



NOTES ON ECONOMIC AND LABOR FACTORS IN COLOMBIA 2005¹

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I. THE GROSS DOMESTIC PRODUCT

A country's production of goods and services is the primary indicator of the state of its economy. An expansion of this production not only increases the sum of products that can be acquired by the average citizen, but also in turn adds to the number of job opportunities for the unemployed and job stability for those with work. This type of increase can lead to higher real wages⁴, reduced inequality, and lower poverty. Conversely, a drop in production indicates reduced employment, lower wages, lower quality of living, and a rise in poverty⁵.

The product generated by a country (the gross domestic product or GDP) also reflects the behavior of its internal and external markets: these are factors related to stability, dynamism, stagnation of production, and the growth or decrease of imports and exports. The performance of the GDP is also affected by the domestic market, by household consumption, public and private investment, and the amount of money a government spends on its economy. In short, the GDP reflects the behavior of many economic and social variables, and ultimately has an effect – both direct and indirect – on the well-being of a population.

For the above reasons, the GDP will be the focus of our analysis; we will outline the characteristics most relevant to its behavior up to September 2005. It is important, too, to keep in mind not just the time period involved, but to have a larger scope that includes socio-historical factors and more nuanced economic trends. This will allow us to present the most holistic picture of the economy in the context of overall economic globalization.

i. The Economic Cycle Comes to A Peak

The business cycle is an inherent characteristic of every economy. As we look at a country's production in a historical perspective, we see general economic growth over the long-term. This is an expected trend, as increased population naturally leads to increased demand in goods and in turn increased production⁶.

Nonetheless, when we examine an economy in smaller chunks – in five year periods, for example – we find that this growth is not sustained and that in fact there are significant bumps along the way. It is in this fluctuation that we see times of crisis and times of stability, increases and decreases in production, and overall trends that affect other variables such as

⁴ Real wages are understood as the ability of income to meet basic needs for a set group of goods and services.

⁵ An increase in a country's production has the potential to increase employment and wages, but it is possible that this does not occur. On the other hand, a drop in production is almost always met with a drop in employment and real wages. This phenomenon can be explained by the fact that productivity can spike at a given time, and the same number of workers can account for increased production.

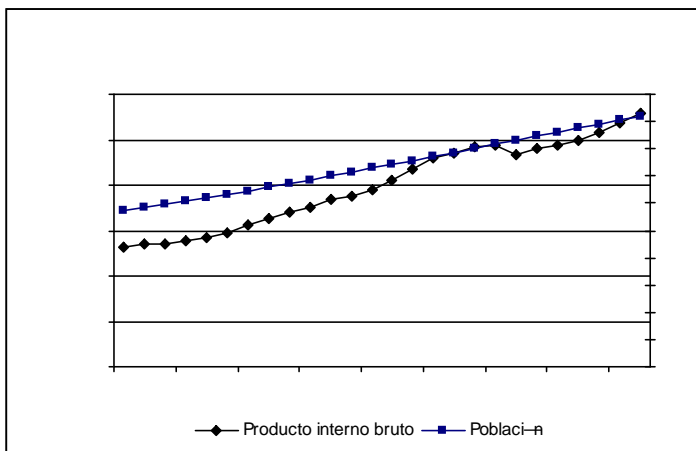
⁶ Multiple factors can explain a growth in production; in addition to population growth, there is the rise of technology, an influx of capital, the structure of labor and production, and many other unique factors. Understanding economic growth is one of the key goals of contemporary economic theory.

employment and wages. A holistic analysis, then, is also an analysis of economic cycles.

The behavior of Colombia's economy has been defined by these characteristics. Graph 1A demonstrates production trends over the past twenty-five years alongside total population; 1B looks at economic cycles (rates of growth in the GDP) from 1990 to 2005⁷. The overall growth in production is evidenced in 1A. Between 1980 and 2005, the GDP grows exponentially, almost without interruption; it is only from 1994 to 1999 that we see this trend not present, with a large growth at the beginning of that period and a sharp drop at the end. Even so, the overall trend remains consistent, despite the economic crisis in Colombia at the time⁸. Similarly, the nation's population shows consistent positive growth, even if it is not with the same intensity as GDP growth, which in two instances reaches population levels⁹. In summary, then, it is seen that production increases over the long run and is linked to, among other things, a growth in number of inhabitants.

