 1.5% in agriculture and 8.2% in manufacturing. The importance of the labor movement is restricted to the public sector, and even there, percentages have been declining (Table 15).

Colombia has traditionally been characterized by a dualistic labor movement. While, in general, unions have traditionally been weak, public sector unions -- and especially teachers', health worker's, and state owned enterprises unions (*Telecom* and *Ecopetrol*, in particular) have been extremely powerful. Existing unions, however, have been quite combative, effectively using strikes as a pressure tool (*Misión de Empleo 1986*). In fact, Wiesner (1998) has argued that the rent-seeking practices of organized labor in key public sector services –health and, especially, education—have played a crucial role in retarding much needed structural reforms.

[33] See Urrutia (1983, 160-61).

Table 13. **Main actors in the political economy of Colombia's reforms: degree of influence and views regarding core aspects of the reforms**

	Degree of Influence and Power	Opening of international trade	Relaxation of Exchange Controls	Labor reform	Financial reform	Privatization
A. Labor Movement	Dualistic. Low degree of unionization, especially in comparison to other Latin American countries. Public sector and large firms (including SOE's) unions very powerful. Influence exercised through political channels.	Opposed strongly	Opposed	Mixed feelings. Opposed labor market "flexibilization", although in favor of any measure reducing the costs of creating new unions	Opposed	Opposed very strongly.
B. Gremios						
FEDECAFE (Coffee)	Extremely powerful and influential until 1988. Since then declining level of influence.	Favored to the extent that it would result in lower costs and a more depreciated real exchange rate.	Favored to the extent it meant a more efficient system for obtaining the returns from foreign exchange	Supported	Favored if it resulted in reduced financial costs.	In favor, although not very enthusiastically.
SAC (Agricult.)	Relative degree of influence, exercised through direct lobbying and through members of congress from agriculture producing zones.	Mixed feelings. Willing to support selective opening that lowers costs of inputs while protecting them from fluctuations of commodity prices. Strongly opposed reforms that would expose them to international competition.	Opposed, since perceived as increasing real exchange rate volatility.	Supported.	Opposed, because perceived as reducing forced credit allocations to agriculture	Supported mildly.
ANALDEX (Non Traditional Exports)	Increasingly powerful as a result of the diversification of exports.	Mixed feelings. Supported to the extent that it implied a real exchange rate depreciation. Opposed elimination of export incentives.	Mixed feelings. On one hand seen as a force towards reducing cost of credit; on other as possible source for real exchange rate overvaluation	Supported.	Mixed feelings. Wanted export subsidies programs to continue.	Supported, as long as export promotion was maintained. Supported privatization of ports.
ANDI (Manufactu-ring)	Powerful, representing a diverse group of industries. Mostly focused on obtaining protection -- either through tariffs/licenses or depreciated real exchange rate.	Mostly opposed, although some non traditional exporters in favor. Most groups willing to accept it only if accompanied (or preceded) by real exchange rate devaluation.	Mostly opposed as seen as disturbing exchange rate stability.	Strongly favored.	Favored, as seen as a modernizing force contributing to lower financial costs.	Favored.
FENALCO (Commerce)	Grouping of a very large number of retail commerce owners. At times highly vocal.	Favored, as seen as providing a major blow to wholesale smuggling ("San Andresito")	Favored.	Favored.	Favored.	Mixed feelings.
ANIF (Financial Sector)	Highly sui generis "gremio". Its views usually correspond to the personal views of its president	In favor of gradual reform, that did not open the economy fully	Opposed to the extent that it meant an end to the revered crawling peg regime.	Favored.	In favor of gradual and selected opening that would maintain some barriers to entry. In favor of ending administrative allocation of credit	Favored limited action in this area

ASOBAN-CARIA (Banking)	Quietly influential. Links to "modern" intellectual community. Exercises influence through technical assessments.	Favored. Considered to be a needed modernizing force in the country.	Largely favored. Banks believed that they would be able to intermediate foreign funds flowing into the country.	Favored.	Favored.	Favored. Seen as opening opportunity for new deals and increased level of operations.
C. Military	Staid mostly out of politics after 1957. Interested in maintaining large budget. Involved in fight against guerrillas and drug lords. Since 1964, a military named minister of defense.	Favored gradual opening. Main concern is border trade with Venezuela	Mixed feelings	Mixed feelings. Clearly opposed any attempt at reducing their economic positions.	No strong views	Mixed feelings. Wanted to maintain parity with Venezuela.
D. Catholic Church	Largely conservative. Influential and interested in maintaining strong catholic education. Highly concerned with morality -- and family oriented – issues.	Neutral	Neutral	Mixed feelings. Some members of the church opposed it, since it was seen as reducing workers past "conquers"	Neutral	Neutral
E. The Civil Society	Extremely weak. Almost does not exist beyond private business lobbying groups – the "gremios".	No coherent views.	No coherent views.	No views.	No views.	No views.
F. Politicians	Initially grouped in two traditional parties. Later joined by ex-guerrillas movement (M-19). With convocation of Constitutional Assembly their traditional (high) degree of influence greatly reduced. Very diverse views, depending on party and/or faction within party.	Very diverse views (DV). In general, the Gaviristas favored an array of reforms, while the traditional liberals (Samperistas) were significantly more skepticals. Conservador party slightly more prone to support reform	DV	DV	DV	DV
G. The Bureaucrac	Technocrats in the economic ministries highly influential. Top levels moved in and out of government with ease. Views very consistent and favorable towards reform among top "change team". Views among lower ranks, highly diverse	DV	Opposed	Opposed	Mixed feelings	Opposed
H. Drug Cartels	Increasingly influential as they tried to gain social respectability. Increasingly active in social and political activities -- either directly or indirectly.	Mixed feelings. Opposed it if it meant a greater degree of scrutiny of the country by the rest of the world.	Favored strongly.	Favored.	Favored to extent that it facilitated the move of funds in and out of the country.	Favored.

Source: Edwards (1996).

Table 14. Organized labor

Year	Membership rate*	Number of unions	Number of members
1939	2.80	571	76274
1947	5.50	809	102023
1965	15.80	892	165595
1980	15.70	3781	600000-700000
1984	9.32	2172	873442
1990	7.80	2265	880155

* Organized labor force as % of total

Source: Urrutia (1976), Londoño (1986) and Ministerio de Trabajo y Seguridad Social

Table 15. Labor union membership rate by economic sector

Economic sector	1984	1990
Agriculture	1.8	1.5
Mining	12.7	4.9
Manufacturing	8.1	8.2
Public utilities	53.2	42.0
Construction	3.9	3.0
Commerce	3.0	2.6
Transportation and communications	51.4	27.4
Financial intermediaries	12.8	14.3
Services	19.6	18.4
Total	9.3	7.8

Source: Ministerio de Trabajo y Seguridad Social

Table 16. Partisan orientation of Executive Directors of Fedesarrollo

Executive Director	Partisan orientation	Partisan orientation of the government in place
Rodrigo Botero	Liberal	Conservative
Roberto Junguito	Conservative	Liberal
Carlos Caballero	Liberal	Conservative
José Antonio Ocampo	Liberal	Conservative-Liberal
Guillermo Perry	Liberal	Liberal
Miguel Urrutia	Conservative	Liberal
Eduardo Lora	Independent	Liberal
Mauricio Cárdenas	Conservative	Liberal
Juan José Echavarría	Liberal	Conservative

As argued earlier, in 1990 the political and institutional crisis was becoming increasingly serious. This created a polarized environment that affected virtually every actor in the Colombian social and political landscape. Members of congress -- which largely formed the traditional "political class" -- were decisively in the defensive, as there was an increasing feeling among the public that they were unable to pass meaningful legislation. Voter's rejection with the political status-quo reached a peak in March 1990, when in an almost spontaneous way they overwhelmingly voted for convening a constitutional assembly. This episode became to be known as the vote of the *"séptima papeleta"*, and became instrumental in the Gaviria's administration effort to reform the constitution. Drug traffickers, which during the 1970s had become increasingly influential in all spheres of Colombia's public life, had also taken a defensive stance -- albeit a very aggressive and violent one --, as the Barco administration had stepped up the war against them. They feared extradition to the US, and saw their empires at risk by police actions. And finally, the guerrilla movement which for years had waged a war of attrition with the government had accepted to enter into serious negotiations geared at finding conditions under which they would lay their weapons down. By mid 1990 a major guerrilla group, the M-19, had deposed its arms and had joined the democratic political process (under the name ADM-19, *for Alianza Democrática M-19*) and a number of other groups were above to follow suit. The ADM-19 did surprisingly well in the presidential election of 1990, suggesting to many that Colombia's two party system was coming to an end. As may be seen, Table 13 lists some of these groups -- congress, the catholic church, drug lords -- as important actors, and describes briefly their position (if any) regarding the different aspects of the reform process.

In Colombia, as in most developing countries during the late 1980s and early 1990s, policy discussions were also affected by the views of the multilateral institutions. Possibly the most important "external" actor was the World Bank which, as was discussed above, had a fruitful a long term relationship with Colombia. As pointed out, the Bank was particularly important in helping launch the trade liberalization effort during the last year of the Barco administration. However, as it was often the case in Latin America during the early 1990, the Bank was soon outdone by the reformist government, and the Gaviria policies became significantly deeper than those endorsed by the Bank staff (more on this later). The IMF, on the other hand, had significantly less influence, as Colombia had tried (successfully) since the late 1960s to avoid entering into IMF-sponsored programs. However, to the extent that World Bank quick-disbursement structural adjustment programs required IMF support, the IMF became increasingly involved in monitoring the Colombian economy.

In many ways Colombia faces a unique external environment, since the DEA plays an important role in determining the US attitude towards the country. The DEA advises the president on whether to "certify" different governments as having made progress with respect to the war against drugs, and is very influential in determining the administration's support -- or lack of it -- for certain programs. In a September 1994 report (DEA, 1994) the DEA argues -- in an almost paranoid-surrealistic fashion -- that drug traffickers had taken advantage of the Colombian reforms. The report is remarkable for its naivete and lack of rigor; after reading it one cannot fail to come out with the impression that the State Department bureaucrats are convinced that the whole reform effort was masterminded and carried out by the drug cartel forces.[34]

Though not explicitly considered in Table 13, technocrats are another important actor in the reform process. The specific group that was active during the Gaviria administration certainly deserves a special mention (see below). On a more general basis, several authors have emphasized the role of "technocrats" in Colombia's economic decision-making process. To be sure, that was not always the case. Rivera (1976) persuasively argues that in the early 1960s Colombian technocrats were not considered as valuable as their Latin American counterparts. When during the Lleras administration (1966-1970) their role in policy-making was enhanced, they were vehemently antagonized by politicians. Edwards (1995b, pp. 117, our translation and emphasis) has also highlighted the role of "technocrats" in explaining Colombia's relative economic stability. In his words, "Fedesarrollo (a private research institution) has been the intellectual breeding ground of an amazingly large number of those in charge of economic policy. *It could be argued that Fedesarrollo's bipartisan and non-ideological positions is a good reflection of Colombia's implicit pact according to which Liberals and Conservatives share power.*"

Fedesarrollo has been home to many of Colombia's policy-makers. More interesting than its clout, is its non-partisan orientation. Of its nine Directors, 5 have been Liberal, 3 Conservatives, and 1 independent (Table 16). In all instances but one, the Director has had a different party affiliation from that of the government in place during his tenure. It is the same people, sometimes acting as government officials, sometimes as independent analysts of economic policy. It can be argued that the institution is a facilitator

[34] The report, for example, asserts that the Colombian government privatized electric and telecommunications companies (p. 1). It didn't.

for achieving consensus, not because of its intellectual power, but rather because it credibly internalizes policy options that are politically viable.

For better or for worse, Colombian economic technocrats, irrespective of party affiliation, have frequently been inclined to reach broad consensus on economic policy among themselves. For example, in early 1978, during the peak of the coffee boom and in the midst of a huge accumulation of reserves, the Colombian Bankers Association held a symposium. Wiesner (1978) reports that of the seventeen young economists who expressed their views during the discussions, only one of them hinted at the convenience of doing away with exchange controls. The rest, in one way or another, endorsed the then accepted economic policy paradigm: without exchange controls the economy would repeatedly enter into stop-go cycles that would curtail growth, hamper export oriented industries and promote capital flight. The voices of these economists were not simply those of academia. Of the seventeen speakers, six would eventually become finance ministers, three would hold ministries in other economic areas, and seven would become either advisors to the monetary board or members of it successor institution, the central bank board.

CHAPTER 3. THE REFORMS

From the early days of his administration President César Gaviria decided to tackle four major, and interrelated, issues that in his view were standing on the way of Colombia's progress. The first one was the reform and modernization of the economy. Second, Gaviria's program was aimed at modernizing Colombia's political system, broadening the extent of democracy and reducing the power of local political lords. The third major objective of the administration was bringing drug lords --and in particular the leaders of the Medellín cartel-- to justice, and the fourth was to forge a peace agreement with the different guerrilla movements that had been roaming Colombia's country side since the 1960s. What makes the Colombian experience particularly fascinating is that these four objectives --and in particular the economic and political reforms-- were undertaken simultaneously.

César Gaviria had become convinced that in order to modernize Colombia's political system --and to move beyond the legacy of the *Frente Nacional*-- it was essential to reform the constitution. At the same time, he was aware that this was a very difficult political challenge. As President Barco's Minister of Government order to implement the political reform, Gaviria had become painfully aware of the difficulties of launching a major political modernization, when, in 1988, he had led a failed effort to reform the constitution. Gaviria understood that, although the *séptima papeleta* movement had given popular legitimacy to the idea of reforming the constitution, the program still faced formidable institutional challenges. In particular, the administration feared that the Supreme Court would, as it had in the past, block any attempt at reform by declaring it unconstitutional. In order to minimize the Justices' political opposition, the administration strategists decided that the President should convene a Constitutional Assembly with a limited mandate. In particular, it was decided that the chances of having a positive Supreme Court ruling would be higher if the Constitutional Assembly was banned from dealing with international treatises and other international issues. Under these restrictions, a Presidential Decree convening the Constitutional Assembly was issued in October 1990.

Vargas (1993) and Silva (1997) report the intense efforts made by the Gaviria administration to convince the Court that decree 1926 convening the assembly --which was based on legislation enacted in 1957-- was indeed legal, and that the members of the assembly should be elected. At first it appeared that the Court would favor repeating history, and would block the constitutional reform process. However, after a period of significant uncertainty, serious intellectual debate and strenuous negotiations an agreement was reached: the court would rule in favor of convening an assembly, if the administration would remove all limitations regarding the topics the assembly could address. The administration decided that this was a gamble worth taking, and it amended the convening decree. The assembly was elected in December of that year. Surprisingly, this election resulted in a massive backing of the ex-guerrilla movement M-19, and many analysts predicted a decisive change in the Colombian way of doing politics. As we will see, however, nothing of that sort happened.

During the first eight months of the Gaviria administration most of the public's attention was on the political reforms. In particular, people wondered whether the leftist party M 19 -- which was led by former guerrillas-- was going to be able to "hijack " the Constitutional Assembly. This allowed Gaviria's economic team to quietly and rapidly make progress on the economic reforms front. As analyzed in great detail in Chapter 4, by following a strategy based on broad alliances and the dispensation of compensations, the Gaviria administration was able to make tremendous progress in the economic front in a period of thirty months. In this chapter we describe the key economic aspects of the reforms undertaken by the Gaviria administration, and provide a brief analysis of some of the most important economic aspects of the 1991 Constitution. The discussion on the political economy process surrounding this reform process is the subject of Chapter 4.

The Gaviria administration attacked several economic reform fronts simultaneously. Table 17, which contains a schematic chronology of the most important reforms, helps understand the speed and sequencing of this modernization process. In order to have a broader idea of the content and depth of the reforms, in the rest of this section we deal in greater details with most of these policies. For a subset of them, political economy issues will be discussed in the next chapter.

A. Labor Reform (Law 50 of December 1990)[35]

As has been the case in a number of Latin American countries, Colombia's traditional labor legislation was extremely rigid, imposing very high costs on formal sector firms. Until 1990 Colombia's main labor regulations were the Labor Code (Código Sustantivo del Trabajo) –which in 1950 had compiled a vast amount of disperse legislation—and Decree Law 2351 of 1965. With the purpose of protecting workers rights, these pieces of legislation had severely distorted the labor market, yielding results that were contrary to those that had been expected. Among others, they produced significant employment

Table 17. The Colombian Reforms: An Itinerary

REFORM	Date Reform was Initiated	Comments
Financial Sector	- Presented to the lower chamber of congress on October 31, 1990. - Enacted on December 19, 1990	The basic piece of legislation regarding financial reform was Law No 45 of 1990
Taxes	- Congress discussion started on October 1990. - Enacted on December 31, 1990	Law No 49 of 1990 included provisions regrading capital repatriation by Colombians (tax amnesty). In 1992 a second tax reform that raised the VAT rate to 12%, as a way to finance some of the increase in public expenditures mandated by the new constitution.
Labor Reform	- Congressional debate started in early October, 1990 - Enacted on January 1st, 1991	Law No 50, approved on January 1st, 1991
Housing Policy	- Congressional debate initiated in December 1990. - Approved in mid January 1991.	Law No 3, 1991 approved on January 16, 1991.
Exchange Controls	- Proposal submitted to congress in mid September 1990. - Final approval on January 17 1991	Law 9 of 1991 drastically reformed the regulations governing direct foreign investment. It effectively put an end to the surrealistic array of controls established by art. 24 of the Acuerdo de Cartagena.
Ports Deregulation	Approved on January 21st 1991.	Law 1 of 1991.
Trade Liberalization (*"Apertura"*)	Announced during the presidential campaign as "gradual" and "selective." First phase carried out in the second half of 1990; in September 1991 the elimination of trade barriers was accelerated.	At first it was seen as a continuation of the Barco reform; it quickly became apparent that it would be a significantly more radical process.
Central Bank Independence	Law 31 of 1992.	The independence of the Banco de la República was established by the Constitution of 1991. A law, however, was required to make it operational. The idea originated among Bank staff, and was initially opposed by the administration.

Financial De-regulation	Approved in early January 1993	The new constitution established that financial, stock exchange and insurance activities had to be regulated by law.
Decentralization	Approved on August 1993	Law 60 of 1993 provided the details on the process mandated by the Constitution of 1991. It established that increasing amounts of resources had to be trasfered to departments and municipalities.
Social Security	Approved on December 1993 (Law 100), after approximately three years of congressional debate and negotiations.	Allows workers to chose between two retirement systems: (a) A defined benefits system run by state; and (b) a capitalized, defined-contribution system run by private pension funds. Workers are free to transfer across systems. The reform implied an increase in contributions from 8% to 13.5% of salaries. The reform of the national health system was also included as a long term objective (to be completed by year 2000).
Privatization Reform	Through a number of executive orders and decrees the government privatized several assets and opened up areas previously reserved to the public sector. Many of these measures were established, at least in principle, by the 1991 constitution.	Large number of financial firms privatized. Some participation in Ecopetrol owned firms was also sold, as were some interests in tourism concerns. After the telecommunications strike a very limited effort to impelment further privatizations was made.

Edwards (1996).

instability, as it made lay-offs extremely expensive, especially in the case of employees who had been with the same firm for over 10 years. In addition, legislation had become a barrier to the generation of employment in the modern sector as the double retroactive character of severance payments (see below) increased labor costs and made them highly unpredictable. These distortions became even more relevant in the context of trade liberalization, as domestic production would be increasingly exposed to foreign competition.

The norms in Law 50 of 1990, which came into operation at the beginning of 1991, can be classified into three groups:

Flexibilization of contracts and reduction in labor costs

Previous legislation implied that a labor contract was in effect whenever the following three conditions were satisfied: personal activity on the part of the employee, continuous subordination, and a monetary retribution. Even if a contract was not written, the fulfillment of these three conditions gave rise to the *presumption* that there was one, with full implications in terms of benefits (severance payments, bonuses, etc.). Following Law 50, a contract is not presumed to exist. Persons who routinely provide remunerated personal services within a liberal profession or in a accordance to a civil or commercial contract, are now in the obligation of *proving* that there is a labor contract.

Prior to 1991, a fixed-term labor contract could not last less than one year, except under very special conditions (vacations, seasonal production and sales). As a result, firms would use, and sometimes even constitute, Temporal Empoyment Services (*Empresas de*

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[35] For more details, see Ocampo (1987), Henao (1995), Lora and Henao (1995) and Posada (1995).

Servicios Temporales, EST), with highly unfavorable conditions: (i) wages were lower than those earned by formally employed workers with similar qualifications; and (ii) there were no benefits.

Law 50 gives firms the possibility of hiring employers for fixed terms of less than one year. Firms have to pay vacations bonuses to all workers, in proportion to the time worked, regardless of the duration of the contract. In addition, EST now have to: (i) abide by the Labor Code and by Law 50; (ii) pay all benefits to which permanent employers are entitled to; and (iii) pay wages that are competitive with those of permanently employed workers of similar qualification.

Prior to 1990, the law provided that if an employer was laid off without "proper cause" (term which the law did not define), employees would have to pay a penalty equivalent to the wages that were due until the expiration of the contract, if it was a fixed-term arrangement. If it was not, in addition to all legal benefits, the employer had to pay wages for 45 days if the employee had been with the firm for one year or less. If he had worked between one and five years, the worker would receive an additional 15 days wages for every year (20 days wages if he had worked between five and ten years, and 30 days wages if he had worked for more than ten years).

In the latter case, the employee had to be re-hired (*acción de reintegro*) and was entitled to receive payment for the period he had been idle (*pago de "brazos caídos"*). In addition, the employer was entitled to a pension (*pensión sanción*), starting at the time of lay-off if he/she was 60 years or older, or at the moment he turned 60.[36] If the employer

[36] According to Hommes *et al.* (1995) the probability of a worker staying in a job for more than 10 years was

had been with the firm for 15 years or more, he had a right to a pension when he turned.[37]

Law 50 eliminated the *pensión sanción* only for those employers that were contributors to the Instituto de Seguros Sociales (ISS). This feature should motivate employers to affiliate their employees to pension funds. In addition, the *acción de reintegro* and the *pago de "brazos caídos"* were also eliminated, at the same time that penalties for unfair lay-offs were increased.

Until 1990, the most controversial aspect regarding labor legislation was the double retroactive character of severance payments. The law stipulated that every year workers were entitled to a bonus equivalent to a month's wage, plus 12% interest. This liability was due upon retirement. In the meantime, it was working capital for the employer. Workers could make withdrawals in order to purchase (or improve) housing. Even if the employee had made one or more withdrawals, thereby exhausting the funds he/she was entitled to receive at the time, the employers liability would not be fully cancelled. At the time of the final liquidation –and taking into account the nominal wage increases that occurred between the time of the withdrawals and the time of final liquidation--, only the nominal value of withdrawals was taken into account. Because of this, firms liabilities increased every year, in an uncertain manner, since they were affected by how long employees had been at the firm, by the amount of partial withdrawals and by the return the firm could obtain by investing these funds.

To eliminate these distortions, Law 50 created private severance payments funds ("*Fondos (privados) de Cesantías*"), where every year an employer deposits the severance

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2.5 percent.

payment plus 12% interest, thereby completely canceling his obligation with the employee. The fund has to produce a rate of return no lower than the representative three month interest rate on CD's. If the fund obtains higher returns, a part of them corresponds to the worker, and the fund is then entitled to charging a commission. The worker can make withdrawals in order to pay for higher education or to purchase a house. Membership to a severance payments fund is mandatory for all labor contracts signed after January, 1991. Now, as a result of the changes introduced, employers liabilities as well as workers assets are perfectly known, and funds are entrusted to specialized private agents, controlled and supervised by the government.

Homes *et al.* (1995) argue that the reform reduced the cost of dismissal of an employee with 10 years of service by 56 percent -- under the old legislation the dismissed worker had the right to 30.8 monthly salaries, while under the new one he was eligible for receiving the equivalent of 13.5 monthly salaries.

Protection of worker's rights

Prior to 1990, a workday could not last for more than 8 hours *and* a workweek for more than 48. Now, a workday can last up to 8 hours *or* a workweek up to 48. Law 50 allows for employers and employees to sort out the matter. The workday can be extended, without constituting extra work (which is paid at a higher wage).

In addition, given that through affiliates or through economically subordinated, but legally independent subsidiaries a firm can diffuse its labor obligations and elude certain

[37] If it was the employer who ended the labor contract without a "fair cause", he would have to pay the employee a penalty equivalent to 30 days wages.

benefits while at the same time diminishing the power of labor unions, the law created a figure known as "firm consolidation" (*unidad de empresa*). It can be determined by the Labor Ministry after the corresponding administrative investigation.

Law 50 determined that when a firm declared bankruptcy, the liabilities it had with its employees (including wages, severance payments, penalties and others) has exclusive precedence over all other liabilities. Finally, maternity leave was increased from 8 to 12 weeks, and the mother is now entitled to transferring one week to his husband or permanent companion.

Promoting worker's unions

The labor reform also incorporated into the Labor Code provisions in a series of ILO conventions that Colombia had signed throughout the years, but had failed to implement. Prior to 1990, establishing a labor union was a very inefficient process, as many procedures at the Labor Ministry had to be satisfied. This allowed small and medium-sized firms to lay off workers that wanted to conform a union, thereby making the minimum membership requirement unattainable. Law 50 removed most of the red tape and established that a union would automatically exist ones an Incorporation Act was drawn. In addition, from the day of incorporation all members of a union have labor union privileges.

