

# NAVAL POSTGRADUATE SCHOOL Monterey, California



## THESIS

**COLOMBIA'S ECONOMIC RECESSION: THE IMPACT  
OF GUERRILLA VIOLENCE, ILLICIT DRUG  
TRAFFICKING, AND THE 1991 CONSTITUTION**

by

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December 2001

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**COLOMBIA'S ECONOMIC RECESSION: THE IMPACT OF GUERRILLA  
VIOLENCE, ILLICIT DRUG TRAFFICKING, AND THE 1991 CONSTITUTION**

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**MASTER OF ARTS IN NATIONAL SECURITY AFFAIRS**


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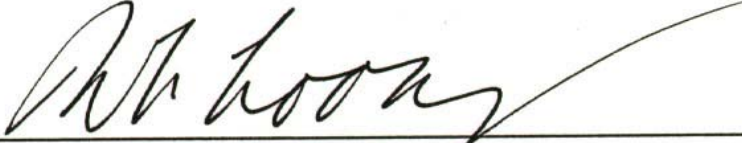
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## **ABSTRACT**

Colombia has tolerated for almost fifty years the oldest guerrilla movements in the region, but at the same time the country has showed stable economic growth up until 1998. Now, in the face of an economic recession, the puzzle is to establish which of the following variables; guerrilla violence, illicit drug trafficking, or the 1991 Constitution, have most affected economic stability in the last half of 1990s.

The thesis will argue:

- (1) Guerrilla violence is the most important variable that impacts Colombia's economy, causing severe internal and external migration. Kidnapping, extortion, terrorism, and infrastructure attacks represent the loss of million of dollars in economic damages.
- (2) The illicit drug trafficking is the second most important variable that has affected Colombia's economy, causing an economic domestic boom during the period of the Cali and Medellin drug-cartels, infiltrating the economy with money laundering and fictitious business.
- (3) The 1991 Constitution, the third variable, established many new economic responsibilities at the state level, which aggravated the state fiscal crisis. The separation of taxation and spending among different levels of government has fueled severe problems of fiscal imbalance, because the bulk of tax revenues is collected by the Central Government but spent at municipal levels.

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## **EXECUTIVE SUMMARY**

### **A. GENERAL AREA OF RESEARCH**

Colombia in 1999 faced the deepest economic crisis in fifty years with a negative GDP of 4.5 percent. Colombia historically has had one of the most stable economies in Latin America. The economy enjoyed uninterrupted growth from 1932 until the mid-1990s when the economy began to unravel due to a complex blend: (1) terrorism and violence generated by subversive actors; (2) Clinton's drug war decertification (the U.S. sanctions did not succeed in driving President Samper from office, but they reduced business confidence and contributed to the sharpening of the economic crisis); and (3) weak institutions incapable of enforcing the rule of law to prevent rampant corruption and impunity.

### **B. RESEARCH QUESTIONS**

The puzzle is to establish which of the following variables: guerrilla violence, illicit drug trafficking or weak institutions created with the 1991 Constitution have most affected economic stability in the last half of the 1990s.

### **C. MAIN FINDINGS**

#### **1. Guerrilla violence**

The accumulation of terrorism and violence generated by the Army Revolutionary Forces of Colombia (FARC), the National Liberation Army (ELN), and the Self-Defense Organization (AUC)—called paramilitaries—were the heaviest factors contributing to Colombia's economic recession in 1999, considered the most critical in Colombian history in the twenty-century. The lack of domestic and foreign economic incentives for investment was due to terrorism and violence, which until today continues spreading its damage over the national territory. The terrorism continues fueling unemployment, economic uncertainty, and the lost of confidence for opening new businesses or for starting joint ventures, especially in the agricultural, cattle, and mining sectors. These sectors are considered very important for peasantry stability by preventing migration to the metropolitan areas where urban violence is rising.

## **2. Illicit Drug Trafficking**

Drug trafficking was the second heavy factor that fed subversive violence and contributed to the economic recession. Today drugs continue spreading its criminal power through its atomization in small white-collar organizations, its complicated tracking and its detection (due its low profile) by law enforcement.

In fact, the drug-profit continues to return to Colombia (it is no more than 20 percent of the total foreign drug-markets earnings) with the implication of being converted into weapons, ammunition and logistic supplies for the terrorist actors. Thus, the aggregate value for Colombia's economy sector is minimal. Additionally, money-laundering in the informal sector continues to feed smugglers and contraband businesses, worsening the economic situation of the medium and small Colombian enterprises due to unfair market competition, causing unemployment and social unrest.