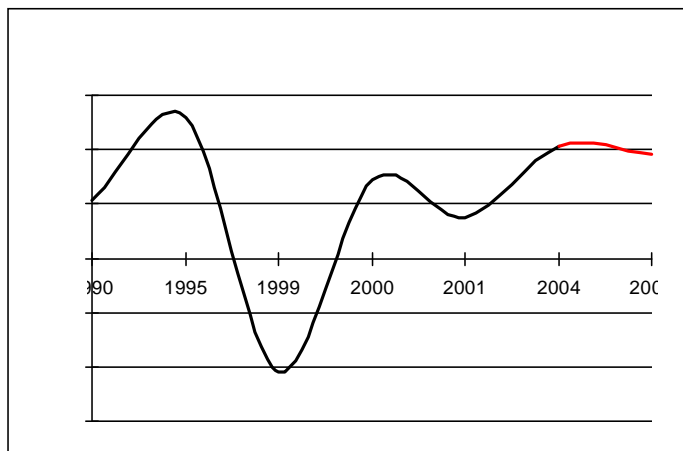
Graph 1

(GDP and Population in Colombia)



1A

(Growth of the GDP)



1B

Source: DANE. * 2005 projected

In contrast to the long-term performance of production, which displays sustained upward movement, the growth of this production, when looked at as a percentage and assessed over smaller periods, shows multiple fluctuations. Graph 1B illustrates these oscillations and

⁷ Graph data: figures for 1990, 1995, 1999, 2000, 2001, 2004 y 2005; for 2005, a projection of 3.9% was used, an average of the first two quarters.

⁸ This crisis was both external and internal in nature: there was the impact of international crises, errors in domestic economic policy, and the effects of a new social and economic regulatory model.

⁹ In the population figures we see an almost straight line, partly due to a statistical adjustment by the DANE (National Administrative Statistical Department).

economic cycles from 1990 to 2005.

This graph shows us that the performance of the Colombian economy is anything but homogenous, and in fact shows volatile instability in certain years. The nature of this production, alongside industrial, agricultural and service growth, appears in summary to be a “meandering walk” more than a consistent trend; we have no way of predicting future trends, much less short-term performance. Nonetheless, we can infer some important things from the above graph.

There are two periods clearly defined; one, from 1990 to 2000, with one global maximum and one global minimum (where growth and decline is most stark) and one local minimum and one local maximum (where fluctuation is less drastic); the other period, from 2001 to 2005, saw one maximum and two local minimums. The first period corresponds to the direct effect of economic liberalization: in 1990 the Colombian economy¹⁰ grew by 2.1%; but with a strong influx of capital, imports and a growth in private internal debt, as well as increased public spending and demand, the economy grew by some 5.2% in 1995, the highest rate in the past 15 years.

This situation reverted quickly, however. The re-valued currency, high interest levels, the departure of capital, international insecurity and few internal safety nets came to a head in 1999, when the economy dropped by some -4.2%, the highest decrease in the country’s history. Nonetheless, following a decline in production, there is invariably a growth; in 2000, production grew by some 2.9%. It is worth noting, though, that this rate is far lower than that seen in the first five years of the decade, and below the long-term Colombian average rate of growth, which from 1925 to 1990 came in at 4.4%.

The second period, from 2001 to 2005, if not directly influenced by liberalization, was certainly indirectly affected. The reorganization of production occasioned by these reforms led to changes in the types of goods and amount of production seen in the country. Two characteristics mark this period: i) higher volatility than in the previous ten years; ii) smaller fluctuations than that period. In other words, there was greater volatility within a narrower range. In 2001 economic growth dropped to 1.5%; in 2003 and 2004, it recovers to 4.1%, but it is expected to drop again to 3.9% for the current year.