Under the previous legislation labor unions could not actively participate in partisan politics or in religious activities. Even though as private citizens union members were not constrained from participating in politics, to elect and to be elected, the limitations faced by unions were such that the norm was repealed. In addition, previously an administrative procedure from the Labor Ministry was enough to revoke a labor union's right to operate.

Now, sanctions to any labor union are a matter to be determined through the judicial system.

The former labor code established the mandatory intervention of the government, through the Labor Ministry, if employers and employees were unable to reach an agreement on a new labor contract. This intervention is no longer mandatory. The new regulations also determine that workers must be informed two months in advance in case of massive layoffs or of the closing of the firm.

Previously, the decision to strike was quite undemocratic. A strike could be called by an absolute majority of workers present at a worker's assembly. Now, a strike can only be voted either by an absolute majority of the members of the union if more than half of the workers belong to the union or by an absolute majority of all the employees. Finally, the 1991 Constitution grants the right to strike to all workers except those involved in services deemed *essential* by the legislator. As of today, the definition of what constitutes an essential service has not been provided, giving legal status to frequent strikes in the public sector.

Finally, it should be note that the government tried to include the reform of the social security system as part of the labor reform package. Congress, however, rejected the idea and decided to tackle the pensions issue independently. More on this below.

B. Trade Reform (la "apertura")

The dramatic opening up of international trade is, perhaps, the most impressive aspect of the Colombian reforms during the first half of the 1990s. It was a remarkable achievement, not only because it was done very fast and in a comprehensive manner, but particularly because it was the third liberalization attempt in a generation. Some details on the previous two are worth recalling.

The liberalization of 1965-1966

At the time, import's policy was managed more under a criteria of macroeconomic stabilization than as a development model. The existence of multiple exchange rates linked import policy with economic adjustment mechanisms against problems of the balance of payments.

Against the problems of the external sector and due to the deplorable results of the devaluation of 1962, quantitative restrictions became the tool of choice to control imports and stabilize the external sector. (Diaz-Alejandro, 1976). The following data account for such a statement: free imports expressed as percentage of total imports were reduced from 60% in 1960-61, to nearly 35% in 1964 and even more in 1965. Additionally, the period for import authorizations was considerably extended, reaching an average of three months in 1964. As of the end of 1964, 35% of import applications were rejected and on several occasions, the advance import deposits had to be kept at the Central Bank for over ten months.

Starting in 1963, a three level multiple exchange rate system was in operation. The lowest (least depreciated) rate was assigned to traditional exports (coffee and oil); the intermediate rate to "essential" imports, certain services and some capital transactions; finally, a high (free) rate for non-traditional exports, other types of services and for the majority of capital transactions. The Central Bank defended a col$10/dollar rate in the "free" market, generating considerable losses in international reserves and the need to strengthen quantitative restrictions on imports. In October, 1964 the Central Bank decided to allow the market to determine the (now) free rate which, as of June, 1965 was around col$19/dollar.

Since the end of 1964, the Monetary Board had begun to consider the possibility of a new devaluation. In June, 1965, reserves reached their lowest level since 1957 and at the end of that month a decision was made to restructure the existing regime. The applicable rate for coffee exports was devalued from 7.7 to 8.5 pesos per dollar; a preferential rate of 9 pesos per dollar was established for certain imports, interests on the public debt, some services and domestic oil purchases; the applicable rate for basic imports increased from 9 to 13.5 pesos and the applicable exchange rate for minor exports --that was linked to the performance of the free rate following the flexibilization of October, 1964-- was revalued to 13.5 pesos per dollar. Whit the President finally dissuaded from undertaking a gradual devaluation plan, starting in September, 1965, these measures were accompanied by a strong process of trade liberalization.

This liberalization plan consisted in removing approximately half of the imports from the previous license regime over a period of six months and, eventually, 65% of all imports. The list of free imports was consistently expanded between September, 1965 and August, 1966. Furthermore, since October 1965 it was decreed that the prior import deposits would be reduced 5% per month. In 1965 15% of registered imports were included in the list of free imports. In October, 1966, this ratio amounted to 80%.

In the second half of 1966, the liberalization program was apparently firmly established. Since 1965, the IMF insisted on the fact that if the balance of payments position continued to be precarious, a new devaluation should be decreed. President Lleras (who took office in August, 1966) argued that a devaluation was not necessary and that the reserves were low due to unfavorable external conditions. Furthermore, he argued that while liberalization had taken place faster than expected, a retrocession in imports was anticipated, considering they had reached their peak. What Colombia required was more financial support for its liberalization program.

Notwithstanding intense negotiations, the IMF was inflexible. Although the Government expected other multilateral institutions not to take sides with the Fund, they did condition any assistance to reaching an agreement with the IMF (November 27, 1966). On Tuesday, November 29, during a television address, the President informed that given the collapse of the negotiations, the market exchange rate would be abolished, strict import controls would be imposed and an exchange control would be introduced. The liberalization program had lasted for slightly over a year.

The 1978-1982 liberalization attempt

Given a surplus in the balance of trade (due to a huge rise in the price of coffee) and a considerable increase in external indebtedness, reserve accumulation reached a record level in 1981. It was considered that, apart from monetary sterilization, import liberalization was an effective short term measure to reduce the inflationary pressures associated with reserve increases. The main features of this trade liberalization process were:

- The real exchange rate appreciated 25% between 1975 and 1981.
- During 1979-1981, 29% of items were in the prior license regime and 71% could be freely imported. The import of goods under the prior license regime that exposed domestic production to foreign competition was generally authorized.

- Regarding consumption goods, 33% were included in the prior license category and 67% were under free import. In order to foster imports of consumption goods that could help control inflation, tariff levels for perishable consumption goods with a price-elastic demand were reduced.

In late 1981 and early 1982, the effects of the coffee boom started to dwindle. In addition, there was lower growth in developed countries, increases in international interest rates and limited access to external resources. The situation became particularly worrisome following Mexico's declaration of moratorium on its external debt.

The loss of reserves generated a massive transfer of goods away from the free import regime. During 1982-1983, the prior license regime was managed with the greatest possible austerity. During the first part of the Betancur government (1982-1986), 97% of import items were included in the prior license regime or were outright prohibited. By 1984, the Colombian economy was as closed as it had ever been (Table 12).

Setting the stage for the "apertura"

In 1985 Colombia began a process of macroeconomic adjustment. Its main objectives were the correction of exchange rate overvaluation and the curtailment of domestic expenditure. An import rationalization process was begun in 1985, with the purpose not so much of exposing domestic production to foreign competition, but of expediting administrative procedures. The following measures are worth noting:

- The percentage of the tariff universe that could freely be imported increased from 0.5% in 1984 to 36% at the end of 1986. The items included in the prior license regime and in the prohibited import list decreased from 63% and 83% to 1% and 16.5%, respectively.

- The percentage of the amount of rejected applications for 1986 decreased to 39%.
- The average tariff, that amounted to 42% in 1985, was reduced to 31.2% in 1986.
- Reforms started to be introduced to the drawback program known as "Plan Vallejo".
- The tax incentive to exports was reformed. Four levels were established for the Tax Reimbursement Certificate (CERT).

Between 1987 and 1989 there were no significant trade policy reforms. No changes were registered in the structure nor in the composition of the import regime, 61% of which remained under previous license, 38% as free imports and 1% in the prohibited list. The objective of this "first stage" had been to transfer from the previous license regime to the free import regime goods that were not domestically produced or whose production was competitive in international markets. In terms of tariffs, the objective was the rationalization of the structure for capital goods and inputs, without reducing the effective protection that had been provided in the past.

"Apertura"

The liberalization program began by the Barco administration (1986-1990) in 1989 was geared towards the following actions: 1) the elimination of quantitative restrictions; 2) reduction of tariffs and number of tariff levels; 3) reduction of the paperwork for foreign trade; 4) institutional reforms; and 5) international trade treaties. The first three could be carried out by Presidential decree, the last two required congress-approved legislation.

The first two points, considered to be the most important, were implemented between March, 1990 (Barco administration) and September, 1991, (Gaviria administration). The third point, regarding facilitation of paperwork, was implemented starting in mid-1990. The fourth point, institutional reforms, was developed through the Framework Law for Foreign Trade (January 16, 1991).

The modernization program began in February, 1990 (CONPES Document, February 22, 1990), initially, for a 5-year period. The first stage consisted in replacing the protection implicit in quantitative restrictions, by explicit tariffs. To find the "equivalent tariff" of those restrictions, foreign exchange auctions were carried out, first in April and then in September, a mechanism that permitted the negotiation of import licenses for certain products[38]. Given its complexity and limited transparency, the system registered a very low demand.[39] The degree of utilization of the foreign exchange quota approved for the first cycle was 15% ($16.31 million). Of 744 tariff items available, offers were received for only 300. The results of this first tariff auction cycle are described in Table 18. For the second auction cycle, a new regulation was established, in which the groups disappeared

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[38] Auctions were designed to identify the optimum tariff that should be assigned to certain goods with domestic production. The optimum tariff would be determined by what importers were willing to pay for the procurement of import licenses through an auction. The objective, once the tariff was determined, was to transfer these goods from the prior license regime to that of free import. The mechanism worked as follows: Participants confidentially informed the additional tariff they were willing to pay to receive the import permit. Auctions were designed taking into account the foreign exchange budget (by groups and positions). Incomex demanded a deposit equivalent to the additional tariff offered, charged on the FOB value of the merchandise to be imported. This deposit was partially returned if the auction determined a lower tariff than that offered by the particular importer or in full when the proposed tariff was lower than that established by the Government. The opening of forms was public and their appraisal was carried out in descending order, starting from the bid with the highest additional tariff. The amounts requested (and approved) were compounded for each group, until reaching the quota limit. The resulting additional tariff for each item was the lowest additional one approved before exhausting the quota.

[39] According to Vesga (19??), "even the supporters of trade liberalization find the new mechanisms to be slow, impractical and incomprehensible." Hommes (1994, pg. 84) went even further when he argued that "during the Barco administration a trade liberalization program was implemented; it had several design problems and nobody felt threatened by it."

TABLE 18. FIRST TARIFF AUCTION (April 15, 1990)

GROUPS	Quota ($millions)	# of items	Quota used	Results and regulations adopted
1. Food and Beverages	41.0	139	16%	Additional tariff between 1% and 16%; the majority are 0%.
2. Textiles and other inputs for clothing	22.3	78	11.22%, with group 3	Additional tariff between 2% and 30%; the majority are 0%.
4. Woods, Tools and construction materials	9.8	56	14%, with group 6	Additional tariff between 1% and 10%; the majority are 0%.
5. Automobile Sector	10.8	32	97%	Additional tariff between 2% and 30%; the majority are 0%.
6. Household Goods	12.0	112	14%, with group 4	Additional tariff between 1% and 35%; the majority are 0%.
7. Consumer electronics watches and jewelry	1.7	72	67%.	Additional tariff between 6% and 35%; the majority are 0%.
8. Miscellaneous	33.0	160	4%	

Source: INCOMEX

and the selection was carried out simultaneously for all the products subject to this mechanism, in such a manner that the resources belonging to a sector with a low demand could be used in those where the demand was higher. Of the total budget auctioned, only 24.7% ($33.3 million) was demanded.

Apart from the above, several measures were taken during 1990 to expedite the trade liberalization program of which the most outstanding are: (i) an increase in the availability of foreign exchange for the financial system, aimed at facilitating foreign purchases (June 6); (ii) an anti-dumping statute was adopted and penalties were established for importers who sold their products below their production costs (July 11); (iii) the obligation to reimburse revenue from exports was abolished (July 25); (iv) the payment of import taxes in banks was established (July 25); (v) measures to support exports were adopted by expediting proceedings (including the decentralization of the "Plan Vallejo", the restructuring of Incomex and the modification of free zones regimes).

When President Gaviria took office almost one half of all imports were subject to import licenses. Already in the campaign trail candidate Gaviria announced that, if elected, his administration would continue to implement the trade reform initiated by the Barco administration.[40] He promised, however, that the reform would be carried out in a Colombian style: it would be gradual and it would be preceded (or at least accompanied) by a real exchange rate depreciation. In that regard, he argued, the exchange rate movement would compensate -- or, better yet, fully offset-- the decreased protection resulting from the

[40] This is, perhaps, a good point in this story to remember that in some areas Gaviria presented his program as being a natural continuation of Barco initiatives. Recall that Gaviria had served in two capacities in the Barco administration. First as Minister of Finance and then as Minister of Government.

reduction in import licenses coverage and tariff reduction. Interestingly enough, at the time the Gaviria administration embarked on the trade reform the real exchange rate had already reached its most depreciated level in many decades. As we discuss in a later chapter, efforts to maintain the real exchange at approximately the level it had reached in 1990 introduced serious instability during 1991, encouraging speculation and attracting large capital inflows.

During its early months the administration virtually eliminated the import licenses scheme, announced a time table for gradually reducing tariffs, and made an effort to maintain -- and even increase-- the degree of real exchange rate depreciation attained during the latter months of the Barco administration.

In October, 1990, CONPES approved a detailed schedule for trade liberalization that differed from the one approved in February in two essential aspects: (i) the new schedule was designed for a three-year period, between September 1991 and August 1994; (ii) the agricultural sector was included in the modernization program. Notwithstanding the approval of this second schedule for tariff reduction, the tariff measures taken in November 1990 would continue to be in force until September 1991, to the extent that the government considered it prudent to grant an additional year of protection to the domestic industry.

With the measures adopted since the beginning of 1990, at the end of that year the average nominal tariff had been reduced to 36% (Table 19), although the effective production was still at levels nearing 65% (Table 20). The distribution between free imports and prior licenses had changed from 38.8% and 60.1%, respectively, at the beginning of 1990, to 97.7% and 3.3% at the end of the year (Tables 21 and 22). At the same time, the number of tariff levels was reduced to 14 in September and to 9 in November (Table 23).

TABLE 19. AVERAGE NOMINAL PROTECTION (TARIFF PLUS SURCHARGE)

	1989	1990				1991			1992		
	Dec.	Mar	Sep	Nov	Dec	Jun	Sep	Nov	Ene	Jan	Feb
CONSUMPTION GOODS	58.50	53.20	49.90	49.60	51.67	37.79	21.51	21.42	18.46	17.93	17.45
RAW MATERIALS AND INTERMEDIATE GOODS	37.90	35.70	32.00	30.90	33.48	24.86	11.83	12.04	9.17	9.17	9.97
CAPITAL GOODS	37.10	34.30	27.90	27.30	27.66	20.43	12.69	12.50	9.57	9.57	10.30
TOTAL	41.60	38.60	34.40	33.50	36.28	26.78	14.32	14.35	11.46	11.32	11.79

Source: DIAN

TABLE 20. EFFECTIVE PROTECTION (TARIFF PLUS SURCHARGE)

	1990	1991	1992	1993
CONSUMPTION GOODS	108.6	46.6	37.4	36.8
RAW MATERIALS AND INTERMEDIATE GOODS	58.6	22.0	17.7	17.7
CAPITAL GOODS	38.3	18.4	15.0	11.8
OTHERS	42.3	33.4	13.4	10.9
TOTAL	65.2	26.6	21.6	21.3

Source: DIAN, DNP, DANE.

TABLE 21. IMPORT REGIME

(% of items)

	DATE		FREE IMPORTATION	PRIOR LICENSE	PROHIBITED IMPORTATION
Barco Presidency	1989	December	38.8	60.1	1.1
	1990	February	55.6	43.3	1.0
		May	55.7	43.3	1.0
		June	57.9	41.1	1.0
		July	67.0	33.0	0.0
		July	67.4	32.6	0.0
Gaviria Presidency		September	76.4	23.6	0.0
		November	96.7	3.3	0.0
	1991	July	99.9	0.1	0.0
	1992	April	99.9	0.1	0.0

Source: Presidency of the Republic, *La Revolución Pacífica*. 1990-1994

TABLE 22. IMPORT REGIME EVOLUTION
(number of items, 1990)

	February 22		July 24		September 18		November 6	
	No. Items	%	No. Items	%	No. Items	%	No. Items	%
1. Free	1,999	38.90	3,475	67.40	3,940	76.40	5,005	97.00
2. Prior license	3,090	60.10	1,683	32.60	1,218	23.60	153	3.00
prior-free			541	10.50	76	1.50		
prior-quota			236	4.60	236	4.60		
prior- survey			552	10.70	552	10.70		
prior-prior			354	6.80	354	6.80		
3. Prohibited	54	1.01		0.00		0.00		
TOTAL	5,143	100	6,841	100	6,376	100	5,158	100
	BARCO PRESIDENCY				GAVIRIA PRESIDENCY			

Source: INCOMEX.

TABLE 23. NUMBER OF TARIFF LEVELS

Date	No. of levels
Ago-90	20
10-Sep-90	14
14-Nov-90	9
19-Jun-91	7
13-Sep-91	4

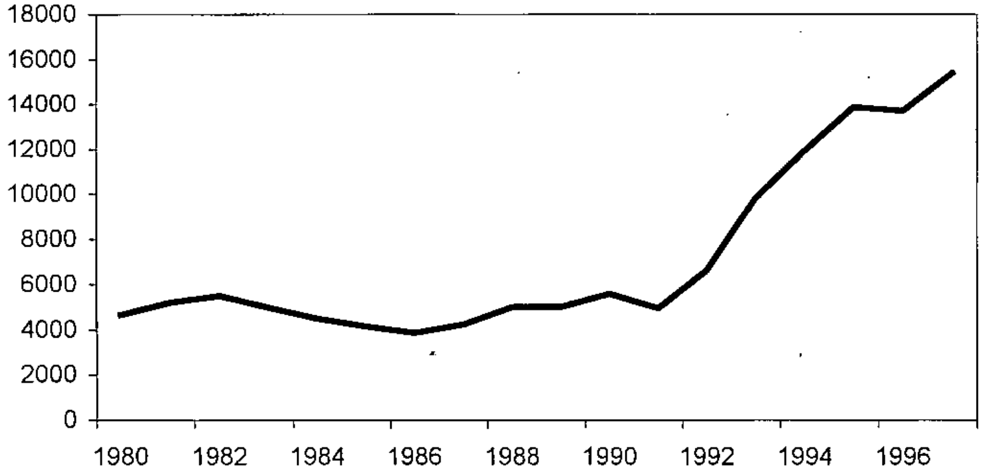
Source: INCOMEX.

In February 1991, CONPES approved the liberalization of food imports and established a price band, equivalent to a flexible tariff system, that would come into force as of June 1.

It was expected that the reform would generate a rapid increase in imports putting additional pressure on the real exchange rate. Surprisingly, however, instead of increasing imports declined --see Figure 3. This, plus large capital inflows encouraged by the opening of the capital account, generated a large and unexpected balance of payments surplus and accumulation of international reserves, which made monetary management exceedingly difficult (see Figure 4 on reserves). In terms of tariffs, on June 19, 1991, it was decided to accelerate the reduction previously agreed upon, in such a manner that the initial schedule would be executed by September, 1991. The evolution of this program determined that by the end of 1991 the average nominal protection reached 14.35% and the effective protection was reduced in almost 40 percentage points compared to the previous year, from 65.2% to 26.6% (Tables 19 and 20). Additionally, the number of tariff rates was reduced on two occasions: on June 19, from 9 to 7 and on September 13, from 7 to 4. As of July, 1991, 99.9% of items were in the free import regime. The remaining 0.1% required a prior license, for national security reasons.

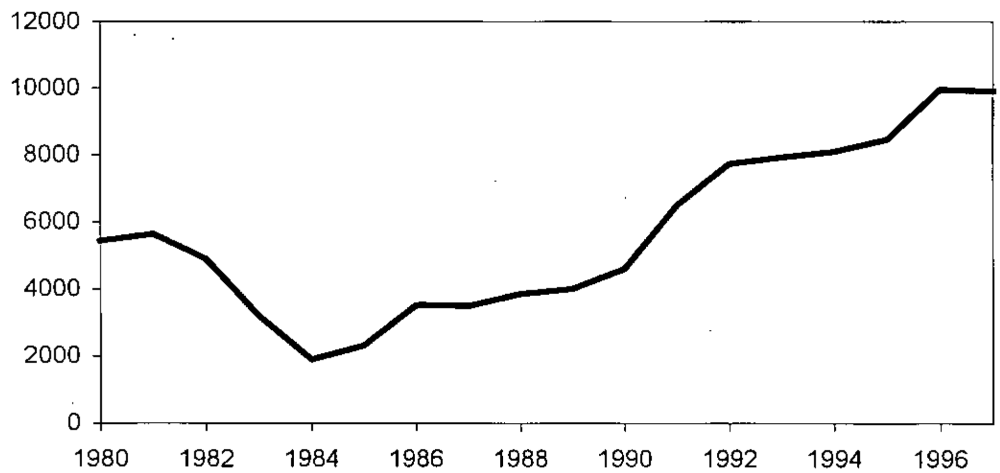
In retrospect, there is little doubt that from a political economy perspective this was one of the most daring --and one could even argue, most costly-- decisions taken by the Gaviria administration --the other one was backing-off from the attempts to privatize the telephone company. Paradoxically, what was supposed to be a slow and gradual trade liberalization experiments became, overnight, one of the most abrupt openings of international trade experienced in the Western Hemisphere. The political economy details behind these policies -- including the reaction of different actors to this change of speed --

Figure 3. Imports
(u$ millions)



Source: Dane

Figure 4. International Reserves
(u$ millions)



Source: Banco de la República

are the subject of much of chapter 4.

During 1991, there were significant institutional reforms as well. Law 7 of January 16, 1991 (Framework Law for Foreign Trade) created the Ministry of Foreign Trade and the Superior Council of Foreign Trade, which absorbed the Trade Council and the National Council on Customs Policy. Proexpo was transformed into a foreign trade bank (Bancoldex) connected to the Ministry of Trade. Furthermore, Incomex was associated with the Ministry, replacing its role in authorizing imports, for that of the control of harmful trade practices. Law 9 of 1991 reformed the foreign exchange regime, particularly in two critical areas: the relaxation of exchange controls and the decentralization of the foreign exchange market. Prior deposits on imports were also eliminated.

Concerning administrative support measures, the CERT was reformed in April. Among the changes, the following are worth noting: (i) the existing structure was simplified to three levels: (5%, 8% and 10%); (ii) the incentive granted to exports destined to Latin America (excepting Panama and the Andean Group) was increased in an equivalent of 30% of the basic CERT; (iii) the CERT was reduced to 5% for traditional agricultural exports (cotton, sugar and banana).

In 1992, changes in terms of tariffs were very modest. Although the average nominal protection was modified in three opportunities, it was only reduced from 14.35% to 11.79%. The effective protection rate went from 26.6% in 1991 to 21.6% in 1992. During that same year, several adjustments were introduced to the foreign trade regime aimed at harmonizing the tariff structure within the framework of bilateral treaties, improving control mechanisms of unfair trade practices and increasing the protection to the agricultural sector, given the fall in international prices (see below). Specifically, an external common tariff was agreed upon in February in the framework of the Andean Pact, which did not cover the agricultural sector. Additionally, a reference price list was adopted for some imports (textiles, clothing, cars and certain agricultural products) and instruments were designed to fight unfair competition and unusual increases in imports that were deemed detrimental to domestic production.

Liberalization of the agricultural sector

The liberalization program initiated in 1990 gave a special treatment to agriculture, through a slower reduction of import tariffs. Nevertheless, the sector was not immune to the acceleration of the tariff reduction that took place in 1991. As a result, the average tariff for the agricultural sector was reduced from 31.8% in 1991 to 14% in 1992. The special treatment received by the agricultural sector is evidenced when observing the evolution of the effective protection rate. Between 1991 and 1992, it was reduced from 77.5% to 36%, while that of the rest of the sectors went from 49.3% to 19.8%.

By mid-1991, a price band system was established for several agricultural products (wheat, barley, corn, rice, sorghum, sugar and milk and 104 additional related items). The ranges sought to isolate the domestic price from significant variations in international markets.

Reforms included the termination of the monopoly of IDEMA (Colombian Institute for Agricultural Marketing) on grain imports as well as the gradual elimination of its direct participation in the domestic market (through purchase of harvests). At the same time, support prices (which covered production costs) were replaced by basic prices, established according to the evolution of international prices.

The crisis in the agricultural sector that unfolded in 1992 determined significant policy changes. During the first months of the year, the participation of IDEMA was intensified in the purchase of rice, corn and sorghum. The price band for corn was replaced in October and two ranges were created , one for corn for human consumption and one for corn for animal consumption. Both implied higher protection levels. The collapse of the cotton price led the government to intervene in negotiations between producers and the textile industry. An announcement was made in November by which export subsidies would continue until 1993, given the depression of international prices and the European restrictions towards Latin American bananas.

Minimum import prices were set for 32 products and (on various occasions) the estimation methodology of the price bands was altered, in order to offer added protection. In July 1993, milk and chicken parts imports were suspended given their very low prices as a result of reduced consumption in the United States. Moreover, at the beginning of 1994, the tariff on beans and cotton were increased and a security statute was established for imports in case they increased as a result of the decline in international prices. This mechanism was first employed in June, 1994 to control for Vietnamese rice imports, under the assumption that its production was subsidized.

International agreements

Before the nineties, commercial integration was a mechanism through which Latin American countries tried to protect themselves from the economic influences of the world. More recently, integration is seen as a strategy to open the economy, under the principles of a new integration model that has been called "Open Regionalism". In this context, Colombian negotiations on the subject not only cover the traditional subject of trade in goods and policies that affect it, but also trade in services, investment and intellectual property. Among the negotiations carried out since 1992, the most important correspond to the Andean Pact, negotiations with Venezuela, the G-3 and agreements with Chile.