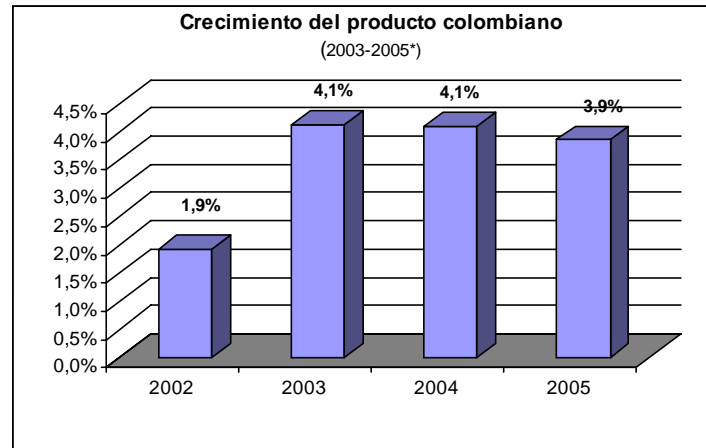
This percentage corresponds to the average of the first two trimesters of this year and is marked by the red line in the graph. It is possible, nonetheless, that this year’s rate could be higher if we take into account that in the past five years rates of growth have tended to grow (Graph 1B), even though we postulate here that the economic cycle has reached its apex.

There are four reasons to believe that production will decline. The first is the cyclical nature of the economy, such that every growth is followed by a lull; since 2003, the Colombian economy has grown at rates higher than 4.0% (graph 2), and there is cause to believe that this

¹⁰ Periods of GDP growth are referred to as “economic growth.”

has reached its highest levels¹¹. While this may seem like an exceedingly subjective and intuitive assesment, it's important to recognize that economic science is severely hampered by the nuanced factors involved, such that observations of this type are often more effective than theoretical predictions.

Graph 2 (Growth of Colombian Production)

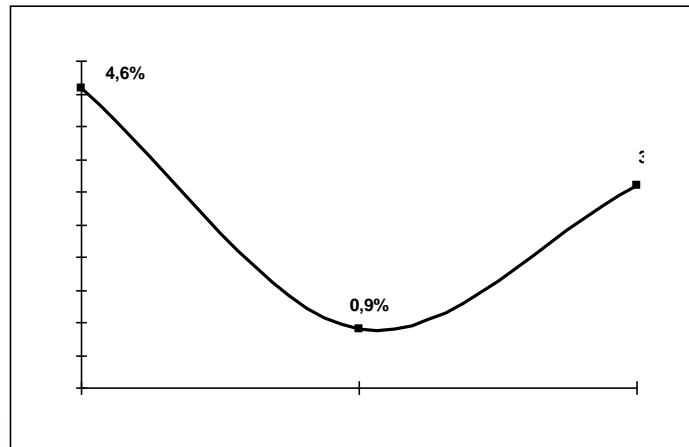


Source: DANE

The second reason is the historical behavior of production growth. Until 1990, the Colombian economy grew by an average of 4.4% per year, a rate that dropped to 2.9% in the following fifteen years. These rates act as natural limits to economic growth, such that overall growth does not deviate much beyond these rates. As seen in Graph 3, the economy has been less dynamic in the past decade than overall levels would suggest: from 2001 to 2005, growth stood at 3.1%, and only 0.9% in the lustrum prior to that.

Graph 3

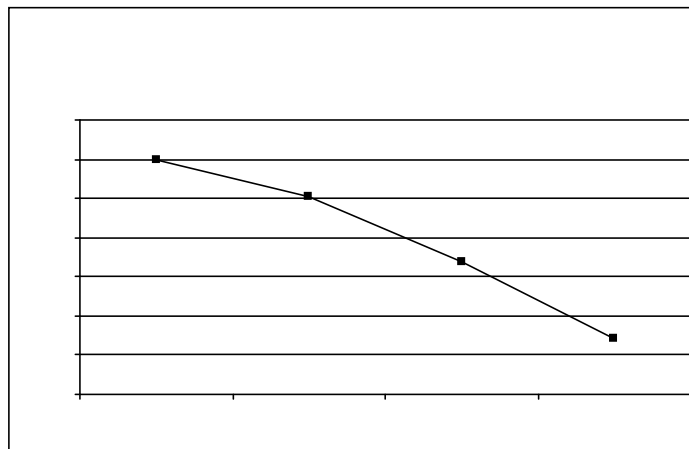
¹¹ It also worth noting that, assuming that trends will continue, over the past fifteen years the change in growth has occurred in two-year intervals.



Source: DNP¹² y DANE

The third factor to consider is related to job creation. Job growth has declined in the past three years, with growth of only 2.5% in 2003, 1.7% in 2004, and just 0.7% through August 2005. The size of the work force is, naturally, a limiting factor on production, and a decrease in labor supply will naturally lead to a halt on goods and services, which traditionally drive economic growth.

Graph 4 (Growth of Employment in Colombia)



Source: DANE.

* Growth for August, as compared with previous year

The fourth factor has to do with quarterly growth in production, which is further explained in the section below.

¹² DNP: National Planning Department

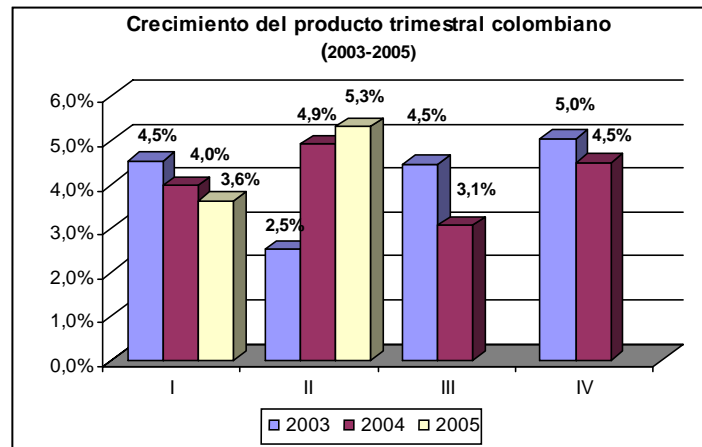
b. A Decline in Quarterly Production Growth

The annual economic growth can hide certain key factors that deserve closer scrutiny. While at first glance, growth over the past three years appears to be high and consistent, a look at quarterly growth reveals just the opposite.

Looking at quarterly growth as shown in Graph 5, we see that since 2003, save for the second quarter, there has been a consistent drop. That quarter has seen a growth from 2.5% to 4.9% to 5.3% in the present year, but it is an anomaly; in the other three quarters, the performance is the opposite.

The first, third and fourth quarters have seen sharp decreases. In the first quarter for 2003, the economy grew by 4.5%; the following year, that growth dropped to 4.0%, and this year it stood at 3.6%. The drop in the third trimester is even steeper, from 4.5% in 2003 to 3.1% in 2004. The final trimester saw a drop in growth from 5.0% in 2003 to 4.5% the following year.

Graph 5 (Quarterly Production Growth)



Source: DANE.

These decreases in growth suggest that for the present and near future, we will continue to see quarterly slowing of growth, further bolstering the notion that the present cycle has reached its peak. Moreover, we should not look at this behavior as erratic: while the high level of growth in 2003 had residual effects on the following years, the impact of that spike in growth weakens and weakens with every passing quarter.

Moreover, we should understand this behavior in light of the employment situation. If the largest growth is concentrated in one discrete period and is not sustained, employment and wages are affected accordingly; workers only receive part of yearly wages, or are only employed for part of the year, leading to an overall drop in income and higher instability.

This is an insidious form of labor precariousness.

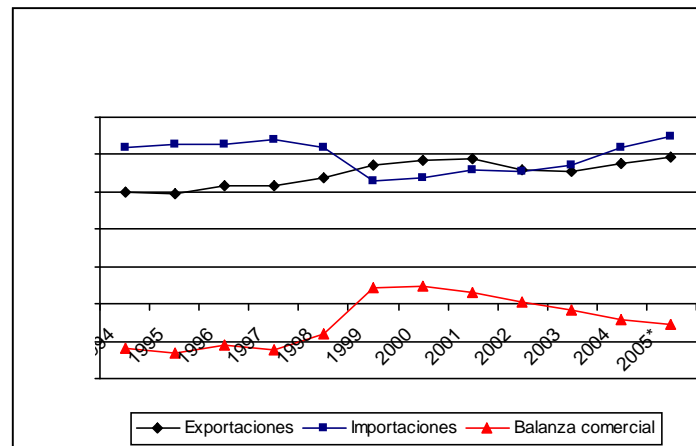
II. THE EXTERNAL SECTOR

The development model implemented in Colombia as of fifteen years ago proscribes a fundamental role for external commerce. Growth in exports and an overall insertion into international markets was one of the primary goals of these new policies; ideally, this increased focus would bring labor and quality of life factors along with it.