After slightly over a quarter of a century of existence of the Andean Pact, debates for the creation of a customs union were successfully completed in September 1992, after a negotiation process that was revitalized in 1990. The tariff structure agreed upon has five levels: 0, 5, 10, 15 and 20%. In February, 1993, a consensus was reached regarding the tariff universe. In November 1994, the decision was approved by Bolivia, Ecuador, Venezuela and Colombia. Additionally, in February 1995, a Common External Tariff (AEC in its Spanish acronym) came into force, without participation from Peru.

Complementary measures were also taken, such as: (i) to allow group members to negotiate free trade agreements with non-member countries, as long as they abide by the rules set by the Andean Pact authorities; (ii) deadlines were established to eliminate subsidies and fiscal incentives for exports; (iii) agreements were subscribed to facilitate transportation within the region.

Integration with Venezuela is one of the highlights of Colombian commercial negotiations. In the framework of the Andean Pact negotiations, in 1992 these two countries created a free trade zone and a customs union that, besides removing tariff barriers and eliminating import quotas, gave effect to a common external tariff for over 90% of the tariff universe. Overcoming the fears of the critics of free trade, this integration resulted in enormous benefits for the two countries. Even the sectors that were supposedly the most sensitive -such as aluminum and automobiles- have benefited from free bilateral trade.

Apart from the removal of trade and investment barriers, the negotiations included other relevant aspects: (i) the possibility of exchanging agricultural products was included; (ii) quality certifications and procedures for non-agricultural products were harmonized; and (iii) transportation liberalization increased bi-national flights more than six-fold in just one year.

The Treaty for Free Trade of the G-3 (Colombia, Venezuela and Mexico) was subscribed in June, 1994, following negotiations that began in 1990 and which took shape in 1993. The treaty came in force in 1995; 50% of Colombian manufactured exports enter Mexico free of tariffs, as well as 9% of Mexican exports to Colombia.

The final structure of the agreement includes the following elements:

- Access to markets: (i) progressive elimination of tariffs over a 10-year period (until 2004); (ii) Mexico will eliminate tariffs more rapidly than Colombia and Venezuela and in more products, considering its greater degree of development; and (iii) they will be preserved and homogenized.
- Goods that incorporate imports from outside the region will classify as originated in G-3 countries, if the materials have been sufficiently transformed within the region.
- Investment barriers are suppressed and a common investment regime is established.
- The three governments agreed to treat government purchases as if they were carried out by any other national institution, in such a manner that the governments will be treated equally, regardless of whether they are foreign or national.
- Anti-dumping regulations will be adopted according to GAT criteria.
- The agreement considers the gradual liberalization of services. Nationals and foreigners are treated equally.

Finally, it should be noted that in December, 1993, Colombia and Chile subscribed a free trade treaty that came to force in January, 1994. On that date, approximately 40% of tariffs were eliminated. The rest of the products will have a three-year tariff reduction period. For more sensitive products, tariff elimination will take place over a five year period.

C. Abolition of Exchange Controls (Ley 9 of January, 1991)

In 1967, in the midst of a balance of payments crisis and with the explicit opposition of the International Monetary Fund, the government of President Lleras Restrepo implemented a generalized exchange controls mechanism. This system, known as "*Estatuto Cambiario*" -- or Decree 444 -- became the center of Colombia's external sector policy. It established a strict control over foreign exchange transactions, while allowing flexibility in the nominal exchange rate policy through a crawling peg regime based on frequent mini devaluations. For years this system was credited, by Colombian and foreign observers, as allowing the country to maintain a stable real exchange rates and avoiding recurrent balance of payments crises.[41]

In January 1991 congress abolished Decree 444 and approved Law 9 on foreign exchange transactions. This is a very general piece of legislation --in contrast with the cumbersome *Estatuto Cambiario* with its 200 articles, the new law had only 33 articles--, that gave ample powers to the central bank to determine the rules applicable to foreign

[41] As pointed out above, in 1987 twenty years of the Exchange Controls Statute were celebrated with a major international seminar. Then President Virgilio Barco, as well as every living former president participated in the celebration. Among others, papers were presented by Paul Krugman -- he developed a small model justifying capital controls --; by Roque Fernández, the current Minister of the Economy in Argentina; by Rudolf Hommes and Armando Montenegro, the architects of the Gaviria reforms; and by the two authors.

exchange transactions, capital controls and the exchange rate regime. Between 1991 and 1993 the central bank adopted a number of regulations that virtually eliminated its monopoly over foreign exchange transactions, greatly reduced the extent of capital controls, allowed the public to hold foreign currency and implemented a floating-cum-bands exchange rate regime. As we argue in chapter 4, this reform had a tremendous symbolic value, as it virtually eliminated the one piece of legislation that was -- at least in appearance -- approved by the vast majority of the public and --perhaps more important and perplexing-- by the overwhelming majority of Colombia economists.

D. Financial sector and foreign investment Reform (Law 45 of 1990, Resolution 49 of 1991)

As in most of Latin America, the Colombian financial sector was highly distorted and regulated during the 1960s, 1970s and 1980s. An important number of banks was state controlled, and ownership was highly concentrated; interest rates were subject to ceilings; forced credit allocation was very important; securities markets were discouraged; and supervision was lax. In the early 1980s Colombia experienced a serious financial crisis, when two private conglomerates, which were at the center of a web of interrelated and questionable financial transactions, failed. As a result of this, two medium size banks --the Banco Nacional and Banco del Estado-- which held 5% of deposits, had to be taken over by the government. This led to a tightening of government regulations, and to the flight of deposits from the banking system. Between 1982 and 1986 the Colombian government intervened over 20 financial institutions, including banks, brokerage houses and insurance companies (Montes-Negret, 1988).

Colombia's experience illustrates how even with fairly stable rates of inflation and stable fiscal policies private securities markets can deteriorate. By the end of the 1980s less than 100 companies were listed on the stock exchanges as opposed to 400 in the 1960s, and privately issued securities (stocks and bonds) amounted to 2% of total financial system liabilities vs. 20% in 1965.[42] the 1980s as float (the percentage of free voting share relative to total share in circulation) was often no greater than 10% for most companies.[43]

In December of 1990 the Colombian congress passed Law 45 allowing the executive to implement sweeping reforms, and a few months later—in April of 1991—the Gaviria administration presented its reform program. The most important measures in the package include the relaxation of barriers to entry, the reduction and rationalization of reserves requirements, and the freeing of most (but not all) interest rates. In an effort to increase the degree of competition of the banking sector the government privatized some of the banks that failed during the first half of the 1980s.

From a supervisory perspective, an effort was made for all banks to comply with the capitalization standards set forward by the Basel Accord. Forced bank investments on government securities was sharply reduced. Also, direct lending requirements to the agriculture sector have been limited to 6% of total loans for large and medium-size farmers,

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[42] The increase in political and drug-related violence also affected the security market. Entrepreneurs feared that public listings of their companies could make them the target of terrorist attacks.

[43] The deterioration in Colombia's securities markets during the decade of the 1970s and 1980s can be partly traced to four fundamental factors: increased government intervention in the intermediation of savings, both through government ownership of intermediaries and through an extensive network of directed credit and forced investment programs; real trade restrictions coupled with a significant government presence through ownership of certain non-financial companies that lessened incentive to undertake investments and raise capital to remain competitive; a highly distorted taxation system; and, capital controls and entry barriers to provision of financial services either by offshore institutions or domestic institutions (on the stock exchanges). These policies created disincentives for companies to raise capital through public offerings and permitted easier retention of control. On these issues see, for example, Glaesner (1992).

and to 1% for small farmers. Although this was a marked improvement with respect to the historical situation, it maintained a significant distortion. Fixed nominal interest rates and rate ceilings have been replaced by a system of flexible charges, where preferential rates are linked to market interest rates.

The financial reform effort also affected the direct foreign investment statute. Law 9 of 1991, eliminated sectoral restrictions affecting DFI, established national treatment , and eliminated the requirement of obtaining prior approval. Additionally, existing limits on the percentage of profits that foreign firms could transfer to headquarters were also eliminated. In spite of these reforms, there are still many lagging areas, including the development of securities markets. Steiner *et al* (1997), for example, have concluded that the very high interest spreads that still affect Colombia's banking sector are largely the result of a lack of competition, stemming from remaining barriers to entry.

E. Some Economic Implications of the 1991 Constitution

In October 1990 President Gaviria convened a Constitutional Assembly to write a new constitution for the nation. The sheer fact that the Assembly was convened was a major accomplishment. Almost every Colombian President since López Michelsen had tried to initiate a constitutional reform, only to see their efforts frustrated by different Supreme Court rulings (Hoskin, 1994).[44] Even before being sworn in as President, César Gaviria had managed to generate a political and legal compromise that allowed for the constitutional reform process to be launched (see Cepeda, 1993). In October 1990, and after the idea of

[44] As Cepeda (1994) reports, and as pointed out earlier, Gaviria had been a central figure during President Barco's attempt at reforming the constitution during 1988.

convening a Constitutional Assembly had been supported by over 85% of the voters in May, 1990, the Supreme Court ruled that the convocation was constitution and the election for the members of the assembly could be called.[45] Once elected, the members of the Constitutional Assembly -- a majority of which represented the opposition parties -- worked hard and on July 5th 1991, Colombia had a new constitutional order.

The new constitution is a vast document -- with 380 permanent articles, plus 59 transitory articles -- that regulates the main aspects of Colombia's political, social and economic life. Contrary to what the public expected at the time the assembly was convened, the new constitution did not reduce the power of politicians, nor did it result in reduced influence of interest groups. In fact, as Wiesner (1997a) has argued, many groups, and especially those associated with the provision of public goods (education, health and some infrastructure) were able to ensure at the constitutional level their ability to capture rents.

As in many Latin American countries --Brazil being the premiere example--, the Colombian constitution establishes rights, regulations and obligations in an incredibly detailed way. This is almost unavoidable when the drafting of constitutional rule is the result of political compromise. Although providing a detailed analysis of the economic consequences of the constitution is well beyond our purposes, in this section we discuss some of the ways in which it impinged on the economic organization of the country.[46] This

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[42] As explained earlier, the process through which the assembly was finally convened was rather surrealistic and included a preliminary -- almost spontaneous -- vote in march 1990. This is the so called "seventh ballot" -- *séptima papeleta*.

[46] Not surprisingly, the most important -- and more controversial -- aspects of the new constitution referred to the political and judicial organization of the country. By far the most important provision -- and one that strained the relationship between Colombia and the US -- was the one that banned extradition. This article

discussion focuses on four points: Property rights; constitutional provisions related to labor markets and social conditions; transfers, and in particular transfers to specific groups or regions; and the creation of institutions aimed at reducing transaction costs and, in general, at reducing the costs of doing business.[47]

Regarding property rights, the 1991 Constitution provides an array of rules, which try to strike a balance between, on the one hand, protecting private property rights (including promoting privatization) while, on the other hand, promoting the state ownership of certain resources. For example, according to the constitution the property of non renewable resources and electromagnetic waves are reserved to the state (art. 63, 75 and 332). Article 58, on the other hand, guarantees private property rights, and article 60 establishes that the state will promote access to private property by the population. More interesting, article 336 vows to protect the public from inefficient state-owned monopolies. Almost every provision protecting property rights, however, pales in comparison to article 63. This extremely ambiguous article leaves, for almost every practical purpose, the door open for massive state ownership. It is worthwhile quoting this article fully:

> "Goods of public use, natural parks, the communal lands of indigenous groups, nature sanctuaries, the archeological patrimony of the Nation and other properties established by law are not subject to alienation, and cannot be seized by creditors.[48]

(art 35) was clearly written with the case of narcotics drug lords in mind. Providing a general analysis of the 1991 constitution is, of course, well beyond the scope of this paper. See, however, Cepeda (1995b).

[47] This constitution, as most constitutions do, set rather general principles -- although in this case the constitutional principles were very specific. The discussion that follows concentrates on these principles, but also discusses some of the specific enabling legislation passed by congress to make the constitution operational.

[48] In Spanish, this article states: "Los bienes de uso público, los parques naturales, las tierras comunales de los grupos étnicos, las tierras de resguardo, el patrimonio arqueológico de la Nación y los demás bienes que

Articles 64-65 provide a vivid illustration of the way in which the new legal order catered to some specific interest groups. Article 64 establishes that it is the state's obligation to ensure that agricultural workers become, gradually, landowners. Additionally it states that it is the state's obligation to promote peasants access to "education, health services, housing, social security, entertainment, credit, telecommunications, commercialization channels for their produce, [and] managerial and technical assistance." Not one word on how these services would be financed. Not one. And article 65 states that the production of "foodstuffs will enjoy the state's especial protection." This article goes on to say that the state should support the activities of those engaged in the "agriculture, cattle, fisheries, forestry and agribusiness sectors, as well as those engaged in the provision of infrastructure" related to these sectors.

A large number of articles in the 1991 Constitution are aimed at protecting labor rights and, more specifically, at protecting certain sectors of organized labor. Article 25, for example, establishes that "[e]very person has the right to a job in dignified and just terms". Articles 39, 43 and 44 provide modern civil rights by establishing the rights of unions, banning gender discrimination and establishing the rights of Colombian nationals with disabilities. Articles 48, 49, and 54 establish that social security, education and health provision are the responsibility of the state, even if the private sector can participate in their provision.

Article 54 goes well beyond the protection of civil rights, and establishes that it is "[t]he obligation of the state and employers to provide technical and professional training to

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determine la ley, son inalienables, imprescriptibles e inembargables."

those that require it." An this is not all. In an effort to protect the rights of retired people, Article 53 indicates that the indexation (of pensions) is a constitutional right: "the state guarantees the opportune payment and *periodical adjustment* of legal pensions." (emphasis added). Many of these articles suggest that the 1991 Constitution is, undoubtedly, a very well intentioned document, but one that is clearly devoted of much realism. The most interesting constitutional provision regarding labor markets is, perhaps, contained in article 334, which states that "[t]he state would intervene, in a very special way, to ensure that full employment of human resources is achieved..."

The 1991 Constitution established a significant degree of political as well as financial decentralization. For example, articles 339-344 state that the National Development Plan -- including the National Plan of Public Investment -- will have to be elaborated after a detailed process of consultation with the sub-national governments.[49] A number of articles establish in a very specific way the magnitudes and modalities of financial transfers from the national to the sub-national governments -- departments and municipalities.

Many of the provisions in the 1991 Constitution implicitly protect rents related to specific activities and sectors of the economy. Article 356, for example, establishes that the national government will set, by law, a proportion of total national revenues to be transferred to sub-national entities --the so-called "*situado fiscal*". It further establishes two crucially important points: first, these funds have to be used for financing education and health provision. Second, the amount of transfers will "increase annually until they have

[46] Lleras de la Fuente (1992) argues that these provisions of the constitution would result in a new, enhanced and more efficient way in which the private sector interest groups (*los gremios*) would participate in the

reached a percentage of the nation's current revenues that allows the adequate provision of [educational services]." Although money's fungibility reduces the effectiveness of any legal rule that earmarks revenues for a specific use, the fact that the constitution establishes that national transfers are reserved for the provision -- by the state -- of two social services reflects the ability to extract rents by those involved in the production of these public goods (Wiesner 1997).

Article 357 of the 1991 Constitution establishes that municipalities would have a participation in the nation's current revenues. More interestingly, this article establishes that the share of revenues that the central government has to transfer to municipalities would increase annually, from 14% of current revenues in 1993 to no less than 22 % of current revenues by 2002. This, independently of the country's other obligations, or of its economic performance . As a safeguard, however, this article establishes that in order for additional resources to be actually transferred, the municipal authorities have to show that they are making progress in attaining their social goals.

Articles 360 and 361 regulate the use of income generated from the exploitation of natural resources. Although the provisions in these articles are quite general, it is not an exaggeration to say that they were written with the case of oil production -- and more specifically of the state-owned oil company *Ecopetrol* -- in mind. Article 360 establishes that the state will earn royalties from any activity related to the exploitation of non renewable natural resources; article 361 mandates that these funds will have to be spent on new mining projects. This provision constitutes, to a large extent, a major concession made

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nation's political and economic debates. In retrospect, however, this does not appear to have happened.

by the Constitutional Assembly --with the government's implicit support-- to the oil workers' (*Ecopetrol*) union.

In addition to providing concessions to some interest groups, the 1991 Constitution also established a number of economic and political institutions aimed at protecting the private sector and Colombian citizens from economic abuse. There is no doubt that the most important of these was the establishment of an independent central bank (art 371-373). Other constitutional provisions are aimed at restricting congress's ability of increasing, during the budgetary process, the fiscal imbalance. Article 351, for example, states that congress will not be able to increase any items in the Nation's budget without the explicit agreement of the corresponding minister. And according to article 341, congress will only be able to modify the National Public Sector Investment Plan as long as overall financial balance is maintained.

In retrospect, and from the strict perspective of the economic reform process, it is possible to argue that the 1991 Constitution was not particularly helpful. In fact, an analysis of the different economic provisions of the new constitution suggests that by providing special concessions to specific interest groups -- the armed forces, teachers unions, and other powerful labor groups -- the constitution promoted rent seeking, and created an economic structure inconsistent with an efficient and impersonal modern economy. It may be even argued that from the point of view of the overall modernization reforms, some of the most important provisions of the new constitution were not those directly related to economic matters, but those that established the transitional political organization of the country during the second half of 1991, strengthened democracy and protected the rights of minorities.

Transitory article 3 abolished congress on the day the Constitution was enacted (July 5th), and transitory article 6 established the creation of a transitory 36-member commission (*Comision Especial*) that would take many of Congress's responsibilities during the July 15-October 4th 1991 and the November 18-30 1991 periods. This commission -- which came to be known as "*El Congresito*" or "little congress "-- played an important, although not always acknowledged, role during its brief tenure. It passed some important enabling legislation that made modernizing provisions in the constitution operational. Also, by passing the 1992 budget rapidly and without significant opposition it helped maintain the notion that economic matters were under control. As the Gaviria administration painfully found out in 1992, the new congress -- elected on October 27 1991, and sworn into office on December of that year -- was not as willing to embark on the reform project with the same degree of enthusiasm as the *Comisión Especial* or, for that matter, as the old congress. In fact, as is discussed in greater detail below, starting in the early months of 1992 the new congress was openly against many of the most daring reform propositions of the Gaviria administration.

For the purposes of our analysis, two reforms deserve particular attention: the granting of independence to the central bank and the changes introduced to the pension system.

F. The central bank

There are important reasons, both empirical and analytical, for having altered the nature and duties of the Bank. As regards empirical evidence, several studies have highlighted the high correlation between the degree of independence of the Central Bank and the achievement of low inflation rates.[50]

From an analytical point of view, it is socially desirable to limit the authority's possibility to exploit the apparent trade-off between inflation and growth; if such exists in the short-term, it disappears in the long-run, resulting in higher inflation without positively affecting economic growth. As to limiting the discretionary powers over monetary policy, there are two possibilities: i) that defended by the most orthodox monetarists[51] which proposes that the law should define the rate of growth of monetary aggregates, removing all discretionary power from the authority; ii) that supported by various others (for example Blinder, 1987) --and that would seem to have inspired the recent changes that have taken place in Colombia—which recognize that the authority is competent and its discretionary power is convenient.

How can successful inflation control be achieved with an authority that can exercise absolute discretionary power? By assigning it a specific objective and a relatively long planning horizon, something difficult to achieve with the participation of politicians or Government officials. A sufficiently long planning horizon leads to assigning less weight to short-term goals and more to those of a more permanent type. Independent central banks are characterized for establishing long-term policies, notwithstanding the political cycle. For that to be feasible, the period for which the directors are appointed is different from the presidential period, and, generally, considerably longer.

In Colombia, the desire to reform the Monetary Board, which exercised as monetary and exchange authority since 1963, gained force at the beginning of the last decade when

[50] Several of the main studies on the subject are referenced by Cukierman (1992).

the monetary financing of the fiscal deficit was identified as one of the main causes of the serious macroeconomic imbalance. At that time, the essence of the proposals to reform the Monetary Board consisted in removing those members of the Executive branch that were exercising the most significant pressure for the financing of the Central Bank, namely the Ministers of Agriculture and Development.

There were also those who favored the reform of the Bank itself, which until 1991 limited itself to executing those policies designed by the Monetary Board. In particular, Hommes (1989) had attracted attention to the fact that it was highly inconvenient for the Bank to extend development credits with charge to the inflationary tax -which discouraged the creation of long-term capital markets- or to finance cultural activities, task that should be undertaken by the Government with charge to the National Budget.

When the Constituent Assembly was convened in 1990, the Bank{s management and the Presidency of the Republic considered this to be a very opportune moment to reform the central banking regime. It was probably not very difficult to conclude that such reform should promote the achievement of two essential principles: i) that the Bank, not the Government through the Monetary Board, should be in charge of designing -and not only executing- the policies typical of a central bank; ii) that the Bank should concentrate its effort on maintaining a low inflation rate.

In a closed economy, the conjunction of these two objectives and the above analytical principles will probably have lead to a consensus in terms of having a central bank detached from the interests of the Government or any of the private sector segments,

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[51] Apart from the classic writings by Friedman, we suggest review of the works of Barro and Gordon (1983) and McCallum (1987).

with complete autonomy to design monetary policy and the mandate to stabilize prices. In an open economy, the achievement of such consensus is much more complex, since besides monetary policy there is also exchange rate policy, and it is well known that the exchange rate, while significantly affecting prices, also has serious implications on practically all economic spheres.

For that reason, it is not surprising that the reform of the Bank was not a simple process. There were many interests at stake. Maybe there was a generalized belief that it was inconvenient for the Bank to habitually finance the Government and the private sector. But there were certainly contrasting criteria with respect to having the Bank manage credit and exchange rate policies independently from the Government. The main points of discussion are reviewed below.

The original idea

Among the most outstanding aspects of the reform of the Bank that took place with the Constitution of 1991 we may note the following: i) it was established that its Board would become the authority regarding exchange rate, monetary and credit policies; ii) the Bank was given a specific mandate, to maintain the purchasing power of currency, in coordination with general macroeconomic policy; iii) its Board was granted a considerable degree of autonomy, since the President can only appoint a minority proportion of the Board; iv) the possibility of extending primary credit to the government was seriously limited and it was prohibited to extend it to the private sector; v) the submittal of periodic reports to the Congress was instituted as well as the surveillance of the Bank on the part of the President.

If it is accepted that the above enumeration constitutes the essence of the reform, we can state without any doubt that the current Central Banking regime is similar to the one originally conceived in the working document "*Propuesta sobre el Régimen Monetario en la Reforma Constitucional*" (Proposal Regarding the Monetary Regime in the Constitutional Reform) prepared by the management of the Bank in December, 1990 and submitted for review of the Presidency, to be included in the Bill for the Amendment of the Constitution that the Government would submit to the Constituent Assembly. The Bank's document included a draft bill, whose most relevant features were:

- Art. 1:... (the duties of the Bank shall be) the regulation of monetary, exchange rate and credit policies...
- Art. 2 The Bank will promote the maintenance of the purchasing power of currency, save for cases when an economic or social emergency has been decreed, and may not grant guarantees or any monetary financing of the Nation, territorial entities, decentralized agencies nor to the private sector other than financial institutions.
- Art. 3: By initiative from the Government, the law will determine the composition of the Board of the Bank and the qualifications of its members, who will be appointed by the President and among which there shall in all cases be a Minister of State. The remaining members of the Board will hold their positions on an exclusive dedication basis and for fixed periods.

Between the project originally drafted at the Bank and the one finally approved by the Assembly, several others were considered. In particular, the project officially submitted by the Government to the Assembly -which was the Bank's project reformed by the

Presidency- and those prepared during the various periods of such Assembly.

According to Minister Hommes (1995) "the project that finally emerged from the Constituent Assembly was very different (from the Bank's original draft), since the original one was only a timid advance in favor of administrative and technical autonomy, directed more towards isolating the Bank from the state bureaucracy, its controls and its political clients, and to get rid of the spending Ministers, and less towards creating a modern authority completely autonomous from the State and liable for policies, the inflation rate and the exchange rate".

On this same issue, former constituent Lleras (1995) expressed a radically different opinion. In his words, "a luncheon was held by bank officials and some constituents, to explain the differences between the two projects (the Bank's and the Government's). The constituents who attended this luncheon ... familiar with the arguments of the Bank, became advocates of the objectives pursued by the institution, considering they were better documented than the government texts. The project's background deserves to be recalled because in truth, the Assembly performed its analysis based on an illusive initiative, that is, on a proposal that was never officially submitted... It was this document (the Bank's working document) that served as the basis for the debates that were carried out at the Assembly and that, thanks to the perseverance and patience of the Bank, originated the current law –which introduces modifications to the original text and ensures a greater autonomy of the Board, compared to the project supported by the Minister of Finance, which allowed for an easier control of the Bank by the Government."

Therefore, it would seem that the Bank prepared a document that was very well received by distinguished members of the Constituent Assembly. However, the Presidency, without prior consultation with the Minister of Finance,[52] altered the original project to such an extent that the bill submitted by the Government to the Assembly did not meet the goals of various members of the Assembly, and, even less, of the Minister himself.

Issues for discussion

There were discussions on various topics within the Assembly, ranging from very profound issues to irrelevant or non-conducive ones, including interesting controversies about the precise wording of regulations. An interesting debate also took place between analysts.[53]

For example, the Assembly discussed whether the Bank manages "*the* international reserves" or "*its* international reserves." The choice of article, that may seem irrelevant at first glance, is extremely important in terms of the determination of the Bank's financial results and therefore, on its implications over fiscal policy.