This re-alignment was in contrast to the previous model, which looked to prioritize internal production and the development of the domestic market. The role of the state was, primarily, to aid development of economic sectors, particularly industry. The current configuration is markedly different: a smaller role for the state and industry in production and employment, and an overall stratification of the economy.

Graph 6 helps us see the importance of the external sector in the Colombian economy. On average, exports fluctuate between 15% and 20% of the GDP, which indicates that some 80-85% of Colombian production is for the internal market. If the objective is to increase external commerce, then a growth in exports must be buffered by a change in internal production, as to avoid the dangers of exposing the economy to free import of all types of goods and services. The 20% of the GDP geared towards exports cannot be prioritized at the expense of the remaining 80%. In the past decade and a half, though, this has been the prevailing policy adopted by Colombia.

Graph 6 (Share of Exports, Imports and Commercial Balance in the GDP)



Source: DANE.
* First Quarter 2005

If 20% is a high number for some, -2.3% surely is not; that is the mark for the average

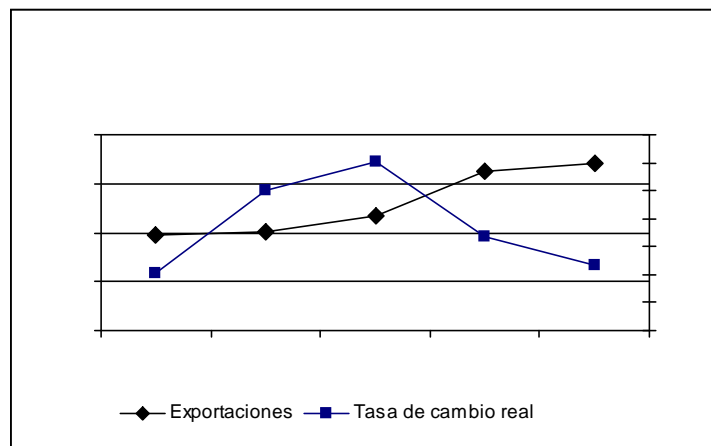
growth in the commercial balance from 1990 to 2005, as indicated by the red line in Graph 6. The impact of exports drops strongly with the influx of imports; in the past fifteen years, there has been a trend towards commercial deficit, calling into question the effectiveness of current policy to address the issues brought up by the liberalization of different markets.

i. Re-Valuation has not Deterred the Growth of the External Sector

For years, the devalued nature of the Colombian currency guaranteed competitiveness for their products in the external market. Colombian producers gained high revenue through the influx of foreign currencies or by high sales levels driven by the low prices. Upon re-valuation, though, these same producers suffered significantly: they saw lower sales and lower profits, and were forced to ask for intervention from the central bank.

Since 2003, the Colombian currency has been significantly re-valued, by almost 25%, from 2900 pesos that year to 2200 pesos currently. This has, once again, led for calls by businesses for greater intervention from the central bank. Despite the fact that the situation seemed critical, the country's external commerce has not dropped; in fact, it has grown (Graph 7).

Graph 7 (Colombian Exports in \$US Millions and Rate of Real Exchange)



Source: DANE.
* First Quarter 2005.

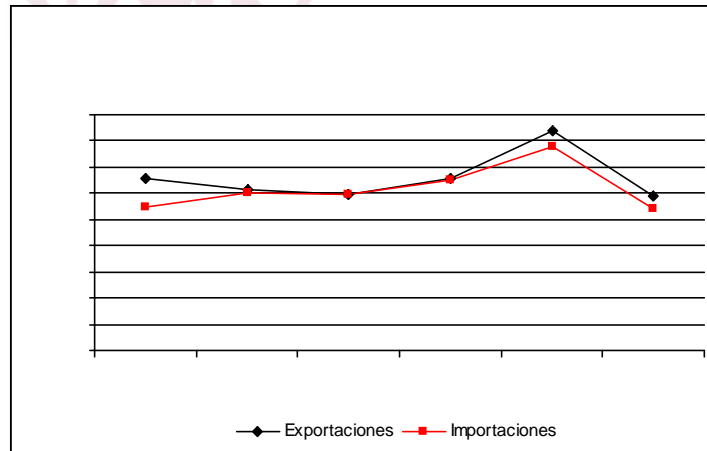
This behavior is an absolute paradox. While the Colombian peso increases in value, exports become more intense. It seems that a greater demand on Latin-American products, as well as partners such as Venezuela (that also re-valued) who have reduced the impact of capital, in addition to a rise in oil prices, a growth in productivity (through lower labor costs), and

other factors, can explain the phenomenon. Nonetheless, this trend merits a deeper discussion that has yet to occur.