Concerning inopportune initiatives, several constituents proposed regional representation in the Board of the Bank. Should such a view have succeeded, the amendment would have put the Bank back many years, instead of modernizing it.

The mandate of the Bank and the coordination with the Government

Regarding the mandate of the Bank, the Constituent Assembly introduced two in-depth

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[52] This statement was personally confirmed by the former Minister who declared that he was not familiar with the Bank project.

[53] The institutional position of Fedesarrollo, (1991) a significant think tank, was that the central banking regime should not be an issue at the constitutional level. A researcher from the institution (Lora, 1991) expressed that "the advantage of merging the design and the execution of the monetary policies in one agency is not very clear. The current separation -between the Monetary Board in charge of designing policies and the Board of Directors of the Central Bank, in charge of executing them- has been very convenient and should even be increased, strengthening the Government's control on the Bank with regard to the allotment of

reforms to the project submitted by the Government. On one part, it was established that it is the State, through the Bank, who is obliged to maintain the purchasing power of currency. On the other hand, it was noted that in the pursuit of that goal, the Bank would act in coordination with general economic policy. The idea that in the event of a dispute between the interests of the Bank and those of the Government, the Bank must abide by the goal of lowering inflation, was also recorded.

The positive aspect of the changes introduced is evident. On one hand, considering that the State is responsible for maintaining currency stability, it is the Government's responsibility to execute a fiscal policy consistent with this objective. Likewise, by acting in a coordinated manner, the Bank is obliged to design the instruments it controls in such a way as to not completely relinquish other economic purposes, in the pursuit of price stability. Unfortunately, in practical terms the above arrangement might imply that the public does not perceive the anti-inflationary goal as firm and decisive.

Conformation of the Board of Directors

The project originally prepared at the Bank mentioned the presence of a Minister on the Board. The project submitted by the Government included the Minister of Finance, as Chairman of the Board. Apparently, that inclusion was not subject to much argument in the Assembly since it was considered to be an appropriate element to guarantee the referred "coordination."

The subject of the composition of the Board motivated various writings during the period of the Assembly sessions. Currie (1991) argued in favor of entirely removing the

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primary resources and the use of profits..."

Government from the Board, stating that "the Government of President Gaviria suggested the abolition of the Monetary Board and its replacement by the Board of Directors of the Central Bank. But it is the composition of the Board that is important, not its name ... Experience shows that the members must be appointed to work full time on the Board, must have technical training and must not represent any particular industrial sector ... Although for the purposes of coordination of economic policy it could be argued in favor of the presence of the Minister of Finance on the Board, this has generally led to a bias towards lax monetary policy. In any case, it would be convenient for the manager of the Bank to act as the Chairman of the Board and its spokesperson. As a general rule, the responsibility must be proportional to the authority, but this has not been the case of the manager in the past."

A very different position was expressed by Fernández (1991a) who, vehemently opposing the proposed reform, stated that there was a risk that the Board could become "a body of technocrats without political or business organization responsibility."

On his part, and in our view not without reason, Hernández (1991) expressed doubts about the turnover mechanism of the members with exclusive dedication. The first five members were all commissioned for five years, after which the President should change two of them. It is evident that when selecting these two, he also selects the three he ratifies. According to Hernández, that could lessen the autonomy and independence of the Board of the Bank, as it constitutes an incentive for the members of the board to be compliant with the Government. That problem could have been avoided if the original members had been appointed in a staggered manner, one for twelve years, two for eight and two for two.

Within the Constituent Assembly, the decision regarding who would appoint the members of the Board was the subject of considerable debate. The possibility that such responsibility fell upon the Congress was considered, but rejected.

Financing the Government

It is interesting to recall how, at the time of the reform, an important and influential group of economists was concerned about a matter that now seems rather awkward: the prospect that, given its impossibility to extend credit to the Government, the Bank would indeed be hindered from ensuring the flow of money required by a growing economy!

Very respected experts on the subject stated that the country would be destined to "live under economic emergency" (Perry, 1991); that "the primary financing was necessary both for operative convenience and to ensure monetary and economic stability" (Lora, 1991); that the country "could wind up limited, no less than by its Constitution, to resort to indirect methods -not to call them surreptitious- to finance its fiscal deficits through money creation" (Fernández, 1991b); that in the event of reluctance of any member of the Board to extend primary credit to the government, we could validly ask "the question of whether the value of government debt is adequate to provide for the secular growth of money (Hernández, 1991).

The above fears were obviously unfounded. Presently, we have a regulation that severely restricts, but does not prohibit, primary credit to the Government; that allows the Bank to negotiate public debt in the capital market to affect the money supply; and that categorically prohibits the Congress from establishing any sort of credit line. Such regulations have proved to be favorable and, surely, the doubts on the subject that were expressed some eight years ago have been cleared up.

Exchange rate policy

As stated by Hommes (1995) and Palacio Rudas (1995), exchange rate issues were probably among the most important subjects discussed in the Assembly, together with that of the "coordination" between the Bank and the Government.

From an analytical point of view, it is evident that if the Bank operates in a regime where the exchange rate is determined by the Government, such Bank may not set its monetary policy autonomously (Cottarelli, 1991). For this reason, an independent Central Bank must manage the exchange rate. However, the management of the exchange rate, in particular, and the exchange regime in general, have repercussions on various spheres of economy, many of them of particular interest to the Government.

According to several contributions in Steiner (1995), the Constituent Assembly seemed to have achieved a commendable solution on the conflict regarding who should manage exchange rate policy. The Board of the Bank is the monetary authority, subject to laws on the matter issued by the Congress, by initiative of the Government. That is to say, the Bank is responsible for *setting* the exchange rate, process in which it must abide by the *exchange rate regime* defined by the Congress, on Government initiative.

Naturally, to the extent that such exchange rate regime is too narrow, a situation could be reached where the Bank is autonomous to execute the policies defined by the law! We could ask ourselves whether such an arrangement does not in fact represent the establishment of a system in which the Bank eventually ceases to be the authority on exchange rate matters. Could it happen, for instance, that, as in the case of Argentina, a law defines a principle of convertibility according to which the Central Bank commits itself to purchase and sell all foreign currency it is offered to, or demanded from, at a fixed rate? If such is the case, could we still state that the Bank is in charge of exchange rate policy? And if it is not, how then can it be the monetary authority? And if it is neither, how can it be responsible for maintaining the purchasing power of currency?

If our interpretation is correct, the preservation of the Bank's independence - independence to define policy regarding money, credit and the exchange rate- requires the existence of a broad legal framework regarding the foreign exchange regime. That being the case, the Bank's independence cannot be taken for granted, as it depends on the determination of the Government and of Congress to allow it to exercise such autonomy.

Central Bank Profits and Losses

According to Bernal (1995), the advances achieved with the reform include the granting of financial autonomy, the elimination of the possibility of monetizing the effects of currency depreciation and the determination that the Bank's financial results (following the constitution of reserves) is the Government's responsibility, who takes the earnings or assumes the losses. This last aspect has been extensively debated. Hommes (1995) argues that accounting for the losses of the Bank in the Government's budget is highly inconvenient, since the Bank winds up operating as if, in fact, it didn't have a budget constrain. It should be noted that this kind of problem is not present in most other countries, since the central bank has significant equity, which is obviously affected by the institution's operating result. In Colombia, the Constituent Assembly, and subsequently Congress, granted the Bank great powers and immense responsibilities. Apparently, nobody considered important to endow such an institution with enough equity.

G. The pension system

President Gaviria considered Law 100 of 1993 –which, in addition to pensions, also changed the health-care system—as his administration's most important reform (Dinero, 1994). According to Schmidt-Hebbel (1995), "the reform anticipated the explosive increase in inefficiency and inequality that would have arisen as a result of the aging of the population." In obvious reference to the Chilean experience, a senator that was highly influential in the entire reform process argued that "while several countries appealed to different degrees of political dictatorship to reform their pension systems, Colombia has achieved it through a pluralistic Congress, in the context of an open democratic confrontation, and with active participation and dissent from the general public" (Uribe, 1994, pg. 102). According to Anif (1993), "full credit should be given to the President, who not only advanced the original idea regarding the reform, he was actively devoted to passing it through Congress, in spite of the lack of understanding and of the (open and covert) opposition and indifference of many members of his own party."

Background to the reform[54]

In 1946 Colombia established a pension plan for government employees through the Caja Nacional de Previsión (Cajanal). In 1967 the Instituto de los Seguros Sociales (ISS) made pensions mandatory for those employed in the private economy.

When IVM (for *invalidez, vejez y muerte* or incapacitation, retirement and death)

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[54] For more details, see Posada (1991), Ramírez (1991), Botero (1991), Ayala (1992), Uribe 1994 and

insurance started operating, it was decided that the partially funded regime would be constituted with funds from employers (who until then had been fully responsible for pensions), employees and the government. Original estimates suggested that contributions should be around 6.5% of wages, and for a given period of time they should be increased every five years. Unfortunately, contributions were initially set at 4.5% and were increased to 6.5% only in 1985. In addition, the government did not make its corresponding contributions. Contributions to the ISS were done two-thirds by the employer, one-third by the employee. In the public sector the government paid 85%, the employee 15%. The relative contribution of Colombian employees was the lowest in Latin America (Botero,1991).

In the early 1990s coverage of Colombia's pension system barely reached 21%, comparable to that of Haiti. The regional average was between 40 and 50%. Regarding activities in the urban sector, affiliation rates reached 89% for public employees, 21% for domestic servants, 40% for managers, 22% for self-employed workers and 17.5% for assistants in family-owned businesses. Affiliation rates in the formal sector were estimated at 75%, in the informal sector at 25% (Ramírez, 1991).

Between 1980 and 1989 contributors to the ISS increased at an annual rate of 4.22%, whereas pensioners increased by 13.5%. In 1980 there were over thirty active contributors for each pensioner. By 1990 that ratio had fallen to 13 to 1. The reserve coefficient –that is, the ratio between reserves at the beginning of a given year and expenditures for that year—declined from 4.54 in 1980 to 1.55 in 1990. Experts consider a reserve coefficient of 5 to be satisfactory.

Schmidt-Hebbel (1995).

While in the ISS men retired at 60 and women at 55, in Cajanal everybody could retire at 55. Not to mention some public institutions in which a person could retire without any consideration for age. In Colpuertos –the public institution in charge of running Colombia's ports—an employee who joined the company at age 20 could retire at age 37 (Uribe, 1994). Administrative costs as a proportion of revenue were 5% in the ISS and 15% or more in Cajanal. Corruption was notorious. For those that did not condone these practices, required paper-work to obtain a pension could take one year in the ISS, and even three in the case of Cajanal (Ayala, 1992).

Regarding public employees, there were all types of public pension funds, both at the national and at the regional level. Regimes differed, and discriminations abounded. Retirement ages and time of service requirements differed, without consulting any objective criteria. These funds had not constituted any reserves. Pensions were paid out of transfers (either from the central or local governments or from decentralized institutions). Other than for the ISS, there were no actuarial estimations for other social security institutions. In the latter, a pay-as-you-go system was in place and much the same can be said of the ISS, where it's critical financial situation had made the originally intended partially funded regime non viable.

After a quarter century of existence, the ISS was confronted with massive retirements from its contributors. The ratio between contributors and retirees was estimated to reach 5 in 2020. That would require a contribution rate of 21% by then. The system was in need of a substantial contribution hike, even if benefits were curtailed and/or the retirement age increased.

In summary, the pension system that was in place until 1993 exhibited many of the limitations of a public pay-as-you-go scheme. Contributions and benefits differed throughout the many sub-systems; huge transfers in favor of the first generations of retirees; weak links between contributions and expected benefits; inefficient public administration; lack of sufficient reserves; and growing fiscal transfers (Schmidt-Hebbel 1995).

The original proposal[55]

In his inauguration address, President Gaviria referred to a complementary pension system, based on private funds that would stimulate savings and to which all employees, including the self-employed, could voluntarily join. In the draft legislation regarding labor reform – and which was eventually incorporated as Law 50 of 1990—the government had included several provisions regarding the pension system. In agreement with the congressional leadership, it was decided that discussion of matters regarding pensions would be postponed until the following legislature. In the interim period, a Constituent Assembly was convened and elected. The new Constitution touched on aspects of the pension system issues on several occasions. In one of it's transitory articles, it established a commission composed of government representatives, labor unions, business organizations, political parties and social movements, peasants and employees in the informal sector. This commission would produce a reform proposal that would serve as the basis for the new draft that the government would submit to Congress.

The 1990 proposal referred to a basic IVM system ran by the ISS –guaranteeing a minimum pension for all those affiliated, and operating under the principles of solidarity

[55] This section is based on Posada (1991, 1992), Botero (1991) and Ayala (1992).

and redistribution. This system would be mandatory for all employees. There would also be a fully-funded system, also mandatory, ran by the private sector. The young and the new affiliates that had contributed for only a short period of time would have to join both systems. The senior contributors –defined as those who would not be able to conform a pension by joining the private system—would only join the basic system. This sub-system would pay the pensions of those already retired, of all senior contributors, and would supplement the pensions of those that, when reaching retirement age, had not been able to constitute enough funds to pay for a pension equivalent to the minimum wage. This sub-system would be financed by the government, by the entire contributions of senior contributors and by a fraction of the contributions of young workers and future affiliates. The benefits of current pensioners would undergo no change.

For the public sector there would be a basic system, similar to that of the private sector –in fact, institutionally and operationally integrated with it—, and a supplementary system. The latter would provide additional benefits, depending on the conditions of particular institutions. The young and new public servants would have to join the private, fully-funded system. During the transition period, the pay-as-you-go system ran by the ISS and by all sorts of public funds would undergo, among others, the following changes:

- Contributions to the ISS would increase from 6.5 to 13.5%, and contributions by public employees would be established.
- Retirement age would increase, to 65 in 2000 for men and in 2005 for women.
- To calculate benefits, real wages for the last 10 years (instead of 2) would be averaged. In addition, a 30 year minimum contribution period would be introduced.

- Pensions for injury and death would be similar in both sub-systems. Benefits for public employees would be defined by the government, in the context of another Law (4 of 1992).
- Obligations of all insolvent public sector funds would be consolidated into one fund.
- The government would take care of the liabilities of the ISS and of all insolvent funds, including pension bonus's issued in favor of contributors that shifted to the private system.
- Based on the new contributions, and with the purpose of taking care of their obligations, the public sector funds would establish funded pension systems.
- Benefits exceeding those established for the ISS would be the sole responsibility of those institutions that established them.
- Finally, another segment of the social security system would be responsible for providing subsidies to the old and poor, or to those who fell into poverty as a result of premature illness or death of the household head.

Reactions to the original proposal

The pension system reform process was characterized by a lively debate among different interest groups.[56] Several proposals were set on the table –from the Ministry of Finance, the National Planning Department, the ISS, JLB Actuarios and Fedesarrollo. They all coincided in a basic pay-as-you-go system, with the possibility of a supplemental fully-funded scheme (Cárdenas, 1992). Apparently, only ANIF (the national association of

[56] In this regard, the exchange of memorandums between the Central Unitaria de Trabajadores (CUT, 1992) and government representatives (1992) is very revealing.

financial institutions) departed from this broad consensus. It called for 100% of contributions to go to private funds, with as short as possible a transition process.[57] Important segments of the labor movement backed minor changes, but no fundamental alteration, to the existing system.

According to H. López (1992), the government's project was a winning proposition. In spite of its natural rhetorical opposition, the labor movement would support it, since it entailed no major changes to most of those already active in the labor force. The financial system would certainly appreciate the enhanced business possibilities it would now confront. All of this was possible because most of the costs of setting up the new system would be paid for by the government –not so much by the current one, but by those that were to follow.

The government's reform proposal was the subject of several criticisms. Some considered the reform process to ambitious, others thought it was not radical enough.[58] Leading the former group were previous managers of the ISS (see Consenso, 1993, below). Among the latter group, ANIF played a critical role. A central aspect of the debate had to do with the alleged fact that the proposed system would bring enormous benefits in terms of

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[57] Since very early in the process, ANIF played a key role. In 1990 it had already highlighted the benefits of individual capitalization in the U.S. and in Chile, where private pension funds had increased long-term savings and democratized equity ownership (ANIF, 1990). On opposite ends, Eichler (1992a,b,c) argued that even though there was widespread believe that ISS was not fulfilling its job, that did not imply that a capitalization scheme was the preferred alternative. He suggested that enhanced efficiency through privatization was perfectly compatible with a pay-as-you-go scheme and insisted that the government was more interested in developing the capital market than in providing a well functioning pension scheme.

[58] Ayala (1992) suggested that 70% of workers in the private sector and 74% of workers in the public sector were in favor of the proposed changes. According to him, those more knowledgeable on the subject were also in favor of the reform, but they would rather have a basic pay-as-you-go fund complemented with individual capitalization funds.

developing the capital market, at the cost of sacrificing key elements such as solidarity.[59] Ramírez (1991) argued that the private individual capitalization system would increase savings and enhance the transparency with which funds were managed and disposed off, but would have a hard time fulfilling any sort of intergenerational solidarity. In the same sense, Cárdenas (1992) asked "¿how can we prevent doing away with solidarity and social fairness while attempting to develop the capital market?"

On the opposite extreme, ANIF (1991, 1992b) argued that the pay-as-you-go system –which was generally supported because of its alleged solidarity— lacked any redistributive properties and was a big economic mistake. Actually, the system implied no transfers from high wage earners to low wage earners, simply because what the former contributed was not even enough to pay for their own pensions. Furthermore, since in such a system there was no link between contributions and benefits, it was no surprise that contributions were considered a tax --one whose rate was always trying to be minimized and where payments were being avoided.

Debate also took place around certain positive elements that the government attributed to the capitalization scheme. According to H. López (1992), the government's criticisms of the pay-as-you go system were based on false premises. He acknowledged that if initial conditions were that of a fully formal working population and no pension coverage at all, the capitalization system would be the ideal option. However, those conditions did not hold. Therefore, the first issue to be addressed ought to be taking care of the current old, then fixing the financial mess of the current system and, finally, increasing savings. In

[59] Surprisingly, Consenso (1993) was concerned that "the proposal will imply a huge increase in savings, and it is not clear whether there will be enough (secure, profitable, and liquid) financial instruments where to

the latter task, a private pension system could play an important role. In that sense, a private system should be a complement to the ISS, not a substitute. Finally, he saw as a major drawback that the proposed system did not offer any solution to the lack of universal coverage.[60] Consenso (1993) expressed similar ideas and argued that key benefits that the government attributed to the proposed system --such as an increase in contributions and a curtailment of benefits—was independent of the pension system in place.

The fiscal impact of changing systems was also a matter of discussion. Consenso (1993) argued that the high fiscal cost of the reform would necessarily imply a reduction in other government commitments in key social areas such as health and education. On the opposite end, ANIF (1992a) pointed out that the pension bonus that the ISS would issue did not imply a deficit, which was already there regardless of the bonus. In fact, ANIF suggested that fiscal considerations demanded that the transfer to the new private funds system be undertaken as soon as possible. And in clear reference to its main detractors, went on to say that unfortunately "the interests of the country as a whole do not always coincide with those of the managers of an institution such as the ISS" (ANIF, 1992b).

Another hotly debated topic had to do with having two parallel systems and with the pension scheme applicable to public servants. According to Consenso (1993), the government's concerns, as reflected in the motivation part of the proposed legislation, centered on the ISS, almost entirely leaving aside the most serious problem of the current regime –i.e. the pension system of public employees. ANIF in turn argued that combining the existing pay-as-you-go system with a private capitalization scheme was the equivalent

place all those funds.

to "creating a crippled monster that could not survive on its own."

Certainly, critics also made several constructive suggestions. ANIF proposed the following framework for reform: (i) the government should be responsible for pension rights already earned. After the corresponding actuarial calculations, the government should transfer the corresponding funds to the new private entities. (ii) for those affiliated to the ISS who had not reached retirement age, the present value of their contributions should be estimated. Then, the government should provide each worker with a pension bonus for an equivalent amount, that should be contributed to the private funds. (iii) Cajanal should be forbidden from acquiring new obligations, unless they had an appropriate capitalization scheme to respond for them. Consenso (1993), on the other hand, insisted in the need to increase the retirement age and the minimum time of contribution required to be able to enjoy a pension. And, convincingly, argued that the proposed model would increase labor costs and could, thereby, adversely impact on the economy's competitive possibilities. Ayala (1992), a key figure in the government's reform team, recognized the fiscal implications of the proposal and highlighted the need to adopt measures that would prevent the new system from increasing economic concentration.

Although it did not actively participate in the debates, the manufacturer's association did make some comments on the above matters (ANDI, 1992). It argued that, while sharing the basic principles, the government's proposal was not problem free. In particular, the proposed increase in contributions (from 8 to 13.5%) was worrisome. And the fact that the contribution would now rest even more heavily on the hands of the

[60] The fact that the proposal did not address the system's lack of coverage was acknowledged even by the promoters of the reform (p.ej. Ayala, 1992).

employer was unfortunate "as this would diminish the worker's sense of belonging to the system."

The new regime[61]

Following a very interesting debate involving policy-makers, politicians, former ISS managers, and academics (see below), a general pension system (SGP) was established, in order to cover IVM eventualities. The system that emerged from the discussions was a far cry from the governments initial intentions. The SGP is composed of two sub-systems, exclusive of one another: one is partially funded, with pre-established benefits, the other an individual savings scheme with solidarity.

The system is *mandatory* for employees in the private and public sectors –with some exceptions—and those members of the population that, because of their precarious economic situation, are to be beneficiaries of subsidies (in pensions as well as in health care) through a solidarity fund (Fondo de Solidaridad para Extensión de Cobertura). Employees earning more than four times the minimum wage shall contribute one additional percentage point, in order to provide resources for this fund. The system is *optative* for self-employed workers.

Contributions will gradually increase, until reaching 13.5% of wages. In 1994, 8 points will go to the funds, 3.5 to insurance and administration. Contribution to the funds will increase to 9% in 1995 and to 10% in 1996. Employers will pay 75% of contributions, employees 25%. Self-employed workers will be responsible for the entire contribution.

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[61] See Uribe (1994), Dinero (1994), Schmidt-Hebbel (1995) and ANIF (1993).

In order to be eligible for a pension, a worker must have contributed for at least 1.000 weeks, and must be 55 years old if woman, 60 if man. In 2.014 this age requirement will be increased by two years. In the individual capitalization scheme, a worker can retire at will, as long as the funds in his account allow for a pension not smaller than 110% of the minimum wage.

Members of the armed forces and the police, of the teacher's union pension fund, and of Ecopetrol (the state-owned oil company) are exempted. All workers must contribute to the solidarity fund.

The reform that finally became law has been criticized basically on three accounts:

Co-existence of regimes

The most enthusiastic support for the existence of two regimes came from senator Uribe (1994) according to whom "congress was wise enough to incorporate an individual savings scheme without doing away with the partially funded system which, with modifications, should thrive in the future. The co-existence of regimes and of institutions has been a smart decision. In contrast with the Chilean model, we did not eliminate the previous regime, we instead made it viable."

Manufacturer's did not oppose to the operation of two regimes. Surprisingly, they registered, with no comment, the fact that "the new regime applies to almost everybody. Only the armed forces, the police, teachers members of the union's pension fund and Ecopetrol employees are exempted" (ANDI, 1994). And they did not hide their approval of the increase in contributions. They argued that "while some have suggested that the increase in contributions is the equivalent of an increase in taxes, it should be noted that, unlike other tax reforms, this one requires enhanced private and public savings and implies increases in productivity, competitiveness, employment and general well-being."

As expected, ANIF (1993) was highly critical of the co-existence of regimes: "fortunately, the idea of a 'mixed' regime, in which those who chose the private system would be tied to the ISS for the rest of their lives, did not prosper. Although two regimes will exist, they are mutually exclusive." In the same sense, Schmidt-Hebbel (1995) argued that while the co-existence of regimes could conceivably enhance the choices available to consumers, by maintaining a partial capitalization scheme with pre-defined benefits, it actually perpetuates many of the limitations of the previous system.

An extremely slow transition process

According to Ayala (1995), the main problem with the new system is of a fiscal nature, which originates in a political compromise that determined an extremely slow adjustment process for guaranteed pensions. The prolonged transition period implies that women over 35 and men over 40, and all those who have contributed for more than 15 years, will not see any changes in contribution time and minimum age required for retirement and will keep their very high pension/wage relationships.

Adverse selection is emphasized by Lora and Helmsdorff (1995). They argue that the enhanced benefits that the ISS will offer to those less capable of contributing will lead this institution into bankruptcy. They envisage that by 2025 the ISS will have less than one contributor for each pensioner. All of this as a result of having established a very long transition process and having maintained very favorable benefits in relation to contributions.

Dinero (1994) also questioned the long transition process. It pointed out that just as in the case of labor reform (Law 50 of 1990), there was a political trade-off between approving the reform and delaying the implementation of parts of it. In fact, some of the most significant changes will not occur until 2014.

Memorando Económico (1993) registered, with nostalgia, several changes that were introduced to the government's initial reform proposal. The latter included an immediate increase in contributions to 13.5%, increasing the retirement age to 65, and an increasing the time of contribution to 1500 weeks. "These changes, which implied an important curtailment of benefits, were aimed at providing a long-lasting solution to the problems of the pension system."

Unfair competition

The capitalization scheme requires having contributed 1150 weeks, and 62 years of age for men and 57 for women, in order to be able to have the government provide the resources to conform a minimum pension. These more restrictive requirements originate the most criticism, since they obviously imply unfair competition for the private funds. According to Memorando Económico (1993), they ensure the subsistence of the ISS, as many low wage-earners will choose to remain in that system.[62]

According to the president of an important private fund, these institutions have a very difficult time competing with the ISS since "the law establishes that the central

[62] ANIF (1994) reports that according to a private pension fund manager, in spite of the attempts by the ISS to clear its image, its entrenched bureaucracy will prevent it from effectively competing with the private system.

government will take care of any ISS deficit" (Dinero, 1994).[63] Not to mention the fact that on occasions those who run the ISS publicly try to discredit Chile's private pension system (Botero, 1997).[64]

Even worse, according to Ayala (1995) the system now in place gives the ISS the incentive to actively compete for the contributions of young workers, as that generates an initial surplus, that could conceivably help finance the government's budget. According to Lora and Helmsdorff (1995), that strategy will certainly backfire. At best, it will eliminate the current deficit for a few years, at the cost of significantly increasing problems down the road.

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[63] Early on Anif (1993) had pointed out that "populist interests have disavowed the essence of the reform, by providing that the government will cover any deficit in the pay-as-you-go scheme."

[64] In this regard, in 1992 one of the main contrarians to the reform had argued that "we want to avoid one of the main problems of the Chilean model, the concentration of resources in only a few funds" (C. López, 1992).

CHAPTER 4. A FRACTURED REFORM PROCESS: FROM EUPHORIA TO STANDSTILL

Colombians have traditionally been proud of the country's socio-political arrangement, and in particular of the continuity of policies and the absence, since the mid-1950s, of military involvement. It is usual to hear among Colombian intellectuals the idea that "in this country nothing major ever happens; and when something does, it is always by consensus."[65] How can we explain, then, that in little less than a year a boyish looking President aided by a small band of technocrats in their thirties introduced what appeared to be one of the most drastic reforms in the modern Western Hemisphere? Why did the Colombian reforms take the form they did? Who opposed the reforms? And, what form did this opposition take?

This chapter will attempt to answer some of these questions. In analyzing these issues we follow the framework discussed in Chapter 1, and try to determine whether the regularities observed in other countries -- such as a prior crisis, and the existence of an ideologically motivated group of technocrats, for example-- were present in Colombia. The chapter is organized in he following way: In the first section we discuss the general conception of the reforms. We deal with the role of ideas and the influence of the multilateral institutions --and in particular of the World Bank-- in shaping these ideas. We argue that, although the notion of opening up the economy had been accepted by

[65] This view can be found implicitly, for example, in Urrutia's (1989) important essay on the absence of populism in Colombia.

Colombian policy makers by early 1990, most influential figures were skeptical about the bulk of the other reforms. The small group of economists that designed the program --the so-called *"Grupo del Club Suizo"*-- was, to some extent, outside of Colombia's economic mainstream. In this section we also discuss the original strategy --based on gradualism and the compensation of losers-- and the way in which it was presented to the public. This section also deals with the political coalitions formed by the Gaviria administration in order to ensure passage in congress of the most important pieces of legislation. The bottom line of this section is that, contrary to what many analysts have argued --including Williamson (1994) and Urrutia (1994)--, the initiation of the Colombian deep reforms was only possible because the country was immersed in a deep political and social crisis.

The second part of the chapter deals with some specific aspects of the political strategy followed by Colombia's reformists. We analyze how potential opponents were neutralized early on, and we argue that the political and social crisis allowed the government to move swiftly on the economic sphere without attracting much attention from the media or the public. In third section we provide a brief analysis of the dismantling of the Exchange Controls Statute. As pointed out earlier, the importance of this measure lies, mostly, on its symbolic and signaling value.

The fourth section of this chapter deals with the opening of the economy. It addresses why, at least in principle, those sectors negatively affected by the internationalization process did not oppose it fiercely. In a way this is one of the most interesting aspects of the Colombian episode --as in Sherlock Holmes' famous case; the puzzle is why didn't the dog bark. Was it, as Naím has argued in the case of Venezuela, that the groups perceived as "ogres" ended up being "paper tigers," or was it these groups' rational response to the sequence of unfolding events? We argue, at the light of the discussion presented in the previous chapters, that the answer is closer to the latter than to the former interpretation. The final section of this chapter deals with the reaction of the reform opponents in 1992. We discuss the circumstances that allowed the reform-skeptics to slow down the process, bringing it to a virtual standstill.

The Overall Conception of the Reforms: Ideas and Strategy

A fascinating feature of many of the Latin American reforms of the late 1980s and first half of the 1990s, is that they have been led by presidents that either campaigned against market-orientation, or that had a long history of opposing that type of economic organization. This has been the case, for example, of Presidents Menem in Argentina, Fujimori in Peru --remember that, as a dark-horse, he won the presidential election by ridiculing Mario Vargas Llosa's reform program--, Pérez in Venezuela and Cardoso in Brazil. Wiliamson (1994) has called this phenomenon of opposing the reforms in the campaign trail, only to embrace them once in office, "voodoo economics." Colombia, however, presents a clear contrast to this trend. As pointed out in chapter 1, candidate César Gaviria clearly stated from the outset that if elected president he intended to push for a major shake-up of the Colombian economy. In fact, he argued for a reform program early on, during his primary campaign for the Liberal Party's presidential post. This reform effort was supposed to integrate gradually the country to the rest of the world, reduce government intervention and encourage the private sector's role in the development process.

How deep-rooted were Gaviria's market-oriented believes? How did César Gaviria, who after all appeared to many as a traditional professional politician, become a supporter of market-orientation? Who, if any one, had influenced him? Who were his close collaborators in this enterprise? How radical --or, should we ask, timid-- was the original program? What was the original strategy devised by the Gaviria administration to implement these reforms? How was the program presented to the public? Did the Gaviria administration have --as many involved in reform efforts, including Piñera (1994) and Naim (1993), consider as essential-- a concerted public relations program aimed at reducing the population's opposition to the program? These are some of the issues addressed in this and the following sections.

There is little doubt that from the beginning the reform program was as much candidate Gaviria's, as that of his closest associates, including Rudolf Hommes and Armando Montenegro, who would later become Finance Minister and Director of the National Planning Department, respectively. César Gaviria was trained as an economist at Universidad de los Andes, Bogotá's premiere private university, and according to those that knew him during his years as a student, Gaviria developed from very early on a critical view regarding CEPAL's import substitution development strategies, then in vogue in most of Latin America. In particular, he thought that the private sector should take a leading role in development process and that Colombia's way out of poverty required a greater integration of its economy to the rest of the world.[66]

Throughout the years a small number of Colombian economists had argued that Colombia should turn its back to the CEPAL-inspired import substitution strategy and open

[66] Some have intimated that Gaviria came from the provinces (Pereira) which affected his economic views. He is supposed to have been horrified by the influence of interest groups and by the multiplicity of deals that

up to the rest of the world. This was to be accomplished through a reduction of import licenses coverage and through a reduction in import tariffs levels. Rodrigo Botero was, perhaps, the father of the Colombian reformists. In the 1960s he became President Lleras' Economic Secretary of the Presidency, and later under the presidency of Alfonso López Michelsen he became Minister of Finance in 1974.[67] From both of these positions he unsuccessfully tried to persuade the Liberal Party's political leadership to begin a gradual reform process. During the administration of President Julio César Turbay (1978-82) a new attempt at igniting a trade liberalization reform was initiated. Among those in the administration that worked in the reform proposal was a young Vice Minister of Development, César Gaviria Trujillo.[68] This time, as in the past, the efforts were derailed by special interest groups, specially those associated to the powerful *ANDI*.[69]

Interestingly enough, in spite of having been Minister of Finance (1986-87) and Minister of Government (1987-90) during the Barco government, Gaviria did not participate very actively in the formulation of that administration's liberalization program. Gaviria's tenure as Finance Minister was rather short, and he devoted almost every effort to designing --and persuading congress to pass-- a substantial tax reform that, among other things, put an end to double taxation practices. Gaviria's views regarding the interaction between politics and economic policy had also been affected by his earlier tenure as

were cut between politicians and private sector representatives in Bogotá.

[67] In 1970 Botero founded Fedessarrollo, Colombia's -- and Latin America's, for that matter -- premiere economic think tank.

[68] Former Finance Minister Jaime Garcia Parra very kindly discussed with us a number of important issues concerning the origins of Colombia's reformist ideas.

[66] On *ANDI* see Urrutia (1983) and the brief description in Table 13.

Speaker of the House of Representatives during the Betancur administration. From this position congressman Gaviria resisted some of Betancur's populists initiatives. At that time he found out that the Banco de la República, with a long tradition of trying (not always successfully) to stabilize the economy, was a valuable ally in his efforts to deflect high expenditure and inflationary proposals.

As Minister of Government during the Barco government, César Gaviria devoted most of his time to addressing some of the most serious political problems faced by the administration. In particular, he spent time helping design the strategy for dealings with the guerrilla movement, as well as trying to set in motion a major revision of the constitution.

By the late 1980s an increasing number of Colombian economists were embracing Rodrigo Botero's ideas, and were beginning to advocate the implementation of some type of reform package. As we have pointed out above, by 1989 the reform fever had even reached the Barco administration which, out of a sense of inevitability, designed a gradual trade liberalization program. Moreover, and clearly more importantly, a small number of young politicians were beginning to lean --albeit slowly-- towards these ideas. The most important among them was Luis Carlos Galán, the young senator from the Liberal Party, and the leader of its *Nuevo Liberalismo* wing, that in 1989 had clearly become the front runner in the Liberal Party's internal quest to become the next presidential candidate.[70] Moreover, given the Liberal's traditional domination of Colombian politics, Galán was extremely well positioned for becoming the country's next president. Galán's economic program contemplated continuing --and even deepening-- the policies that at that time were

[70] In 1986 Galán had been a presidential pre candidate. He was defeated by president-to-be Virgilio Barco. After it was clear that Barco was the liberal's candidate, Galán declared that he would maintain his

being discussed by the Barco administration and that eventually would result in the reform manifesto *Modernización e Internacionalización*, issued in February of 1990. When candidate Galán is assassinated in August 1989, he became an instantaneous political martyr.

Throughout most of 1989 and early 1990 a group of economists, mostly associated with the modern wings of the Liberal Party --a wing increasingly associated with Gaviria's name--, began meeting in a Bogotá restaurant, the *Club Suizo,* to discuss the country's economic future. The de-facto coordinator of the group --which quickly became known as the *Club Suizo* group-- was Rudolf Hommes, who had advised Galán and later became Gaviria's main economic advisor.

What began as informal meetings, derived into a formal proposition for a new economic policy for the 1990s. This program was published in March of 1990 --two full months before the presidential elections-- in the monthly magazine *Estrategia Económica y Financiera*.[71] The article, which was written by Hommes (1990) and synthesized the views of the *Club Suizo* group, was titled "An Economic Proposal for the Nineties" (*Una Propuesta Económica para los Noventa*). The importance of this document is that it is one of the very few that allows us to know what Gaviria's economic team had in mind in terms of economic policy, before the elections. In fact, many of the most important elements of this document were later reproduced in the government's official National Development Plan (*La Revolución Pacífica*).

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independence.

[71] This magazine had been founded in the 1970s by Rodrigo Botero, Hommes and María Mercedes Cuéllar, who under the Barco administration became Director of the National Planning Department, and who was later to become one of the first members of the board of Colombia's new independent central bank.

An interesting question --and one that has some bearings on the interpretation of the political economy of the Colombian reforms-- is who was an actual member of this group. Cepeda (1995), for example, lists 11 people, most of which had been associated with the economics department of Universidad de los Andes. The "Proposal" article, on the other hand, in its opening footnote lists 26 names. Many of those in these lists went on to occupy very senior positions --including at the cabinet and sub cabinet levels- in the Gaviria administration. Two interesting features of these lists are worthwhile noting: first, the vast majority of those involved in the *Club Suizo* deliberations had graduate degrees from top US or European universities. Moreover, almost none of them had participated actively in politics. In that regard, this group constitutes the core of the Colombian *technopols* --the technocrats turned reformers and politicians-- which according to Williamson and Haggard (1994) and Dominguez (1997), among others, have played a key role in the launching of every one of the Latin American reforms. A second characteristic of this list that deserves some attention is that most of the members of Colombia's economic establishment are absent from it. For example, with the exception of Carlos Caballero, none of the past Executive Directors of Fedesarrollo participated in these meetings. Other prominent economists that for a long time dominated the Colombian economic debate were also absent from the group. There are, of course, several explanations for this fact, including the possibility that many members of the establishment did not agree with the general recommendations being made by the *Club Suizo* group. Although the members of the group were far from being unknowns, it may be argued that they were (at least partially) outsiders, with what appeared to be new, and even puzzling, ideas. Another interesting feature of the *Club Suizo* group is that many of its members had been associated with the

Banco de la República and, as is usually the case with central bankers, had a relatively low profile.

From today's perspective, and in a comparative context, the proposals made by the *Club Suizo* group, appear rather timid and even apologetic. Moreover, the *manifesto* clearly lacks the elements of a comprehensive, global and profound program. The fact that the Gaviria administration quickly surpassed the policies proposed in this document tend to support the view that the original Gaviria program was largely a "continuity program." Hommes (1998) himself has argued that "the reforms had a much broader scope than what was envisaged in mid 1990." The following are some of the most important aspects of the *Club Suizo* group manifesto:

- The document opens by providing a declaration of principles of sorts. It argues that while government intervention is key to correct market failures, it should not choke private sector initiative.
- A recurrent theme is that Colombia suffers a serious governance crisis and that any proposal for the nineties should be aimed at recovering the ability to govern. To that effect it proposes that the country should become significantly more decentralized, with departments and municipalities taking a greater responsibility in the provision of social services.
- It argues that the country's future economic development should be based on outward orientation and export growth. According to the document, a greater degree of global integration will result in enhanced productivity..
- It is argued that the economy should be opened slowly and partially: "[it is] convenient ...to moderately subject the mature sectors of the economy to the rigor of international

competition (p. 13)." There is only one possible reading of this statement: the opening up should be partial (*moderate*) and selective, that is, applicable only to those sectors that can survive with it (the *mature sectors*). Certainly, nothing radical here.

- The document clearly, and explicitly, supported a gradual approach to the reforms. In page 16 it says: "Regarding a rapid opening of our domestic market to foreign imports, ... we do not see the short and medium term benefits of such policy, but rather the short run costs in terms of output and employment."
- The opening up was to be done in conjunction with an enhanced program of export incentives, including export subsidies ("..a dynamic *Plan Vallejo*...(p. 17)"). The idea was that "gradually, and as a result of productivity increases in the domestic industry, it would be possible to reduce protection [to Colombian firms] (p.16)."
- The list of forbidden imports was to be maintained, and only goods with which the domestic industry could compete comfortably were to be exempted from obtaining import licenses. Only the importation of machinery and capital goods not manufactured in the country was to be exempted from import licenses, and from import duty surcharges.
- The document gave a central role to the real exchange rate in Colombia's economic future. It recognized that a "competitive" real exchange rate was a fundamental determinant of exports performance, and argued that the "effective real exchange rate for exporters of [industrial and nontraditional] products, including subsidies and other incentives, should continue to be depreciated ... (p. 15). And it went on to say that "in general, the real exchange rate should not be allowed to appreciate at any time ...

(p.16)".[72]

- The document recognized that inflation had gotten out of hand, and argued for its gradual control. The document talks about achieving inflation levels below 15% in the medium run, and below 10% in a ten years period. Three factors were singled out as affecting inflation: (a) excessive money creation; (b) fiscal imbalances; and (c) the entrenched use of indexation, which had created a significant degree of inflationary inertia. The document went on to say that unless indexation came to an end, it would be very difficult to defeat inflation.
- Sectoral subsidies --especially to agriculture, food production and non traditional exports-- were an important component of the proposed strategy. Regarding the agriculture sector, the document states that "it is necessary to give a new impulse to the agrarian reform, and to complementary fiscal mechanisms that would encourage higher productivity in the country side, as well as making land tenure more uniform (page 13)".
- Public expenditure was to be redirected towards the judicial system --this was part of the overall project to improve the country's governance--, and to the provision of social services --education and health-- to the poorer segments of society.[73]
- The manifesto called for a mild financial reform --based on freezing the volume of forced credit allocation in nominal terms--, a gradual increase in international competition and a slow reduction in interest rate subsidies.

[72] Interestingly, the document argued that even in the presence of a commodity export boom, real exchange rate appreciation should be avoided.

[73] See Montenegro's (1994) fascinating analysis of the Colombian judiciary.

- There is virtually no reference to capital mobility in the manifesto. The closest it gets to it is in discussing financial reform, where in a rather vague paragraph it argues in favor of allowing the inflow of foreign capital into the financial sector, as along as these funds are devoted to capitalizing new financial intermediaries. The document has, however, three long paragraphs arguing that the country should be more open with respect to direct foreign investment.
- The manifesto recognized that labor issues --including unemployment-- were central in the economic debate. It stated that since the construction sector were a major creator of jobs, it should continue to receive government support. Moreover, it argued that the public sector should continue to have the monopoly of low income housing construction. The document also argued that it was essential, especially within the context of a more open economy, to reform Colombia's labor market, including its minimum wage provisions.[74]

Although candidate Gaviria participated in only a few of the meetings, this manifesto clearly represented the core of his campaign's economic ideas.[75] He was, of course, aware of the *Club Suizo* group activities and received periodical briefings on the different issues being discussed.

[74] As was mentioned in the previous chapter, the final drafting of the new labor regulations imply no change at all regarding minimum wage policy.

[72] Cepeda (1995) argues that Gaviria did not participate in any of the meetings. In a personal interview, held on September 4, 1997, ex President Gaviria told one of the author's that he had participated briefly in a couple of them. He also pointed out that many years earlier he used to discuss economic issue at the *Club Suizo* with a small group of people that included Rodrigo Botero. He also pointed out that for a long time he would periodically meet with Ernesto Samper, Juan Manuel Santos and Guillermo Perry to discuss public policy issues.

As the campaign progressed, however, Gaviria started to develop a number of new ideas of his own, many of which had not been discussed by the *Club Suizo* group --or, if discussed, had been discarded as ineffective. Perhaps the most important of these ideas referred to the abolition of the Capital Controls provision of Decree 444, that for more than twenty years had governed Colombia's exchange rate policy. In fact, already in late 1989, still as a candidate for the Liberal party's presidential primaries, he stated that it was necessary to reform --but, notice, *not* abolish-- the capital controls regulations. In one of his campaign appeareances he stated that "it is not worth having regulations that nobody complies with. However, some exchange controls have to be maintained."[76]

Disarming the Opponents: The Politics of Coalitions, Compensation and Preemptive Strikes

The framework developed in chapter 1, as well as extensive historical experiences (Williamson 1994), suggests that many successful reformist strategies have been based on the government's ability to: (a) forge broad political alliances; (b) devise effective compensation schemes that neutralize losers; and (c) isolate the reform opponents. During the first eighteen months of his administration, César Gaviria proved to be a master at these three tasks. He was able to obtain broad support for his overall --and not only for his economic-- program, he seduced his opponents, and convinced the population at large that his program was essential for the survival of the country. As discussed above, even before being sworn into office, Gaviria had been able to negotiate successfully with all political forces in the country, in order to open the door to convening the constitutional reform

[76] Gaviria (1994). Campaign speeches.

assembly. The convening of a constituent assembly might not have been his idea, but he was certainly instrumental in making it a reality.

As noted, it is only possible to understand Colombia's economic reforms within the broader context of the overall Gaviria program. This had four main elements: (1) reforming the economy along the lines discussed above; (2) launching a major political reform, whose corner stone was the constitutional reform; (3) forging a broad peace agreement with the guerrilla movement; and (4) eliminating the influence that the drug cartels had acquired in Colombia's society.

During the first months of the administration the political and drug-relate programs overwhelmingly captured the attention of the public. The peace process launched on August 30th was considered a major breakthrough, as was the fact that a Constitutional Assembly had been convened. Moreover, the very high percentage of the vote received by the former guerrilla movement M-19 in the election of the assembly had become a dominant news. Between August and September the war against drug trafficking was stepped up, when the drug lords went through a kidnapping rampage. A number of influential people were abducted, including journalists Diana Turbay --daughter of former president Julio César Turbay -- and Francisco Santos, a heir from the *El Tiempo* newspaper dynasty. These major developments in non economic fronts allowed the economic team to quietly, but effectively, push forward some of the most important early political measures, including the labor, financial and tax reforms.

But the fact that the public was "distracted" by other initiatives is not the only --and maybe not even the most important-- explanation behind the rapid implementation of the reform agenda during the first half of the administration. Nor can this progress be attributed to a run-of-the-mill "honeymoon" period. It was much more than that. In fact, it is possible to argue that the rapid implementation of a number of key reforms during the first eighteen months of the administration was the result of a deliberate strategy aimed at forming broad coalitions and compensating key opponents in a variety of ways.

In this section we focus on five factors that helped provide a positive environment for the implementation of the reform program: (i) the formation of coalitions; (ii) the generous use of compensation --either actual or based on promises-- mechanisms; (iii) the (surprisingly) early collaborative role of congress: (iv) the role of pubic relations: and (v) a largely positive international environment.

As we discussed in chapter 1, Colombia has a long tradition of forging political coalitions. In fact, between 1958 and 1968 --the so called *Frente Nacional* period-- the Liberal and Conservative parties had a coalition that allowed them to alternate power. As soon as Gaviria won the elections he started forming a number of key coalitions, that would provide his government with a broad support. Early on he was able to attract three groups that, if left outside the government, had the potential of strongly opposing (parts of) his program: (i) the conservative party; (ii) the former guerrilla movement that had joined the democratic process party; and (iii) the more interventionist wing of his own (Liberal) party, led by Ernesto Samper, his former rival in the liberal primary and, eventually, his successor as president. As a result of these coalitions, President Gaviria's initial cabinet looked like a cross section of Colombia's political spectrum, with eleven members from the liberal party --including Ernesto Samper as Minister of Development, a post that would give him a strong voice in implementing the opening of the economy--, four members of the conservative party, one from the AD M-19 (the party of the former M-19 guerrilla approval of most of the reforms. In the first place, the president was very prestigious. Second, there was significant popular support for the Constituent Assembly. Third, the president had been elected on a platform of reform and in his inaugural address had explicitly mentioned those areas in which reforms would be introduced.[80] Finally, Gaviria's ability to work with congress has acknowledged to be quite remarkable.

The Gaviria reform program --or at least the way it was announced during the early months of the administration-- had a number of key built-in compensation mechanisms which, either by design or *de facto*, reduced the opposition to the modernization effort. Table 24 presents a schematic picture of the way in which some of the most important actors saw the reform prospects, including the areas were they expected to benefit from the modernization process. The key feature of this table is that it explicitly lists the compensation mechanisms that were offered -- either explicitly or implicitly -- to these key actors, in order to gain their support for --or at least deflect their opposition to-- the modernization program.

Four aspects of this table deserve some attention. First, these mechanisms were *promised* to these actors and, thus, their effectiveness rested largely on the tremendous credibility of the President, and on his remarkable mastery at charming opponents. Second, no one --not even senior members of the administration-- seemed to realize that many of these mechanisms were inconsistent among themselves and that, as a result of this, it was rather unlikely that the government could deliver on all of them. Third, given the extremely

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[80] Having been outspoken about the need to introduce market-oriented reforms in the campaign trail certainly contrasts with most other regional experiences. It is a well known fact that presidents Menem in Argentina and Fujimori in Peru, two of the fiercest reformers in the region, run for the presidency on explicitly populist platform.

Table 24. Perceived Opportunities and *Promised* Compensation Mechanisms

INTEREST GROUP	COMPENSATION	COMMENTS
Major public sector unions	- Possibility of consolidating rent seeking through provisions in new constitution. - Excluded from most labor reform provisions they were more willing to support program.	- See the discussion on the 1991 constitution presented above.
Rest of labor movement	- Support to union activities and other ILO provisions in new labor law.	- Although the reform reduced many benefits, it strengthened the position of unions.
FEDECAFE	- Labor reform. - The promise that the real exchange rate would not be allowed to appreciate during coffee booms was attractive.	
SAC (Agriculture)	- Subsidies to agriculture supported by *Club Suizo* group. - Reduced protection to inputs, including machinery. - Depreciated real exchange rate.	- Depreciated RER was already in place when Gaviria took over. - The special treatment to the sector could -- as it ended up being the case – be incorporated into the constitution.
ANALDEX (Exporters)	- Depreciated real exchange rate - Additional subsidies to nontraditional exports.	- Interested in ports privatization, reform of customs and subsidized export credit.
ANDI (Manufacturing sector)	- Depreciated real exchange rate. - Lower interest rates in case financial reform was enacted. - Labor reform. - Reduced overall volatility of economic policy in the future.	- Insisted from early on that the process should be seen as a package. It strongly favored some of the components, such as labor reform. - Sequencing was very important.
FENALCO (Retail commerce).	- Lower interest rates. - Lower import tariffs.	

movement) and one from the armed forces. Later in his administration Gaviria would appoint Colombia's first civilian defense minister in a long time. This important step was an essential component of his plan to further democratize Colombia. In line with his overall strategy, Gaviria first "compensated" the armed forces by greatly increasing their budged, including --and very especially-- officers salaries.

According to Silva (1998), Gaviria's original cabinet was the first Frente Nacional type of cabinet, following the Frente Nacional period. This fact, in addition to the congressional support that most reform initiatives received from members of Congress of the conservative party, sheds doubts on Cepeda's (1994) argument that the reforms undertaken in Colombia had their ideological basis on the ideas of Galán, as advanced by Gaviria.[77] Writing while events were unraveling, Montenegro (1992) argued that the reform program was liberal in nature. Presumably, he was referring to the nineteen century concept of liberalism –preeminence of the market, competition, etc...—and not to any Colombian partisan connotation of the concept.