ii. The Commercial Balance Has Reached an Equilibrium

The commercial balance has reached equilibrium and, as of 2004, a surplus (Graph 8). Moreover, this has occurred, as outlined above, within the context of re-valuation. The power of exports is undoubtedly due to improved exchange rates and a rising price of the dollar, but in two primary manifestations: i) greater influx of currency; ii) Venezuela, our biggest partner after the United States, improved its buying power and in turn exports to this country.

Graph 8 (Exports, Imports and the Commercial Balance in the GDP)



Source: DANE.

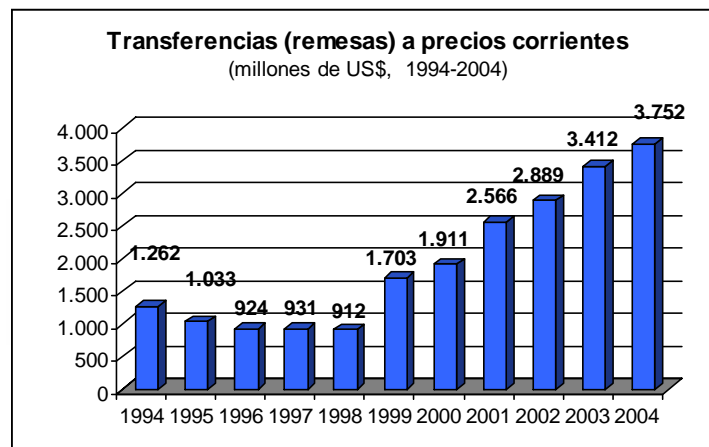
* A julio de 2005.

iii. Continued Growth of Remittances

After the crisis of 1999, one of the options that many Colombians faced was that of leaving the country to find work elsewhere. At that time, as well as now, the domestic economy did not demonstrate the capacity to generate sufficient employment and wages that Colombian workers need. The United States, Venezuela and Spain became major destinations for those

seeking work; workers in these countries would send part of their wages home in order to support their remaining families. Graph 9 reflects the remittances through money sent to the country¹³.

Graph 9 (Remittances in Current Prices)



Source: Bank of the Republic

In 1994, transfers to Colombia reached 1.703 million dollars; five years later, that amount had grown by 220%, reaching 3.752 million dollars. These figures not only reflect the financial instability faced by many Colombians, but also the macroeconomic effect of such a large influx of remittances. The re-valuation has been largely fed by this influx of currency and a drop in unemployment, though of a very particular nature: the unemployed have left the country, and their remittances have supported the inactive population (who are of working age but don't seek jobs).

We should not ignore the presence of narco-trafficking dollars in these earnings. Remittances are an effective way to launder money that enters the country. Nonetheless, it is estimated that the share of this type of money is not significant and certainly not one of the primary sources of foreign money sent to the country.

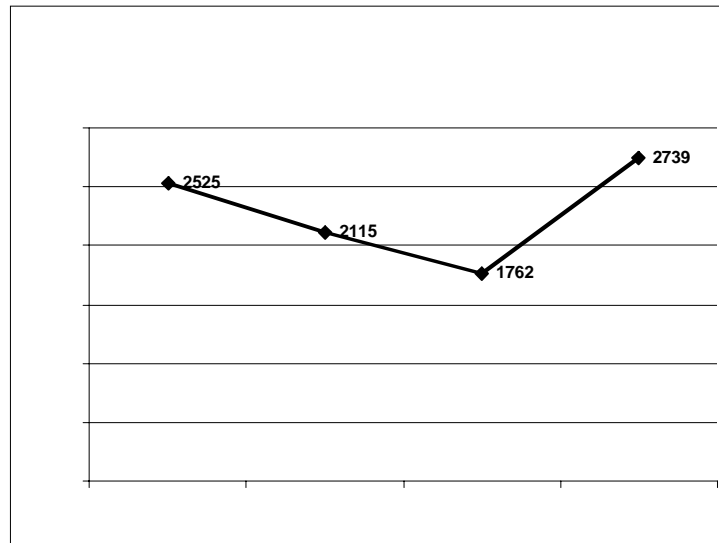
iv. The Growth of Foreign Investment, Primarily in Sectors Marked by Little Employment and High Profit

Direct foreign investment (IED) has grown considerably in the country the past two years, after its significant decline in 1997 (due to the flight of capital in the face of crisis) (Graph

¹³ Of the transfers sent to Colombia, more than 90% are remittances.