It would be tempting to argue that the inclusion of conservatives in the cabinet did not reflect an attempt to form a broad-based coalition, but was merely the result of applying art 120 of the constitution, that called for an "adequate and fair participation" of the 'other' party in the cabinet. This, however, would be a mistaken reading of Gaviria's intentions. In fact, the exclusion --or voluntary abstention-- of members of the conservative party in the Barco administration cabinet had put an effective end to the "*paridad*" principle.

The inclusion of Ernesto Samper in the cabinet was particularly important for

[77] By the way, this idea is also challenged by Vallejo (1994) in his prologue to Cepeda's book.

advancing the reform program. Certainly more important than forging a coalition with the conservative party or with former members of the guerrilla. Samper was then an open reform skeptic, that believed in marginally modifying, and very slowly, the protectionist structure of the country. More importantly, perhaps, he was extremely popular among the more traditional liberal politicians and had a tremendous influence among members of congress --an institution where he had served as senator. Moreover, Samper had also influence among some --but not many-- groups in the private sectors, and especially among those industrialists that more strongly questioned the wisdom of a rapid liberalization of the economy.[78] By having Samper in the cabinet, then, Gaviria was able to neutralize --if not get their open support-- the more traditional wing of the liberals and the industrial lobby. In exchange, he assured Samper that no major policy related to the opening of the economy would be undertaken without his input.[79] This, in the eyes of most observers, would ensure that, as it had been announced so many times, the reforms would indeed be carried out in a gradual fashion. Vargas (1993) reports that at first Samper resisted the Development post, as he thought that some one of his stature and ambitions could not accept any post but Foreign Affairs or Government (i.e. the equivalent of Interior).

Cepeda (1994) mentions several other factors that allowed for swift congressional

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[78] Samper had been president of ANIF, the financial institutions lobbying group. At the time he gained particular notoriety for supporting the legalization of marijuana, a rather innocuous statement that would come back to haunt him, especially in regard to his relations with the United States, when he became president.

[79] This way of doing things is certainly subject to critisism. In his analysis of the Chilean reform process, Piñera (1994) highlights the fact that Chile had a "team of like-minded and similarly trained economists." Furthermore, he questions the wisdom of some other South American country, whose "president told me that he was appointing a minister of economics who shared the views of the Chilean team, but to keep him in line and to have the benefit of their opposing views, he was naming to the labor ministry someone of a very different orientation.".

Major conglomerates	- Privatization opened up opportunities to participate in areas until then closed to them (i.e. telecommunications).	
Armed Forces and Judiciary	- Stepping up of the war against drugs meant increased budgets and influence. - Military excluded on key provisions of labor market and pension reforms.	
Politicians	- A new constitution gave them the chance to increase their standing in society, as well as their power. - Most politicians would benefit from more decentralization.	
Drug cartels	- Non extradition provision in the new constitution was key to them - Maybe financial reform would allow them to move internationally funds more freely. - Privatization would allow them to move into legal business.	
Bureaucracy	- Some saw an opportunity for greater influence, and especially for greater salaries, in the *Club Suizo* group's call for a major upgrading of the civil service.	

Source: Elaborated by the author's.

broad nature of the Gaviria's administration national project, it was possible to offer compensation mechanisms in areas different from the strictly economic. That is, in terms of the classification in Table 1, the Gaviria administration made intensive use of cross-compensation mechanisms.

And fourth, maintaining a highly depreciated real exchange rate --and even, further depreciating it-- was the key compensation mechanism offered to most of the influential private sector *gremios*, in order to obtain their support for the trade liberalization reform. Exporters recognized openly that they had agreed to support the reform process because of the promise of a more depreciated real exchange rate. For example, in a 1992 speech, when disillusionment had already sank in, the Executive President of *ANALDEX* stated that "when the government announced the opening-up program, it offered to compensate the loss in competitiveness ...through a more depreciated real exchange rate" (Ramirez 1992, p. 12).

Between August 1990 and July 1991, when it was abolished, congress provided a wholesale support to the modernization --both political and economic-- process. Some observers have been puzzled by this behavior, since at that time congress as an institution, and its members as national leaders, were being seriously questioned by the population at large. Below we suggest that Congress was acting rationally, given up-coming elections. Of course, this meant that the support granted was quite superficial, and very easily reversible.

In December 1991, when the new congress was elected, things changed markedly, as its members became increasingly skeptic about the reform process. Or more precisely, they started acting according to their true ideological convictions. Suddenly, the support that the administration had enjoyed during its first 18 months became more guarded, and in some cases it just was not there. What makes this change of heart in congress's support particularly paradoxical is that in the October 1991 election, President Gaviria's liberal party maintained a comfortable majority in both chambers of congress --54 percent of the lower house and 55 percent of the senate.[81] As Silva (1997) points out, many of the liberal party members of congress were open critics of the reforms, and referred to them with utmost contempt as "cruel neo liberal reforms."

How can we explain this early backing, and later skepticism? The initial support was the result of two related factors: First, president Gaviria's coalition-making --and in particular the incorporation of his former rival Ernesto Samper to the cabinet-- assured that his initiatives would be supported by all wings of the Liberal party. Second, in 1990-91 politicians in general --and members of congress in particular-- felt that they were under significant public scrutiny for failing to deliver change and meaningful legislation. There was, thus, a generalized feeling among members of congress that by moving the government's legislative agenda swiftly their reputation would be, at least partially, repaired. Moreover, with a new election in sight individual members of congress were under personal pressure to perform.

By December 1991 the political picture had changed significantly, however. First, Ernesto Samper was out of the cabinet -- having resigned because he disagreed on the increased speed of the reform process --, and his (reform skeptic) supporters had a dominant

[81] The terrible post-constituent assembly electoral results of political movements different from the two traditional parties is difficult to explain. Silva (1998) has suggested that it might be related to the fact that their two prominent figures –Navarro and Gómez Hurtado—had been members of the assembly and, therefore, could not head the lists of their organizations in the congressional elections. In any event, it is telling evidence of how short-lived dissenting political movements have always been in Colombia.

position in congress. The new congress had a very large contingent of rookies, who did not feel the reputational-based pressure of their predecessors.

As noted, a number of analysts have argued the existence of a comprehensive and effective media strategy is a fundamental component of any successful reform program (Haggard and Williamson 1995). Naim (1993) has gone as far as saying that the lack of such type of program was at the heart of the failure of the Pérez reforms in Venezuela.

Cepeda (1994) argues that the Gaviria administration masterfully managed relations with the press, a particularly important matter given that, according to Cepeda, Gaviria had never been a favorite of the press. He goes on to say that a well functioning public relations team headed by Mauricio Vargas, a self-trained journalist in his late 20s, was swiftly assembled. This statement appears to go too far, however. As the administration's Communications Minister Mauricio Vargas himself acknowledges in his memoirs (Vargas, 1993), from day one there were permanent leaks to the press, key communiqués were delayed, and some crucial initiatives, such as the attempt to privatize (partially) the telephone company were undertaken without having previously launched a comprehensive public relations offensive.

In any event, two issues are worth recalling. On the one hand, Gaviria appointed Juan Manuel Santos –heir to the *El Tiempo* dynasty and at the time Deputy Director of the newspaper, by far Colombia's most influential daily-- to the newly created and highly visible Ministry of Trade. Second, and following Herrán (1998), government's have always used the concession of space in publicly-owned radio and television frequencies to garner support for its policies. In her words, as a "reward" to those that will probably favorably report on government policy.[82]

During 1990 and 1991 Colombia faced an extremely positive international environment, which provided a friendly backdrop for undertaking the reforms. The price of coffee stabilized, international interest rates declined significantly and the international financial community was rediscovering Latin America. In 1990 there already was a surge in capital flowing into the region and in 1991, Latin America experienced, for the first time in a decade a positive net resource transfer from the rest of the world. Moreover, the multilateral institutions --and especially the World Bank-- became increasingly enamored of Colombia, providing technical and financial support to a number of key initiatives, including decentralization, financial reform and trade liberalization. This multilateral support allowed the administration to claim, in various forums, that its economic policy program was technically sound and had been given a "seal of approval" by an impartial institution.

The Abolition of Exchange Controls: A Symbolic Measure

In 1990, and to the surprise of many international observers of the Colombian scene, the foreign exchange market was liberalized, putting an end to more almost 25 years of exchange controls. Although it is possible to argue that from a strictly economic point of view this constituted a minor reform, it had a tremendous symbolic effect. For years Colombian economists, politicians and business people had credited Decree 444 of 1967 as a fundamental pillar of Colombia's economic success. By monopolizing foreign exchange

[82] With regard to this, the elaboration of rules for mobile phones during the Gaviria administration was an eloquent example of the cost of "adapting" technology to the Colombian reality: the results of the public

operations, the Banco de la República maintained a sense of stability, and had assured exporters that the real exchange rate would not become overvalued. Law 9, of January 1991, put an end to all of that. A number of decrees issued in the months to followed, as well as some key Banco de la República resolutions, opened up the door for a more modern treatment of foreign exchange transactions, as well as a more flexible nominal exchange rate policy. At the same time, a general amnesty was given to Colombian nationals that had kept foreign exchange outside the country. The combination of these measures resulted, as we will see, in very massive inflows of capital into the country and in significant pressures towards appreciating the real exchange rate. This, in turn, complicated things considerably from a political economy point of view, as one by one groups that had supported the reforms turned their backs to them.

From a political economy perspective, the importance of this reform was not related to what happened after it was enacted, but what *did not* happen. There was no generalized outcry, nor accusations that a major institution had been abandoned, nor charges of excessive neo-liberalism. Almost nothing happened. The reform barely made the front page of the papers, and in the midst of the reformist euphoria was quickly forgotten. Only a handful of professional economists had opposed it --including the staff and leadership of the central bank. Their position was argued on strict professional terms, but there is no doubt that there was also an element of self interest. It was not trivial for the institution that had monopolized foreign exchange transactions for so long to give up that role easily. In any event, the bank's main opposition to the reform –"the well known volatility of capital

auction were further concentration and higher prices. It is important to mention that the owners of cellular phone companies are also the most powerful programmers and announcers.

flows" (Banco de la República, 1990, pg. IX)—though controversial, would be an argument espoused by many during the post-1993 period to introduce Chilean-style controls on short-term capital inflows.

In order to avoid surprises, and make sure that the party elders would not turn against the measure, President Gaviria asked his collaborators to inform some key players about the plan. The main concern was that the highly respected former president Carlos Lleras Restrepo, in whose administration Decree 444 had been issued, would be critical. He listened carefully and recommended that things were done carefully. The approval of Law 9 provided important lessons to the administration on the political economy of reform. Timing was essential. It was key to introduce changes from a position of strength, were opponents could be easily isolated. At the time exchange controls were abolished, the country was facing a benign --if not openly positive-- international environment, foreign exchange was plentiful and the real exchange rate was still at highly depreciated. In a way the reform was implemented at a time when the controls were not binding, and no one noticed --at least immediately-- any changes. Law 9, however, allowed for a significantly higher degree of capital mobility. During most of 1991 Colombian nationals as well as foreigners made use of these provisions, as they took advantage of the existence of remarkably high interest rate differentials. Paradoxically, as will be seen in the discussion that follows, during most of 1991 the authorities (mistakenly) undertook policies that maintained these differentials, attracting further capital into the country.

Though it had significant signaling effects, one should not loose sight of the fact that when the foreign exchange regime that dated from 1967 was suppressed, very few were complying with it. According to Hommes (1994), "we have been criticized for doing away with capital controls that nobody abided by, that did not prevent foreign capital from coming in and that, at most, pretended to impede it from going out."

During the presidential campaign, Gaviria (1989-1990) had said "it was not worth having regulations that nobody complied with." [83]

Urrutia (1994) provides a very interesting account of events surrounding exchange control liberalization. On the one hand, he points out that capital controls harmed most everybody, and therefore had very few supporters. Even those who at the time of the reform would presumably be adversely affected by the opening of the capital account – exporters who, as a result of expected capital inflows, would face a more appreciated exchange rate—could hardly go against the government's initiative "since most exporters had illegal accounts and investments abroad." On the other hand, he praises the government for undertaking the reform of the exchange regime in Congress, and not in the context of the Monetary Board. In the latter, the governor of the central bank was particularly influential, while in Congress the Finance Minister could muster enough support.

It is a well-known fact that illegal activities are an important part of Colombia's everyday life.[84] While some uninformed analysts --particularly the DEA (1994)-- have suggested that capital account liberalization was undertaken in order to make life easier for

[83] The lack of effectiveness of capital controls was no obstacle for the DEA (1994) to argue that the main beneficiaries of opening the capital account would be those involved in illegal activities. Steiner (1998) has a detailed analysis of the balance of payments implications of the drug trade. He focuses on the adverse effects of having *effectively* segmented the exchange rate market in two tiers, one legal, the other one illegal. The *negative* black market premium –a rarity by any extent of the imagination— promoted contraband –i.e. corruption and tax evasion—and through it made the Colombian economy much more open than what official numbers suggest.

[84] On the importance of drugs in the Colombian economy see Steiner (1998).

drug-trafficking organizations, Ranis (1994) makes the very interesting point that "as society came to place increasing weight on minimizing illegal activity, it seemed more attractive to eliminate the pervasive controls and regulations that had driven much of foreign trade (for example) into the black economy." This interpretation is very much in line with Hommes's (1998) argument that the foreign exchange regime had become a social totem, basically untouchable, in spite of the fact that almost nobody complied with it, and that it had become a rather ineffective tool of economic policy.

The Opening of International Trade: The Dog that didn't Bark?

There is little doubt that the 1990-1991 Colombian trade reform was one of the most dramatic ever undertaken in a Latin American country --or in the world, for that matter. This was an impressive reform from various perspectives. First, the sheer magnitude of the reform was remarkable --see Table 21 for information on the itinerary of import licenses coverage. Second, in spite of announcements and, perhaps more importantly, of Colombia's tradition with gradualism, the reform was carried out very quickly. In fact the acceleration of import duties reduction implemented in mid 1991 constituted a major turning point in the Colombian approach to economic policy making[85]. Third, this trade opening took place at a time a powerful and open reform-skeptic --Ernesto Samper--, was at the helm of the Ministry of Development. And fourth, the whole process took place with minimal opposition on behalf of those groups and *gremios* supposedly hit hard by the

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[85] Notwithstandind the fact that trade reform was originally conceived as a gradual process, in the campaign trail candidate Gaviria went on record as saying that he found "inconceivable that the reform process is so timid and that its gradual nature is justified on a pessimistic view of the international economic situation."

reforms. In particular the *ANDI,* which in the past had successfully opposed major liberalization reforms, was remarkably quite. It was, in Sherlock Holmes' parlance, the dog that did not bark.

As pointed out in the previous section, the original program was to finish the trade reform process by late 1994. By March of 1991 it was becoming increasingly clear, however, that the reform was not having the effects the economic team had anticipated. Perhaps the most surprising fact was that imports were not growing and, as a result of it, the country was experimenting an increasing trade surplus. This, in conjunction with large inflows of capital --resulting from the abolition of exchange controls and the amnesty granted to foreign securities holders--, was pressuring on money supply, making macroeconomic management very difficult. As inflation increased, the real exchange rate began to lose ground and both exporters and income competing sectors began to lose competitiveness.

The Banco de la República reacted to this situation by implementing a series of policies, which in retrospect appear to have been contradictory among themselves. First, an aggressive policy of sterilizing reserve accumulation was undertaken. This was done by issuing indexed short term securities (the OMAs). In the first 10 months of 1991 the stock of this instrument shot up from $405 million to $1.2 billion, or 85% of the monetary base. Naturally, this policy resulted in an increase in domestic (peso denominated) interest rates, and a significant interest rate differential. This attracted further capital into the country, frustrating the sterilization policy itself. Second, the authorities decided --as it had done in the past when facing coffee booms-- to postpone the monetization of export proceeds. For this reason, in 1991 the Banco de la República started to issue "exchange certificates" *(certificados de cambio)* in exchange for foreign exchange. These certificates could be traded in the secondary market, and initially had a 3 months maturity, which was later extended to one year. Moreover, the central bank established a maximum discount for the certificates in the secondary market of 12.5 percent.

All of this, of course amounted to an attempt at controlling too many variables --the spot and future exchange rates, the nominal interest rate and the stock of money-- at inconsistent levels. During the first 10 months of 1991 Colombia had been trapped in a vicious circle: a very rapid process of reserve accumulation, generated high inflation and a real exchange rate appreciation; but the policies put in place to combat these phenomena created incentives for capital inflows and a further appreciation of the real exchange rate. Paradoxically perhaps, one of the monetary authorities' main concerns in mid 1991 was how to engineer an end to the accumulation of reserves.[86]

These events generated two political problems to the Gaviria administration. First, exporters and import competing sectors were becoming increasingly unhappy with the real appreciation of the peso and, second, the lack of progress in the anti-inflationary front was a black spot in an otherwise quite positive picture[87]. In a way, the administration was facing some unforeseen costs of the trade reform without getting its benefits in the form of higher

[86] In a 1993 interview –see Giraldo (1993)-- Minister Hommes would later say that capital inflows and reserve accumulation were actually an intended policy. That is, interest rates were increased in order to attract foreign financing and make the balance of payments sustainable under a liberalized trade regime. This ex post facto rationalization is controverted by Urrutia (1994) and by Steiner (1996).

[87] In November 1991 ANALDEX argued that "given the continous changes in the rules of the game, trade reform lacks credibility. The exchange rate appreciation and the reduction in tariffs fosters contraband and imply an aggression to domestic production." (Exponotas No 22, November, 1991). Despite being a technical nonsense, the argument according to which trade liberalization stimulates contraband is continuously put to the forefront by business organizations, and seldomly challenged by the authorities.

imports. The question then was how to stimulate imports.[88]

According to Vargas (1993), in May 1991 President Gaviria already contemplated the acceleration of the liberalization process as a way of stimulating imports. Urrutia (1994) persuasively argues that the President pushed for the acceleration of trade liberalization as a way to control inflation.

In that sense, the 1989-1991 trade reform --though justified on grounds of lagging productivity and the need to incorporate Colombia into the global economy—was actually very much determined by macroeconomic issues, very much as previous liberalization attempts. This point is worth highlighting when discussing the sustainability of the reform process. Politically, there were pros and cons for the option of accelerating the reduction in import tariffs. On the positive side, it would contribute to solving the macroeconomic management difficulties. Additionally, it would move forward in time the expected unemployment costs of the final rounds of trade reform.[89] This appeared to be attractive in a situation where the government was facing an unprecedented degree of popularity.[90] Urrutia (1994) provides a very interesting interpretation –based on a conversation he had with Gaviria himself-- when he points out that "one can also consider the hypothesis that although the president gave strictly economic arguments for his initiative, he might also

[88] In Urrutia (1993) Ocampo –Minister Samper's principal advisor and who was to become Minister of Agriculture in 1993-- argued that "it was the mistakes in macroeconomic policy that led to sacrifice the gradual nature of trade reform and the success of non-traditional exports." With or without hindsight this statement is almost irrefutable. The discussion that follows in the text certainly supports the argument that exchange rate overvaluation –regardless of whether it was the result of bad fiscal policy or inadequate nominal exchange rate management-- became the issue of utmost concern for most business organizations.

[89] As it turned out, however, there was very little unemployment generated by the trade opening reform.

[90] Interview with President Gaviria, September 4, 1997.

have felt that, given the very comfortable level of international reserves, a once-and-for-all liberalization would be less costly politically than the possibility of a long, drawn-out debate about liberalization during the whole four years of the programmed tariff reductions." If that interpretation is correct, then once again expediency might have to be balanced with sustainability.

On the negative side, accelerating the reforms meant breaking up with Samper who, as Minister of Development, had been assured would have a fundamental say in the reform process. And, given Samper's background and his constituencies, it was highly unlikely that he would agree with this change in policy pace. Additionally, there was no assurance that the acceleration of the reform would actually work. Of course, it was possible that imports would not pick up, and that real exchange rate appreciation would continue. This would be the worse of worlds. Tradable goods producers would be hit by the more rapid duty reduction, and would fail to be compensated through a real exchange rate change.

At the end Gaviria decided to take the gamble, and to move in October 1991, straight to the final phase of the reforms. Vargas (1993) provides an insider's account of the process leading to this drastic change in policy course. From it, and from the accounts of others -- including Gaviria himself --, it is clear that this was his own idea, and that it was undertaken in the understanding that Samper would leave the cabinet. This he did, and in late 1991 he became Colombia's ambassador to Spain and started working on his presidential bid. In a farewell speech delivered at an *ANDI* meeting, Samper intimated that he had sympathy towards the industrial sector's growing apprehensions about the reforms. He said: "I share exporters concerns... a few weeks ago I proposed an acceleration in the rate of devaluation, [and suggested] providing credit at more favorable conditions...(Samper, 1991, p. 29)"

Why didn't the *gremios,* and especially the *ANDI*, Fedemetal and ANALDEX react forcefully to the liberalization process? Was it because, as Urrutia (1983) has argued, all *gremios* were "paper tigers"? Or was it because they understood that a market-oriented system, including a more liberal trade regime was, at the end, beneficial to the whole country?

The answer, we believe, is complex, and has to do with regional rivalries, ANDI's leadership, international experiences and Gaviria's policies of (indirectly) compensating the reform's potential opponents. As tables 13 and 24 show, although the ANDI and the other industrial *gremios* had misgivings regarding trade liberalization, they favored most of the other reforms. In fact a number of them, including the privatization of ports and the labor reform, had direct positive effects on their activities. To the extent that the reforms were considered as a package --and as long as the government could deliver on its promised "compensations"--, the gremios were willing --some more reluctantly than others-- to support the package. This attitude was clearly influenced by the experiences of Chile and Mexico, which at the time were seen as important illustrations of successful reforms aimed at implementing a market-oriented economic system and at opening the economy up to international competition.

The fact that the *ANDI* considered the reforms as a package is clearly captured by the pronouncements of its leadership. For example, in a speech delivered in Cancún, Mexico in August 1990, Fabio Echeverri Correa (1990), the President of *ANDI*, pointed out that "[t]he process of modernizing the economy should not be understood as a simple program of imports liberalization, that supposedly has the magic virtue of automatically making the productive sector more productive. No. Modernization is a very complex process, that requires an integral, gradual and selective program (p.7)." He emphasized that in order for this broad program to work it was necessary to "modernize ports' infrastructure..[and] to create a financial market that would provide long term financing...(p. 6)." Moreover, he noted that it was essential to implement a "labor market's reform that would add considerable flexibility to the current labor legislation (p. 7)." The bottom line of *ANDI*'s position was unmistakable: the Colombian industrial sector would support this broadly defined reform package, "as long as it effectively removes the difficulties that currently limit the private sector efforts to become more efficient and productive...(p. 7)" In the same speech the president of *ANDI* noted his concerns regarding the preeminent role the administration had given to the exchange rate policy as a compensation mechanism. He reiterated that "Colombian industrialists support, in general terms, the program's philosophy. We disagree, however, with some aspects...[T]he government has delegated too much responsibility on exchange rate policy. This is not good because international economic relations are not transparent...(p. 8)".

On the other hand, in June 1990, SAC publicly accepted the Apertura program arguing, through a letter to the elected president, that "having exhausted the model of import substitution, that meant a high degree of discrimination against rural activities, and after having achieved self-sufficiency in the most important products of the family consumption basket, SAC considers that it is imperative to penetrate in a more determined fashion into international markets".

In addition to their supportive position, the letter argues for a reorientation of agricultural credit policy. A series of decrees from the National Government and diverse resolutions from the Monetary Board, had ruled out a number of forced investments. The letter stated that "it is imperative to rescue the forced investment regime of commercial banks towards agriculture".[91]

Six months later, in December, an editorial of this gilds' magazines warns that "to avoid unnecessary and painful traumas from the trade liberalization process, it is a welcome news that will be gradual and selective, without shock policies".[92]

In early 1991 ANDI came back to the idea that the reforms should be seen as a package. This time, however, it argued that there was an optimal sequencing of reform. According to a document prepared by *ANDI's* Economic Vice-presidency, "before opening the economy to foreign competition, it is healthy and logical to solve the infrastructure problems, tackle the excessive red tape, and rationalize the size of the state...(ANDI 1991, p. 7)." This document comes back --one could argue that with dramatic premonition-- to the exchange rate issue: "We consider...that the exchange rate is a necessary but not, a sufficient element for defining an opening strategy (p. 9)."

With time, however, some of the most important *gremios* ended up opposing many of the reforms, and in particular the trade liberalization effort. Although in a way it was too late, they did what they could to regroup. Agriculture-based *gremios* were particularly successful, as they were able to obtain legislation aimed at protecting their interests, including surcharges, support prices and reference prices.

In little over one year there was a remarkable contrast in the SAC's attitude towards the reforms. While in August 1990 its president openly supported the reforms program, in

[91] Revista Nacional de Agricultura, No 891 June 1990.

March 1991 it suggested, again in a letter to President Gaviria, that the overwhelming majority of rural managers "do not conceal their confusion and disenchantment relating to what they perceive as a clear underestimation attitude from the authorities with regard to the agricultural sector".[93] Additionally, in September 1991 the SAC executive board publicly expressed its concerns, and in particular argued that the persistent real exchange rate appreciation was greatly hurting its ability to compete internationally. Its main grievance, however, was with the acceleration of the reform program, it expressed that is "a priority to keep, for a relatively long period, the actual levels of tariff protection for products subject to the mechanism of price bands" (SAC 1991a, 1991b).

Later, in December 1992, the position of ANALDEX reflected their augmented discontent with the development of the reforms. They claimed to support president Gavirias' macroeconomic program, but showed their doubts in this regard and expressed the need for concertation regarding the end of exports subsidies.[94]

In spite of their efforts, during the Gaviria administration the traditional *gremios* began to lose power, and their historical role in Colombia's political system was increasingly taken over by the four largest conglomerates --the Santo Domingo group, the Ardila Lülle group, the Luis Carlos Sarmiento group and the Sindicato Antioqueño group--, or *grupos econ*ó*micos*. These had highly diversified interests, and understood that what mattered was not so much a specific policy, but the overall policy stance. And in that

[92] Revista Nacional de Agricultura, No 893 December 1990.

[93] RNA, No 894 March 1991.

[94] Initially, the following had been agreed with the Development Minister (Ernesto Samper): a gradual reduction of the CERT, a gradual increase of interest rates on exports credits, exchange rate stability and a gradual reduction of import duties.

regard, the Gaviria administration continued to push for a more open and market oriented system which these conglomerates supported.[95]

The Old Guard Strikes Back

The year 1991 was a remarkable one for Colombia. A new constitution was approved after more than one hundred years; peace negotiations with the guerrilla movement were showing promise; there was a newly elected congress; Pablo Escobar, the *capo di tuti capi*, had turned himself in, and had been imprisoned; the country had its first civilian Defense Minister in decades; a number of reforms, that had been unthinkable only a few months earlier, had been enacted; new (and very large) oil reserves had been found; and the international community was seeing Colombia with new eyes.

Foreign observers had a very strong impression that things were going in the administration's way. This was highly deceiving, however, as discontent was growing among the population.[96] With traditional Latin American impatience, the public expected quick and palpable results in terms of growth, real wages, employment and a reduction in inflation. And, as may be seen from Table 11, in 1991 the results in these areas were meager. Growth had declined to one of the lowest levels in modern history, inflation had

[95] The fact that important economic groups have diversified interests seems to have been misinterpreted by Cepeda (1994) when he argues that "(Williamson and Haggard, 1994) did not mention Colombia in reference to compensation schemes. The way Colombia's wealth and economic activity is conformed and undertaken determines that the same persons or economic groups participate in various economic activities. Land owners are also bankers, exporters, importers, merchants, manufacturers and, eventually, politicians or media moguls. *You loose and you win at the same time*" (our emphasis). Obviously, wealth concentration might make the analysis of compensation schemes more complicated, but in no way does it make it less relevant.

[96] Cepeda (1994) argued --ingenuously-- that the population had tangible demonstrations of the fact that the new model was seriously implemented and was operating. He asserted that the inundating of imported goods came to satisfy a long suppressed demand for these items.

actually increased, interest rates had been extremely high, and unemployment seemed to be stuck at approximately the 10 percent level.

There were also political clouds in the horizon. Although the newly elected congress maintained a clear Liberal Party majority, most of its members --and clearly its leadership-- were reform skeptics. Miguel Silva (1997), Gaviria's personal secretary has pointed out that "the government's leadership capacity inside the Liberal Party had been hurt...[T]he majority of [the party's] candidates had campaigned against the fundamental reforms, including the opening up of the economy and the supposedly 'neo-liberal' character of the government (p. 18)."

The agriculture *gremio*, (SAC) was becoming particularly vocal in its criticism of the government and specifically regarding the drastic adjusting measures aimed at controlling inflation. Although the liberalization of trade had reduced (somewhat) the costs of its imported inputs, the vagaries of international agricultural prices was hurting them. And, as with the case of other tradable producing sectors, the strengthening of the peso and the continuously high interest rates were making things even more difficult. What was particularly aggravating for the SAC was that this deterioration was taking place at a time when, as a result of friendly provisions in the new constitution, they expected a favorable treatment from the authorities. "The farmers are not afraid of trade liberalization policies, but we demand a special treatment in accordance with the international market situation".[97]

In fact, in little more than a year there had been a remarkable shift in the SAC's position regarding the modernization program. In August 1990 the President of SAC said that a gradual and selective opening, as announced by President Gaviria, "should not be a cause of concern for our associates. Quite on the contrary, its launching and implementation, according to the proposed plan, could result in the removal of the high costs and bottle necks" that the sector had traditionally endured (Cano, 1990, p. 11). A year later, the SAC magazine published an editorial reiterating the view that the sector was willing to support the reform package, as long as the promised compensation mechanisms were, in fact, implemented: "We support the opening-up of the economy, within a gradual and pragmatic framework... Within these parameters we support the package of reforms proposed by the administration...(SAC 1991, p. 6). The SAC complained, however, that the compensation mechanisms --including the real exchange rate-- had failed and/or had been insufficient. As a way of remedying things it proposed six broadly defined measures, including the adoption of price bands, the harmonization of Andean Pact policies, and minimal and variable import duties for basic products

With the inclusion of agriculture in the commercial liberalization program, the average duty for the agricultural sector decreased from 31.5% in 1991 to 15% in 1992, still mildly superior to the remaining sectors of the economy.

The agricultural sector experienced a poor performance in 1992, which gave rise to an important discussion in connection with the causes of such situation. The problems faced by the agricultural sector translated into a serious deterioration in social conditions. In fact, as may be seen in Table 25, rural poverty increased between 1988 and 1992. According to some, it was the result of the failure of trade liberalization.[98] Throughout 1992-1994 the government increasingly gave in to the SAC and the rest of the agricultural lobby.

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[97] RNA, No 898 March 1992.

[98] In late 1993, César Hart de Vengoechea, presidente of SAC, suggested that "it cannot be accepted that a

Table 25. The Evolution of Extreme Poverty: 1978-92

	1978	1988	1991	1992
Percentage of people below the extreme poverty line in the rural sector.	38.4%	33.1%	29.0%	31.2%
Percentage of people below the extreme poverty line in the urban sector.	12.1%	8.0%	7.8%	8.0%
Percentage of people below the extreme poverty line in the country as a whole.	23.6%	18.7%	16.9%	17.7%

Source: The World Bank (1994)

Forceful evidence suggests that the crisis was the result of the interaction of several factors, among them: (i) the fall in the international price of commodities; (ii) the drought; (iii) the real exchange rate appreciation; (iv) the diminished protection to importable products; (iv) the crisis of the *Caja Agraria*[99]; and (v) the resurgence of violence. Jaramillo and Junguito (1993) state that (i) the crisis registered in 1992 cannot be typified as the worse in history; (ii) the critical variable with most adverse impact was the drought; and (iii) to a lesser extent, the crisis was due to exchange rate and commercial policy.

In mid 1994, SAC argued that the agricultural sector was heterogeneous. Therefore it did not allow for simplistic observations neither from some producers --that asserted that the crisis was totally the consequence of the opening trade policy-- nor from high government officials, according to whom the phenomenon was due to the fall in international prices, the drought and increased violence. Regarding the drought of 1992, SAC asked "how can we explain the simultaneous fall of internal prices and of output crops? The drought can explain falls in production, not in prices"[100].

As noted before, special treatment was given, price bands were established, reference prices were used to calculate import duties and, in accordance with what was mandated by the constitution, a market-based agrarian reform was implemented (Ocampo and Perry, 1995).

In November 1995 one of the conclusions of the XXVIII National Agrarian was that "agricultural producers do not doubt in considering the first half of this decade as the lost

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reduction in the inflation rate do not be pursued by all economic sectors, including obviously, the public services enterprises". RNA No 905 March 1993.

[99] The state owned bank specialized in the agricultural sector.

five-year period of Colombian agriculture, and also, blaming the president Gaviria, in advancing an arbitrary policy, in every aspect opposed to the national interest. This, without prejudice of recognizing the efforts undertaken by the last Agriculture Minister of that administration (J.A. Ocampo), deserves a historical and political prosecution". [101]

In March 1992, things turned decisively against the government when, as a result of a series of factors --including a particularly dry year, as well as incompetence and corruption in the management of the government owned electricity company--, the country faced an energy crisis, and the rationing of power had to be implemented. At first electricity was rationed for only for two hours a day. Later, as the rainy season got delayed, it was extended to as many as eight hours a day. Moreover, the wave of assassinations resumed. And worse yet, the generalized public discontent in Venezuela --discontent that was channeled into a coup attempt-- made some people think that, maybe, the modernization process was not such a good idea after all.[102]

Although President Gaviria's popularity plummeted, he continued to be committed to the modernization process. Several projects occupied his mind: first, and most important, it was necessary to approve a number of laws that would make many of the new constitutional mandates --including central bank independence, the modernization of the state and decentralization-- operational. Second, in order to finance new expenditures mandated by the constitution, it was necessary to increase government revenues. To this

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[100] RNA, No 907, June 1994.

[101] RNA No 914-15, June 1996.

[102] On the Venezuelan reforms, and the public's discontent see, for example, Naim (1993).

effect the administration presented to congress a tax reform project, whose main provision was raising the VAT rate from 12 to 14 percent. Third, privatization --which until then had been timid and had lagged other areas of reform-- was scheduled to pick up. The administration was particularly interested in an early (and partial) privatization of the government owned telephone company. Fourth, the old pay-as-you-go social security system, which as in most of Latin America was facing eminent bankruptcy, was to be reformed. And fifth, the administration was highly interested in reforming the social services sector and, in particular, education and health.

As the year unfolded it became increasingly clear that the opponents of the economic reform program were gathering force, and that it would be extremely difficult to carry out this ambitious agenda. In retrospect it is clear that as public and congressional support dwindled, President Gaviria decided to follow a two prong strategy: first, he decided to prioritize among different projects, spending his much reduced political capital in those programs that were dimmed passable by congress and that were considered to be essential for the administration overall project. Many of these initiatives were related to political developments and were seen as strengthening democracy and the nations' institutions. Second, it was decided to continue with the coalitions and compensations strategy that had served the administration so well during the first eighteen months.

Conditions, however, had changed, as the sense of urgency and anticipation was gone. From a practical point of view this meant that the government had to cave into many --although not all-- of the demands by interest and political groups, and that the make-up of the government coalition had to be revised continuously. Both of these strategies were actively pursued during 1992-1993. The more traditional wing of the Liberal Party represented by Ernesto Samper and his followers got an increased participation in key positions, including José Antonio Ocampo[103] --the able economist that had been Samper's principal adviser in the Ministry of Development and who in 1996 became his Minister of Finance-- as Minister of Agriculture, and Horacio Serpa --who was to become President Samper's Minister of Government-- as Peace Negotiator. Moreover, the traditional --and increasingly weak, in political terms-- wing of the Conservative Party was replaced in the cabinet by the up and coming faction led by Bogotá's mayor Andrés Pastrana.

The extent to which the reform opponents' position had strengthened became painfully clear when, in the first quarter of 1992, the government submitted to congress proposed legislation to privatize the telephone company. Following the compensation approach that had become the government's hallmark, a plan that included the granting of an important percentage of shares to the company employees was devised. At the same time, the government announced that the proceedings from the sale would have two uses: First, a portion would be used to finance increasing coverage of social services to the population at large and, specially, to lower income groups. And second, a portion of these monies would be devoted to irrigation projects that would benefit the increasingly unhappy agricultural sector.

According to Mauricio Vargas (1993, p. 239-240), who by then had become Minister of Telecommunications, the government's project slowly gained supporters among members of congress. The union saw things differently, however. The leadership opposed

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[103] It should be emphasized that J. A. Ocampo enjoyed immense popularity in the agricultural sector. In June 1994 the president of SAC asserted that "in the middle of this situation [agricultural crisis], it is fair to recognize that the Agriculture Minister, José Antonio Ocampo, has made a great effort aimed at recovering the sector, but unfortunately his struggle has been quite solitary within the Government itself". RNA No 907 June 1994.

the privatization strongly and mobilized workers to protest the government plans. Interestingly enough, the guerrilla movement, that until then had not participated actively in the debate on the reforms, backed the unions and released several communiqués opposing the "neo liberal" measure.

In spite of these developments, the authorities were confident that even if the union called a strike, service would be maintained and the union's position would quickly become unpopular with the public. Nothing of that sort happened, however. When the strike finally took place in late April, the country went silent. Mysteriously the back-up computer programs, that would have helped maintain service, had disappeared. The government showed a tremendous inability to cope with the situation and as days passed without the reestablishment of the service, its popularity plunged. Some of the members of congress that had showed some inclination to support the privatization started to back off. Worse yet, President Gaviria, who by then was in a defensive mode, decided not to go all the way out, and left his minister to fight for the privatization on his own.

What had happened? Where was the combative young leader that was going to "shake up" the economy? How could the government missed the public mood so badly? There are several explanations to these developments. First, Gaviria the consummate politician realized that he was too weak to pursue too many unpopular causes. He decided that the effort to pass the tax reform would be too big, as to risk another major fight. Second, the public relations team failed badly, by not building up a major campaign in support of the project. This episode showed that when it came to major initiatives, it was not enough to devise compensation schemes. Also, it reminded the administration that public sector unions continued to be an untamed "monster". This would be confirmed in the following months, as teachers unions, *Ecopetrol* employees and health sector workers, among others, were able to extract more and more rents from the state (Wiesner 1997).

In retrospect, it is particularly interesting to notice that at this crucial juncture the government failed to obtain support from the *gremios*. These had either become disillusioned or, as in the case of *ANALDEX* --the exporters' *gremio*-- and the *SAC*, had become open opponents of the reform program. In late April of 1992, as the government was literally fighting for its program's life, ANALDEX held a national meeting where it strongly criticized the administration's economic policy. ANALDEX's president argued that the government violated the implicit contract by accelerating the trade reform, by not delivering on the promised compensation mechanisms and by altering the announced sequencing of reform: "though in principle we committed ourselves with the Government to support the new economic plan, we expressed our concern on the chronological order and on the way it would be implemented " (Bakalarz, 1992).[104]

A government that only a few months earlier had the generalized support of the private sector had lost the support from congress, unions and the *gremios*, was now standing alone. Unmistakably alone.

Though the vast majority of small business associations expressed themselves against trade liberalization, the positions between them differed. Still, they did not conceal their concern about international negotiations, the increase in contraband, subsidies to exports, the economic policy of neighboring countries and the evolution of the exchange

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[104] In May 1992 ANALDEX expressed its unhappiness arguing that before eliminating exports subsidies, many other changes were required: an operating labor reform; maritime and air transportation deregulation, reduction of energy costs; dismantling of the bureaucratic duty, etc. This did not occur. For example labor reform started to operate a year after the beginning of the elimination of the supports to the exporting sector.

rate.

Associations as Fenalco, Asomedios (National Media Association) and Andigraf (Colombian Association of Graphics Industries) recognized the benefits of trade liberalization. In April 1993, the president of Fenalco argued that "the evaluation of the *apertura* during 1992 did not show negative balances: on the contrary, the results are flattering, without being qualified as spectacular".

At the same time, Asomedios argued, that "the proposal of opening new markets -- some as the result of the reduction of the tariff barriers, others resulting from the institutional transformation of the social security system-- contributed to widen the demand for advertising spaces".

Additionally, Andigraf, in its XII annual Graphics Industries Symposium (1993), emphasized the dynamism of its activity in the preceding years, based primarily on a drastic change in the traditional supply conditions of paper. This was due to: (i) the transformation of the tariff structure, that reduced protection levels; (ii) the reduction of prices in the paper industry, given a mild recession; and (iii) the implementation of projects geared to increase installed capacity.

On the contrary, Fedemetal was skeptical regarding the reform process. In a conference delivered at the Colombian Studies Center in 1995, the president of Fedemetal, argued that "for the sake of insisting on trade liberalization the national industry cannot be sacrificed".

Sectors such as textiles and footwear were particularly affected --in words of their directives-- by the "apertura" policies and particularly due to the increase in contraband that, according to them, this new model has generated.[105] The Colombian Association of Textiles Producers (ASCOLTEX), argued that contraband, the revaluation of the peso and the goal of reducing inflation, among others factors, were the causes of the problems affecting the textile sector. Given the precipitated integration pursued in international markets, this sector has been located at a disadvantage when compared to persistent illegal imports and contraband. For the president of CORNICAL (National Footwear Industrialists Corporation), the opening of the economy and contraband were the main factors affecting the development of this sector.

In the case of ASOCAÑA (Colombian Association of Sugar Cane Growers), his president argued that the revaluation of the peso had been the main determinant of the loss of competitiveness of all tradable products, including sugar.

The preoccupations of the *Gremios* rested not only on the elimination of restrictions to international competition. International agreements meant a new wave of expectations, not always positive, that influenced, to a large extent, the position that the *Gremios* were exhibiting in reference to government policies.

The free trade zone with Venezuela was created in January 1992. By the end of that year SAC expressed that "under no circumstances we can accept that the outstanding methodology, with respect to the price bands, be submitted to transformations that eliminate its efficiency, for the sake of rushing an agreement with our neighboring country".

In June 1994 the G3 Agreement (Colombia, Venezuela and Mexico) was signed.

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[105] Contrabando, apertura y lavado de dinero (por desarrollar).

To this respect in May 1993 *ANDI* asserted that "Colombia is not in conditions of facing an accelerated liberalization process". Together with SAC, both *Gremios* shared concern regarding the size of the Mexican economy.

Additionally, by May 1st --workers' day-- it was clear that the government had lost its battle with the *Telecom* union, and on May 4th the Minister of Telecommunications had resigned. The anti reform forces had their first major victory. Even more importantly, they had managed to put the government in the defensive and, for all practical purpose, they had succeeded in taking privatization --or at least major privatization-- out of the agenda.

It is interesting to quote extensively what two of Gaviria's closest collaborators have to say about this episode and its sequel. According to Vargas (1993, p.258), [A]fter *Telecom*'s strike the privatization program had been frozen. And Silva (1997 p.39) says: [A]s with other topics in the government's agenda, the economic reform lost oxygen in 1992. As a result of the black out, changes slowed down significantly that year. All effort was placed on the approval of the tax reform..." Summing up the first half of the year, Vargas (1993, p 258) says: [A]t the end of the first semester of 1992, all Gaviria had to show was a tax reform that was as popular as the black out [*el apagón*]. The situation was quite bad, but the worst was yet to come."[106]

The worst came on July 21st, when in order to avoid being moved to a more tightly controlled prison Pablo Escobar, the sinister *capo* of the Medellín cartel escaped. There

[106] According to Silva (1998), the fact that the government was able to pass thorough Congress the 1992 tax reform gives support to the fact that, the above setbacks notwithstanding, the president still had firm control over his political allies. On the other hand, and not without reason, Urrutia (1994) suggests that tax matters have always been interpreted as an executive decision, regardless of the fact that tax issues have to go through congress. In that sense, it is the President, and not the Congress, who has to pay the political price every time taxes are raised. That being the case, approval of the 1992 tax reform does not necessarily imply vast political support of the government or of its policies.

was little the government could do. Several (mostly junior) members of the administration and of the security forces were fired and the government agreed to cooperate with congress in a major investigation. Gaviria declared an all-out war on Escobar, and instructed the different branches of the police not to leave a stone unturned. Escobar, on the other hand, feared for his life and vowed not to give himself up. On December 2, the cat and mouse game came to an end, when a tired and disheveled Escobar was killed by the police as he tried to escape a safe house. During the time that elapsed between Escobar's prison escape and December 2, 1992, it seemed that Gaviria's historical legacy would be much more closely associated with re-capturing or not the drug baron than with promoting structural reforms and a new constitution.

Remarkably, perhaps, during 1992 the economy did not do that poorly. As Table 11 shows growth picked up, inflation declined slightly and unemployment stabilized. During 1993 the government slowly built its support up, and towards the middle of the year it felt strong enough as to push for the implementation of the social security and health reform. While the former has a number of design pitfalls --including the fact that it provides perverse incentives and maintains an inefficient public pillar-- the latter is an improvement over the previous system. The main issue in 1994 became Gaviria's succession and, more importantly, however, whether the next president would continue the modernization effort that had started with so much enthusiasm four years earlier, but had slowed down significantly.

Chapter 5: The Road Back to Square One

This chapter deals with the course set by the reform process once Gaviria left the office of President. The political process for the election of his successor is examined, as well as the problems latter faced by the new President. We show that the consequences of these problems have resulted in Colombia facing essentially the same challenges by the end of the 1990s as ten years prior.

The 1994 Presidential elections were part of a busy electoral year. This was the second democratic process to take place that year, following the elections to the Senate, on March 13th. These elections had resulted in a strong victory for the Liberal Party, winning 66 out of 102 Senate seats. The main loser had been the AD M-19, which lost the nine Senate seats it had obtained in 1991. Besides the partisan make-up of the Senate, one must also note that most of the recently elected members were traditional politicians who benefited from the new electoral district model and managed to enter Congress despite their poor public image.[107]

The March 13th elections coincided with a very important event, the Liberal Party primaries. Of the many candidates that participated, the two most prominent were former ministers Humberto De la Calle and Ernesto Samper. De la Calle had been National Registrar, advisor to President Virgilio Barco and, more recently, Interior Minister in Gaviria's cabinet. Having championed Gaviria's political platform in the Constituent

[107] The electoral district model was designed to aid minorities, who by grouping together small clusters of votes in various parts of the country, could try to get elected at the national level. The 1994 elections

Assembly, he enjoyed enormous prestige and, naturally, the support of the party's wing associated with Gaviria.

During the primaries, polls pointed to Samper as the winner and this was, in fact, confirmed on Election Day. Despite his defeat, De La Calle obtained a strong backing, instantly becoming an important figure within his party.

With the primaries over, the candidates for the May 8th Presidential election had been decided. The main contenders were Samper and Andrés Pastrana. The latter, coming from a Conservative background, was promoting a "suprapartisan" movement, the "Nueva Fuerza Democrática" (New Democratic Movement). From a young age, Pastrana had been involved in political activities. His father, conservative Misael Pastrana Borrero, had been the last president elected during the National Front period (see Chapter 2). In addition to having been a City Council member and a Senator, Andrés Pastrana had been the first popularly elected Mayor of Bogota.

The two main candidates held strikingly different platforms.[108] Firm to the convictions shown during his tenure as Minister of Development during the first part of the Gaviria government, the Liberal candidate had a clear "social" orientation -his slogan was "put some heart into economic liberalization". Pastrana was a center-right candidate, more sympathetic to the policies that were in the forefront of the outgoing government.

Samper's program was based on consolidating the liberalization of the economy, with special emphasis on seeking better distribution of the benefits among the various social groups. In aid of this worthy goal, importance was placed on the avoidance of

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demonstrated the opposite, as 93% of the elected Senators were members of traditional parties.

[108] The platform description that follows is taken directly from an evaluation performed by Fedesarrollo and

revaluation of the exchange rate and on promoting lower interest rates, both areas outside his domain and under the aegis of the Board of Directors of the Banco de la Republica (the Central Bank). Samper also emphasized management of the Cusiana[109] resources so as to avoid a "Dutch Disease" and promoted the creation of entities aimed at improving competitiveness and at reactivating the agricultural sector.

Regarding wages, he promised increases equal to or higher than the inflation rate. This platform would most probably increase inertial inflation and make the work of the Central Bank more difficult. Samper championed interventionist ideas. To avoid exchange rate appreciation, he defended tightening controls on capital inflows. In regard to trade policy, he advocated the modification of the tariff structure and the use of para-fiscal. In an effort to promote exports, he proposed direct intervention by the government through the creation of institutions to support competitiveness, the extension of subsidized credits and the maintenance of tax incentives.

For his part, Pastrana focused on the importance of macroeconomic stability and the operation of the markets to increase efficiency and competitiveness, thus demonstrating a close similarity to the Gaviria government policies. In fact, his platform sought the consolidation of the existing structural reforms. He proposed wage adjustments that would permit lowering inflation and was in favor of the liberalization of prices and public utility rates. In terms of the financial sector, he advocated the need to foster competition and privatization, while reducing forced investment. Finally, he envisioned the reduction of unemployment as coming about as a result of a positive economic performance.

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published in *El Tiempo* days prior to the presidential election.

[109] Generic name used to refer to the oil fields in Cusiana, Cupiagua and Volcanera. These fields were in the

To be sure, there was some common ground between the two candidates. Specifically, both supported a reduction in the fiscal deficit. While Samper spoke of curtailing public spending, Pastrana went as far as proposing a reduction in tax rates, a "supply-side" proposition most uncommon by Colombian standards..

At least from an economic viewpoint, the candidate whose platform most clearly mirrored Gaviria's policies should have been the strongest bet to win. After all, by the end of his mandate, Gaviria's government had an extremely high level of popular support.[110] Given this, many assumed that Pastrana would be the next President. This was reflected by the results of various surveys and polls, which starting in early 1994 indicated that Pastrana was the most likely winner.

During the last months of the campaign, the gap between the two candidates significantly closed. The unfolding of strong Senate campaigns by Liberal contenders in March reinforced the party image in general, and that of Samper in particular.[111] But this fact only partially explains the gains made by the Samper block. By far, the most important factor had to do with the choice of Vice President.

Before the 1991 constitutional reform, there was no Vice President. In its place there existed the legal figure of the Designate (Designado), who replaced the President in the event of permanent absence.[112] In 1991, the concept of a Vice President was introduced. He

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early stages of development when the presidential campaign took place. Together they represent the most important oil field in the country.