10). However, we cannot assume that this increased investment leads to new companies or new jobs; this investment goes to sectors that are marked by their low levels of employment and high profitability.

Graph 10 (Direct Foreign Investment in Colombia)



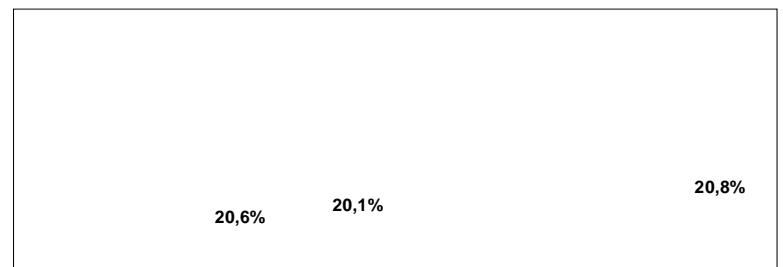
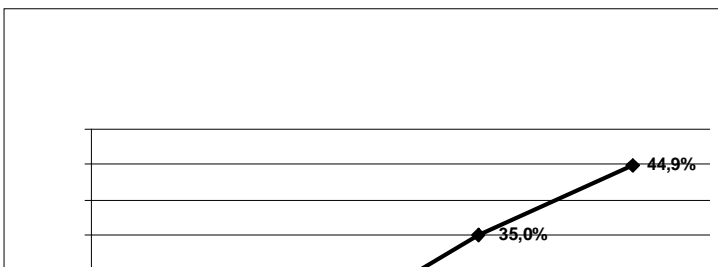
Source: Banco de la República

Graphs 11A and 11B show where IED in Colombia is generally directed. From 2002 to 2004, the share of IED in mines and quarries was 22% of the total; in 2003 that share grew to 35%, and reached 44.95% in the last year. The participation of the oil industry is also considerable, reaching 20.8% in 2004. Together, mining and oil accounted for two-thirds of the total IED. Contrast this with the number of jobs created by these sectors: less than 1%.

Graph 11

(Share of IED by Mines and Quarries)

(Share of IED by Oil Sector)





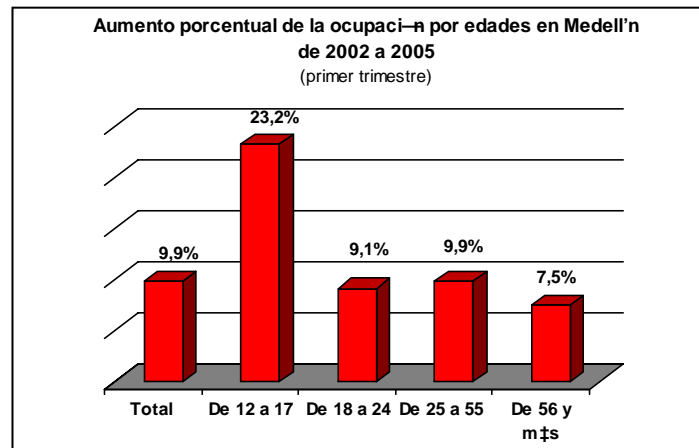
Source: Banco de la República

III. QUALITY OF EMPLOYMENT: A CASE STUDY

One way to look at the nature of jobs created by an economy is through an analysis of unemployment, but also through the lens of age. In this section, we will take this approach to the city of Medellin.

If we look at unemployment rates in Medellin, we see that unemployment drops in recent years: in the first trimester of 2002, it stood at 16%, and in 2005 it had dropped to 13.3%. Employment had grown by 9.9%, representing some 107,848 new jobs. Of these, 74.9% were held by workers between the ages of 25 and 55 years, a group that reflected the total average increase (Graph 12).