[110] On August 2nd, 1994, *Semana* magazine revealed the following results of a poll carried out in urban and semi-rural areas, between June 20 and 30, 1994: (i) How will President Gaviria's administration be remembered? 30% unfavorable or very unfavorable and 66% favorable or very favorable; (ii) Do you agree with the fact that President Gaviria take measures in order to ensure the maintenance of the changes and reforms under his Government? 30% Disagree and 62% Agree; (iii) Is your feeling toward trade liberalization favorable or unfavorable? 28% Unfavourable and 65% Favourable.

[111] It should be noted that 59 of the 66 Liberal Senators elected were Samper partisans.

[112] The Designate was elected by Congress from a list of three candidates presented by the President.

or she was to be elected in the same ticket as the President. International precedent, such as that of the United States --where six of the last ten Vice Presidents later went on to become Presidents-- as well as the novelty of the position, meant that the election of the running-mate became a key component of the campaign.

There were two obvious and ideal vice presidential choices for both campaigns. In the case of Samper, it was Humberto De La Calle, who was much favored by voters and had shown promising electoral power. Even more importantly, he would unite the party and, perhaps, make it unbeatable at the ballot box.[113]

The best vice presidential option for Pastrana was Noemí Sanín, who had successfully held various positions both in the private and public sector, and was perceived as an outstanding Minister of Foreign Affairs under Gaviria. In the latter position she had earned great popularity both within the Conservative Party to which she belonged, and in wider circles.

Given the circumstances, it was clear that the election of the presidential successor was, to a great extent, in the hands of Gaviria himself. After all, the "ideal" Vice Presidents were both closely associated with his name, regardless of party affiliation.

Under the Constitution, the elected Vice President would be barred from aspiring to the Presidency for the following term.[114] This was clearly a problem for both former

[113] According to a poll carried out and published one week before the decision was made, the preferences for the various Liberal Vice Presidents were: 48% for De la Calle and 20% for Horacio Serpa – traditional Liberal, and Samper's close friend. On the other hand, the declaration regarding "unbeatable" Liberalism is not an exaggeration. Since 1930 they only lost against Ospina Pérez in 1946 and against Belisario Betancur in 1982. On both occasions, the Liberal party was divided at the time of the election.

[114] Pursuant to article 204 of the Constitution, "to be elected Vice President, one must have the same qualities as required for the President of the Republic. The Vice President may not be elected President of the Republic, nor Vice President for the term immediately following." This disposition was amended in May, 1995, as a result of a decision of the Constitutional Court.

ministers, who, in some way or another, had declared their presidential intentions for 1998. As if this were not enough, as Interior Minister during the Constitutional Assembly, De La Calle had opposed the creation of the position of Vice President. Even worse, he had a well-known poor relation with Samper, dating back to before the Liberal primaries, where he had been defeated.

Given his aspirations for 1998 and his public near-disdain for Samper, one may ask why De La Calle accepted to run for Vice President in the Liberal party ticket. The answer to this question sheds a great deal of light regarding Gaviria's commitment (or lack off) to the consolidation of the reform process.

One week before the deadline to announce running mates, De La Calle published a letter in which he acknowledged Samper's victory in the primaries and announced his presidential aspirations for 1998. The following Tuesday, he had breakfast with Gaviria. The President "made him see that in the coming four years all the prestige he had built up could crumble, whereas as Samper's Vice President he would definitely place himself in the running to be President one day."[115]

The following day, De La Calle attended a meeting with Samper, at campaign headquarters. He said he would consider reviewing his position. On Thursday, he once again had breakfast with Gaviria. By then, his advisors favorably reacted to the idea of being Samper's running mate. They believed that during the upcoming government they could lose significant political ground, especially due to their scarce representation in Congress. Added to this, party pressure was building up to such a degree that, if he were to decline Sampers' offer, it would leave De La Calle in a weakened position to aspire to be the Liberal candidate in 1998.

Eventually, a meeting was held between De La Calle, Samper and Gaviria. They agreed on the final details of a deal that ultimately led Samper to power.

In the case of Pastrana, matters became extremely complicated. He was in a difficult spot, and his best bet was Noemí Sanín. During the same week in which the Liberal pact was finalized, the Conservative candidate sought by every means possible to convince her to be his running mate.

Early in the week, Luis Alberto Moreno, Pastrana's campaign coordinator visited the Foreign Minister and set out the possibility of the Vice-presidency. She replied with two objections: first, the impossibility of abandoning Gaviria at a critical juncture in his attempt at becoming the next Secretary General of the Organization of American States (OAS). Secondly, as in the case of De La Calle, the problem of being barred from running for President in the following elections.

The next day, Pastrana officially asked Ms. Sanin to be his running mate. The Minister requested the advice of prominent public figures, most particularly that of former Liberal President Alfonso López Michelsen, who, as expected, mentioned her presidential possibilities for 1998. Another meeting, perhaps the most important one, was held with Gaviria, who also reminded her of the risk involved in accepting and becoming barred from the 1998 presidential contest. This led the Minister to answer in the negative, forcing the Conservative candidate to choose a running-mate with less influence at the ballot box, Luis Fernando Ramírez, Gaviria's Minister of Labor.

Thus, "the Liberal party, which had appeared vulnerable up to that moment,

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[115] *Semana* magazine, "Baile de Parejas", March 22, 1994, pp. 29.

suddenly seemed unbeatable. And Pastrana, who for many had also appeared unbeatable, now seemed vulnerable" (*Semana*, "La Novia Dijo No" --"The Bridesmaid Said No"-- March 22, 1994, p. 34).

In hindsight, it is obvious that Gaviria's support for Samper worked against Pastrana's interests. This fact is undeniable, even if Gaviria's support for Samper was not as enthusiastic and clear-cut as was expected from a President towards his own party's candidate.

Of course, a second question becomes relevant. Why did Gaviria support Samper, who did not share his spirit of reform, and who, as his Minister, had attempted to slow down the reformist effort to which Gaviria had devoted most of his attention as President? Why did he act in such a way, when Pastrana was running on a platform of continuity?

The answer is not an easy one, and there are several possible explanations, all of them highly speculative. The first is that Gaviria was not highly committed to the reform process and, therefore, did not mind detaining, if not reverting, the reformist effort as long as he could help his party remain in office.

The second hypothesis is that predicting that in any event the winner of the election would be Samper, Gaviria decided to support him in order to guarantee the survival (even if only partial) of his reforms. That is, support of Samper in exchange for key positions in the next administration in the hands of some of his close associates.[116]

The third, and perhaps most plausible, reason was pressure put by the Liberal party on President Gaviria. The party leadership only co-opted the outgoing President, not his

[116] This "*self-serving proposition*" was revealed to one of the authors by a high official in the Gaviria government, in Washington in 1997.

technical staff. It is quite telling that key members of the outgoing government quickly became the main detractors and critics of the Samper administration.[117]

On June 19, 1994 Samper won the second round of the presidential elections. This same day, with tears in his eyes, Pastrana acknowledged defeat. A few days later, on Tuesday, June 21, the television news program "24 Horas" (owned by the Pastrana family) revealed the existence of a cassette that had been delivered by Pastrana to the authorities, which provided evidence that Samper's campaign had received money from the Cali drug cartel.[118]

From this moment on, clouds of doubt hung over Samper and his cabinet. The new government experienced what López Michelsen called the "biggest political attack that has been seen in Colombia in the past 50 years."[119] This crisis reached a climax in early 1996, when by a vote of 111 to 43, the Chamber of Representatives decided to file an investigation against the President.[120] As part of this process, various Senators, the Attorney General and the Comptroller of the Republic were convicted for of having been on the cartel's payroll. Some of the President's closest aids ended up in jail, including his Minister of Defense and former director of his electoral campaign.

During the process that ended with no impeachment, key political players had different attitudes.

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[117] Among the main critics of the Samper government were Rudolf Hommes, Armando Montenegro and Juan Luis Londoño. The first two were Gaviria's key economic advisors (see above). The latter was deputy director of DNP and Minister of Health during the Gaviria administration. At the beginning of the Samper administration, Hommes held a technical position at the IDB and Londoño a technical position at the World Bank. Montenegro was the Colombian representative to the Executive Board of Directors of the World Bank.
[118] Criminal organization with headquarters in the city of Cali, involved in the trafficking of illegal drugs.
[119] *Semana* magazine (1996) "Habla López", October 1,. pp. 26
[120] His closest campaign advisors suffered a different fate. Former Defense Minister Ferrnando Botero and Santiago Medina were prosecuted and eventually convicted.

- The Liberal party backed the President, despite the opposition of some of its most prominent members. The opposition party withdrew from the government and requested Samper's resignation. Although this position was supported by a majority, it was not unanimous.
- Trade and business associations expressed that "the President has been seriously weakened in the exercise of his authority and capacity to govern. For this reason, he should consider a temporary withdrawal from office."[121] The most extreme members in the business community demanded Samper's resignation and replacement by his Vice President. It goes without saying that by then the relationship between Samper and De La Calle was non-existent. In fact, a reasonable hypothesis is that at a critical juncture the only reason why Samper did not resign is that he was not willing to hand over the office of the President to De La Calle and the whole gavirista movement.
- The unions argued that "we are not in agreement with the resignation of the President, if this is preceded by undue political pressure or positions such as those that have been taken by certain trade associations with their proposals of a strike, or with demands that the President resign, to be replaced by the Vice President" (as stated by the president of the *Central Unitaria de Trabajadores*, CUT)."[122]
- Former Presidents called for respect for the institutions. Mention should be made of the attitude adopted by López Michelsen, who proposed a presidential resignation as a solution to the crisis. He suggested that Samper begin a constitutional reform process (to initiate a historically important event) and then relinquish power.

[121] *El Tiempo* (1996) "Así Juegan los Protagonistas", January 29, pp. 8.
[122] *El Tiempo* (1996) "Sindicatos, Contra la Renuncia de Samper", May 1, pp. 6.

- The military promised to back the office of the President, but at no time showed any signs of supporting the person of Ernesto Samper.

With the workers and a large percentage of the Liberal party on his side, Samper alleged that the upper classes, partisans of raw neo-liberalism, were trying to defeat him and his social democratic ideology. He attempted to garner the support of the mass media, using various types of incentives. As part of the government's tax reform, a proposal had been put forward to increase the VAT. Originally, advertising was to have been included in the rate hike, which would have increased the cost of doing business for the media. The bill that ultimately became law did not include this service among the new taxable items, earning the media's gratitude toward the President.

As a result of his political weakness, Samper was subjected to several protests. To most of them he caved in, especially in matters relating to wage adjustments.[123] As an example, one can point to negotiations with Ecopetrol (the national oil company), Caja Agraria --the public bank serving the agricultural sector--, as well as with employees in the education and health sectors. Herrera (1997) mentions that an agreement was signed with FECODE (the teachers' union) in May, 1995, in which the government promised to grant them a wage increase of eight percentage points over the rest of the public sector for 1996, 1997, and 1998. This agreement, added to the outlay of extraordinary resources for this sector, ended up costing nearly 0.3% of GDP in 1997 and 0.4% in 1998. Similar decrees from the Ministry of Health set wage increases for the health sector which involved a cost

[123] In regard to this, former President López said that "anyone who wishes can get what they want; they go on strike and eventually achieve their goal."

of nearly 0.4% of GDP both in 1997 and in 1998.[124]

In addition to wage benefits, Samper granted unions other political benefits. He appointed Orlando Obregón as Minister of Labor. Until shortly before his appointment, he had been president of the *Central Unitaria de Trabajadores* (CUT), one of the strongest labor unions. As Minister, he resolved various labor conflicts --including those in the energy sector and in Caja Agraria-- , in efforts that were harshly criticized, as they followed strikes that most people felt should have been declared illegal.

Last but not least, Samper sought to cozy up to Congress, his judge according to the Constitution. The co-financing funds, which had been established so that the central government could prioritize regional spending, became mechanisms to buy off political support by the Executive branch. According to Juan Camilo Restrepo (then Conservative Senator and later Ministry of Finance) and Henry Amorocho, "the manner of assigning individual posts to Congressmen so that they can propose projects for the National Co-financing Funds System has its origins in a despicable practice, which was used to obtain parliamentary favors in clear violation of the principles of legality and planning set out in the Parliamentary Budgetary Law and in the Colombian Constitution. The specific budget items, which represented approximately 90,000 million pesos in the 1994 budget, today total close to $165,000 million. This number is 20% of the total budget allotted to the National Co-financing System."[125]

The measures taken by Samper in order to stay in power had heavy institutional and economic repercussions. As can be seen in Tables 26-28, various institutional quality

[124] Decree 439, March, 1995

[125] Restrepo, J. and Amorocho H. This is a follow-up on earlier charges. In Restrepo (1996a) it is alleged that

Table 26. Strength of the Judiciary (total points 6)

	1990	1994	1997
Latin American Countries:			
Argentina	3	5	5
Bolivia	1	2	3
Brazil	4	3	3
Chile	4	5	5
Colombia	1	2	2
Costa Rica	4	4	4
Mexico	3	3	3
Venezuela	6	4	4
East Asian Countries:			
Hong Kong	1	6	5
Indonesia	6	4	2
Korea, Rep.	4	5	4
Malaysia	6	5	5
Philippines	1	4	4
Singapore	6	6	6
Thailand	5	5	5
Selected OECD Countries :			
Australia	6	6	6
Austria	6	6	6
Canada	6	6	6
Finland	6	6	6

Source: Johnson and Sheehey (1995, 1996, 1997).

Table 27. Corruption (total points 6)

	1990	1994	1997
Latin American Countries:			
Argentina	4	3	2
Bolivia	2	3	3
Brazil	4	3	3
Chile	3	3	4
Colombia	3	3	2
Costa Rica	5	5	5
Mexico	3	3	2
Venezuela	3	3	3
East Asian Countries:			
Hong Kong	5	5	5
Indonesia	0	3	2
Korea, Rep.	2	5	4
Malaysia	4	4	4
Philippines	2	3	3
Singapore	4	4	4
Thailand	3	3	3
Selected OECD Countries :			
Australia	5	5	5
Austria	5	5	4
Canada	6	6	6
Finland	6	6	6

Source: Johnson and Sheehey (1995, 1996, 1997).

Table 28. Quality of Bureaucracy (total points 6)

	1990	1994	1997
Latin American Countries:			
Argentina	3	3	3
Bolivia	1	2	2
Brazil	4	4	4
Chile	3	3	4
Colombia	4	4	2
Costa Rica	3	3	3
Mexico	3	3	2
Venezuela	3	3	3
East Asian Countries:			
Hong Kong	3	4	5
Indonesia	1	3	3
Korea, Rep.	4	5	5
Malaysia	3	3	4
Philippines	1	2	3
Singapore	5	5	4
Thailand	5	5	4
Selected OECD Countries :			
Australia	6	6	6
Austria	6	6	6
Canada	6	6	6
Finland	6	6	5

Source: Johnson and Sheehey (1995, 1996, 1997) indicators show that between 1990 and 1997, Colombia exhibited a behavior that was the exact opposite of most Latin American countries. The first indicator (Table 26) refers to the strength of the judicial system, where the higher the number, the stronger the system. The second indicates the perception of corruption in government, with a higher number indicating less corruption (Table 27). The last one reflects the quality of civil service, a higher number indicating better institutions (Table 28).

The economic indicators also show a marked deterioration. As can be seen in Table 29, during the Samper administration (1994-98), the unemployment rate rose sharply, from 7.6% in the third quarter of 1994 to 14.5% in the first quarter of 1998. Inflation fell only slightly, reflecting the failure of the main tool designed to control it, the "Social Pact", an incomes policy program tailored after Mexico's *Pacto de Solidaridad.* In addition, economic growth rate fell considerably.

Clearly, these economic results had various causes, including the restrictive monetary policy imposed by the Central Bank, especially during early 1996; high interest rates, partially due to the above reasons and because of the huge financing requirements of the government; and the deterioration of the business climate, something which was in great part related to decertification by the U.S.[126]

Nonetheless, it is undeniable that political events affected the economic scenario. For example, on January 22, 1996, the former Defense Minister and director of Samper's

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individual assignments are the reincarnation of a parliamentary disposition which was specifically prohibited in the 1991 Constitution.

[126] This is a grade granted annually by the United States to countries involved in the drug war. It certifies that the U.S. considers, unilaterally, that the country is making a real effort and achieving positive results against organizations dedicated to this crime, thereby ensuring the help of the U.S. in various areas, including military to trade. In 1995, due to the scandal surrounding Samper's campaign, Colombia was certified for reasons of security and national interest. Later, Colombia was fully decertified.

presidential campaign gave indications that compromised the President in the gathering of funds from the Cali cartel. The next day, the exchange rate hit the top of the band and the Bogota stock exchange fell nearly 2%.[127]

One more economic indicator deserves particular attention- the fiscal deficit. As shown in Table 29, the fiscal results for the Central Government went from a surplus of 0.2% of GDP in 1994 to a deficit of 3.1% in 1997. The shocking growth of the deficit during Samper's term in office is due, to a large extent, to the growth in the size of government. According to data from Fedesarrollo, public spending went from 28.6% of GDP in 1994, to 33.6% in 1996.

Faced with a serious fiscal breakdown, one should examine the measures taken by the Samper administration. It is relevant to differentiate between structural problems and short-term considerations. The structural problems had five basic sources. The first was the creation of new institutions –including the Prosecutor General's Office-- as a result of the implementation of the 1991 Constitution. The second source was the obligation to transfer a percentage of central government current revenue to territorial entities. According to Ocampo (1997), these two facts explain nearly 41% of the growth in government spending between 1990 and 1997. Besides exercising pressure on spending because of the overlap of functions at various administrative levels,[128] transfers impose limitations on adjustment measures. Since transfers are a function of current revenues, when the latter rise –i.e. as a result of a tax reform--, so do transfers.

The third structural factor placing pressure on spending was wage equalization --

[127] Caballero, C. (1996).

[128] More on this in Echavarría *et. al.* (1999).

Table 29: Main Macroeconomic Variables

	Inflation	Fiscal Deficit*	Unemployment Rate**	GDP Growth***
1992	25.13%	-0.20%	9.80%	4.50%
1993	22.60%	0.30%	7.80%	5.39%
1994	22.59%	0.20%	8.00%	5.81%
1995	19.46%	-0.60%	9.50%	5.83%
1996	21.63%	-2.00%	11.30%	2.05%
1997	17.68%	-3.10%	12.00%	3.24%
1998	16.72%	-3.70%	15.60%	0.39%

* Fiscal result of the non-financial public sector as a percengae of GDP

** Up to December.

*** Real GDP growth.

Source: Banco de la República - DANE

especially in the case of the Armed Forces and the judiciary--, to which the government committed pursuant to Law 4 of 1992. Based on calculations by Ocampo, this meant that defense and judicial spending increased, respectively, from 2.11% to 3.27% and from 0.55% to 1.14% of GDP between 1991 and 1996. The fourth source is the application of Law 100 of 1993, which increased benefits and created the subsidized health regime. Finally, other constitutional sources of fiscal deterioration include subsidies for public utilities and the costs of monetary policy (Law 31 of 1992).

According to various Finance Ministers under Samper – especially Guillermo Perry and Jose Antonio Ocampo–, these factors were the main source of pressure on public spending. They limited the scope of tax reform, making the fiscal deficit reach shocking dimensions. However, one should ask how inflexible were these measures over the four-year term in office of Mr. Samper?

One could claim that during this period it was viable to present to Congress legislation that would have corrected the "growing pains" of the new Constitution. The problem lied with the government, which, due to its political weakness, increased public spending as a means to acquire support, if not from the population at large, at least from influential members of Congress. This is the explanation behind the passage of the "Ley de Metros" or Subway Bill (Law 310 of 1996), by which the government committed to financing between 40% and 60% of the cost of any subway built in the country. This was one of the many political deals seeking to foster regional backing for the President, who could then hardly turn around and propose a cut in transfers to territorial entities.

In terms of public utility subsidies, the government not only proposed a law that changed their structure but, moreover, through Law 286 of 1996 and with the Tax Reform

Law of 1997, postponed adjustments to the stratification system. This meant the permanence of subsidies that were originally conceived to be temporary.[129]

Besides the political limitations faced by Samper in terms of putting forward any kind of reform agenda, it is important to remember that even in the absence of political restrictions, one could not have expected much from his administration in the area of structural reforms. Thus, the Development Plan drafted in the early days of his administration, before the drug-related scandal broke out, did not indicate any decisive conviction on reform. In the first year of his administration, when it still could have acted to build and not merely survive, the few projects related to reform that obtained approval refer to hikes in tariffs and to attempts at protecting domestic industry. As can be seen in Table 30, the market orientation index deteriorated at a time when the majority of countries were moving in the opposite direction, dragging Colombia down to a worrisome 78 in the ranking.

The government did show some interest in carrying out counter-reforms. Fortunately, these never managed to be officially presented to Congress. Among them, perhaps the most important one was the review of the legislation that granted independence to the Central Bank. Although it was never officially proposed, this intention can be inferred from several statements made by then Finance Minister Guillermo Perry. He criticized, among other factors, the lack of a forum to coordinate economic policy between the Bank and the government. He mentioned that the fact "that an independent Central Bank equipped with powerful monetary and exchange instruments, has as its sole objective price stability, or worse, a mandate to reduce the annual rate of inflation, can end up

[129] Op. Cit. Herrera (1997) pp. 142.

Table 30. Index of market Orientation

	Score			Ranking		
	1995	1996	1997	1995	1996	1997
Latin American Countries:						
Argentina	2.85	2.65	2.65	35	37	42
Bolivia	3.20	2.75	2.85	58	46	59
Brazil	3.30	3.45	3.35	63	94	94
Colombia	2.90	3.00	3.10	37	66	78
Chile	2.50	2.45	2.25	20	30	22
Costa Rica	2.90	2.80	2.80	38	47	50
Mexico	3.05	3.35	3.35	51	86	94
Venezuela	3.00	3.50	3.60	46	100	108
East Asian Countries:						
Hong Kong	1.25	1.25	1.25	1	1	1
Indonesia	3.35	2.85	2.85	69	54	59
Korea, Rep.	2.15	2.30	2.45	13	22	27
Malaysia	2.15	2.40	2.60	14	27	36
Philippines	3.30	2.90	2.80	66	57	50
Singapore	1.25	1.3	1.3	2	2	2
Thailand	2.30	2.30	2.30	19	22	23
Selected Developed Countries :						
Australia	2.20	2.10	2.15	15	17	18
Austria	2.05	2.05	2.15	10	15	18
Canada	2.00	2.00	2.10	8	12	15
Finland	NA	2.3	2.3	NA	22	23

Source: Johnson and Sheehey (1995, 1996, 1997) causing serious damage to the economy, in terms of foreign exchange imbalances, recession, unemployment, and economic growth. In my view, this topic requires a broader discussion, and possibly, a review of the law."[130]

Otherwise, the government turned its attention to legislating in areas where consensus existed and which would improve its image. Thus, it passed regulations on the financing of electoral campaigns and toughened the anti-drug trafficking legislation, to a great extent as a result of pressure from the United States.

In 1998, Andrés Pastrana was elected as President. He took over a country in critical condition, in every sense. In terms of the economy, the unemployment rate and fiscal deficit had reached alarming levels, and the growth rate had collapsed. With respect to institutions, there had been a significant turn for the worse (Tables 26-28). As if this were not enough, the internal violent conflict had worsened.

In this scenario, Pastrana faced a double challenge: the armed conflict and the modernization of the economy. Evidently, Gaviria had faced virtually the same situation eight years before. However, he then had a considerably more promising economic situation. In terms of the first problem, Pastrana, even before he took power, established contact with the largest guerrilla group, the "Fuerzas Armadas Revolucionarias de Colombia" (Colombian Armed Revolutionary Forces) or FARC. Based on these contacts, he reached an agreement on the withdrawal of the army from a series of municipalities around the country. Later, a negotiating agenda was defined. At the time of writing, no serious negotiations have been advanced. This process is still in the very early stages. The President himself has acknowledged that most probably the armed conflict will not be

[130] Perry, G. (1995).

resolved during his administration.

In terms of structural reforms, after more than one year in office, it seems that not a lot has changed. The fiscal problem has deepened, to which the government response with lightweight measures to marginally adjust expenditures. As a result, Colombia recently lost its "investment grade" from credit rating institutions.

Faced with enormous financing requirements, the government had to turn to multilateral organizations. The salient feature was the establishment of a program with the IMF –the first in Colombia's history—signed in the second half of 1999. The success of the program depends on fiscal consolidation, monetary discipline, restructuring of the financial sector and *continuing the structural reform agenda.* A demanding time chart has been drafted, to be regularly supervised by the Fund. The agreement includes the following commitments:

- Presenting to Congress, before December 31, 1999, a proposal to amend Law 100 of 1993 (which deals with social security) in order to cut the link between transfers and current revenue, and to limit spending by territorial entities.
- Presenting to Congress, before March 31, 2000, a tax reform in order to eliminate VAT exemptions and to increase the income tax base.
- Develop the provisions of the Financial Reform Law (July 1999) before June 30, 2000.
- Proposal to Congress, before March 31, 2001, of a local tax reform, in the framework of greater fiscal independence for local governments.
- Privatization of all public banks, except Banco Agrario, before December 31, 2002.

Ten years after Cesar Gaviria embarked on an ambitious reform effort, under the tutelage of the IMF Andres Pastrana –whom Gaviria guardedly help defeat in the 1994 Presidential elections—now faces the task of advancing the reform agenda. While Gaviria's initial efforts were made easier because Colombians were concerned with a major Constitutional reform and with the task of ending a bloody battle with drug dealers –and did not care much about trade reform or central bank independence-- Pastrana will most certainly face a daunting task, as he advances market-oriented reforms at the same time he negotiates peace with Latin Americas oldest communist guerrilla movements.

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