Graph 12 (Growth in Employment by Age for Medellin (2002-2005; First Quarter))



Source: DANE

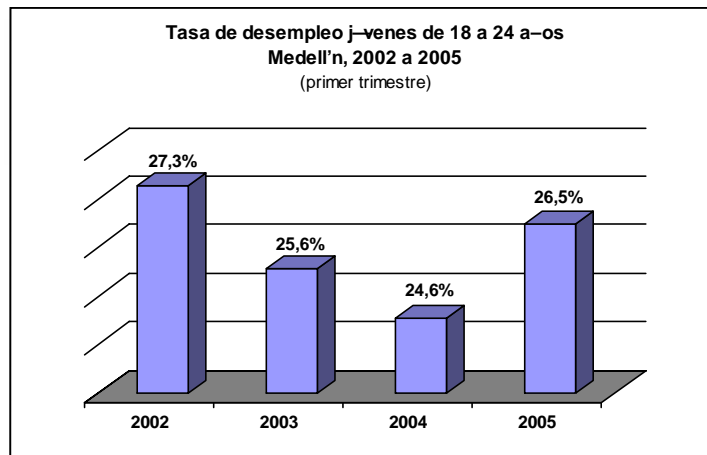
Two relevant – and worrisome – factors come to light in the above graph: i) the highest percentage of growth is seen in children; ii) citizens over the age of 56 search for work, often in an informal capacity, when they ought to be leaving the job market. The problem of minors working in the Medellin area is quite serious: in 2004 we saw the highest number ever of child workers, some 30,497, which was 9,070 more than the previous year. Overall employment grew by 4.1% that year, but it was driven by youth employment growth: 13.1% for those between 18 and 24, and 42.3% for children¹⁴.

¹⁴ The group of age 12 to 17 accounted for 19.4% of the employment in 2004.

As a result, employment from 2002-2005 was driven primarily by sectors that ought to correspond to the inactive population: children and those older than 56. In 2003 this group grew by 11,142 workers to 103,509; for the following year it grew by 301, and in 2005, there was a drop of 4.530, leaving 99.280 jobs.

An analysis of unemployment rates provides additional information. In the figures provided by DANE, we see a drop in unemployment, particularly for those between the ages of 25 and 55; the same can not be said for those between 18 and 24 (Graph 13).

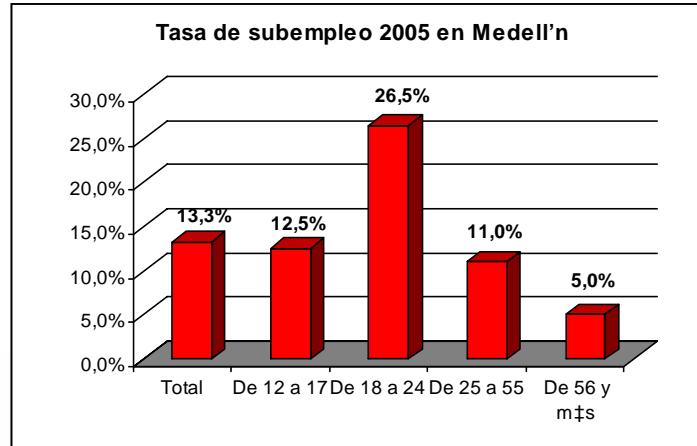
Graph 13 (Rate of Employment for Youth Ages 18 to 24)



Source: DANE.

The rate of unemployment for youth between 18 and 24 years old is the highest of all the age groups. The overall average for all age groups (from 2002 to 2005) is 14.7%, and that of minors and of those between 25 and 55 is 15.5%. The rate for youth, however, stands at 26%. It is no coincidence that this age range also has the highest levels of subemployment. While in 2002 and 2004 there is considerable drop in subemployment, from 27.3% to 24.6%, the first quarter of this year saw a reverse in the trend, and 1.9% growth in subemployment.

Graph 14 (Rate of Subemployment in Medellin 2005 (by Age))



Source: DANE.

Ultimately, we can see that there is insufficient job creation in Medellin, and the quality of jobs created is questionable. Child labor is a problem, and the percentage of subemployed workers (31.1%) is too high, particularly in light of an overall drop in subemployment worldwide. Youth between the ages of 18 and 24 have the highest rate of subemployment of the past three years, some 40.6%. In children, too, the lowering trend has also reversed as of late: in the last year, subemployment grew by 5% to 37.7% for this group.