Finally, the main constraint on the counter-narcotics policy is the traffickers' ability to corrupt and intimidate the political system because drug-power undermines the rule of law.

## **3. The 1991 Constitution**

The 1991 Constitution, the third factor, has indirectly contributed to the economic recession by its lack of power to guarantee through state institutions connivance, justice, peace, development and economic growth. The institutions developed after the 1991 Constitution continue to function with the same clientelistic political behavior where patronage and rent-seeking is the bottom line. The corruption survives because no ex-ante oversight was established. Undoubtedly, "the civil society" willing to do this does not exist in real terms. Moreover, terrorist escalation has impeded the fiscal and municipal decentralization process given its intimidator power and manipulation over almost 600 municipalities and its mayors' outcomes. In addition, the social security system continues to run with a serious fiscal unbalance. Therefore, the system would collapse if due to the lack of political consensus among labor unions, congressmen, and enterprise owners.

Finally, the 1991 Constitution is considered a rigid micromanagement tool that complicated the globalization process and the need for flexibility in opening markets,

labor supply, and domestic and foreign investment. Its criteria of indexation of pensions, goals for inflation, and the allocation of regional public expenditures (as a welfare state) complicated the flow of capital-investment, services and goods required in opening markets. Moreover, the weak state institutions created after the 1991 Constitution demonstrated its inability to provide basic public goods: justice, security and defense. For this reason, peace continues to be an elusive proposition, and the criminal actors often violating fundamental rights of citizens, especially the right of life, continue to exist.

#### **D. CONCLUSION**

Colombian history shows that Samper's Administration from 1994 to 1998 was unwilling to confront the terrorist organizations with enough political and military power. Thus, the intense use of violence and corruption accumulated in this period affected finally Colombia's socio-economic well-being and fueled the economic crisis until it reached a negative (-4.5) percent of GDP in 1999, never seen before in national economic history. In fact, some Colombian experts estimate that this conflict costs the country from 4 percent to 9 percent of growth per year.<sup>1</sup>

The gross direct cost of violence and terrorism between 1990 and 1998 reached \$3.2 billion US dollars a year, meaning 4.5 percent of the GDP. Perhaps, this estimate does not consider facts such as the loss of confidence in the judicial system, the loss of the monopoly in the legitimate use of force by the state, the loss of the well-being of the population, and the opportunity and transactional cost for society loss. In other words, the real cost of terrorism and violence are underestimated due to difficulties in calculating it.

2

The case of loss of opportunity cost due to violence, if this 4.5 percent of the GDP loss could be oriented in population needs, the following be possible: (1) In one year educational coverage for 1,118,000 elementary students under 10 years of age out of the educational system today; (2) in only three years a solution to the national housing

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<sup>1</sup> The World Bank, "Violence in Colombia: Building Sustainable Peace and Social Capital," Washington D.C., 2000, considered 4 percent of GDP. On the other hand, a report from the Colombian Department of Planning, September 9, 1999, considered 9 percent of GDP.

<sup>2</sup> Castro Manuel, Wartember Jorge and Celis Andres, "El Conflicto Armado: La Estrategia Económica de los Principales Actores y su Incidencia en los Costos de la Violencia, 1990-1998," Essay, Grupo de Desarrollo y Paz de la Unidad de Planeación Rural y Urbana del Departamento Nacional de Planeación de Colombia, 2000.

deficit; or (3) in only two years the accomplishment of exploration, development and oil production needed for the next four years.<sup>3</sup>

The subversives showed their ability in causing an unbalance in Colombia's national economy through uncounted terrorists attacks against the economic infrastructure, as well as through many sieges against small towns and villages. These attacks caused internal migration, fueling social tensions and instability in the big cities. The Colombian economic sector most affected by terrorism and violence is the oil and mining sector, Empresa Colombiana de Petroleos Nacionales (ECOPETROL) and its joint ventures with British Petroleum Company (BP), and the Occidental Oil Company which has sector negatively impacted the economy due to the accumulation of thousands of terrorist attacks against its infrastructure.

In addition, the loss of profit derived from these attacks affect domestic investment, especially in those areas where exploration and operation are functioning. Without a doubt, the Colombian government is losing the opportunity to invest in other sectors of the national economy to incentivize employment and development, and to improve the conditions of its weak social security system, especially in health and education.

Due to internal migration of violence, Colombia has passed from being an exporter to an importer of six million tons of foodstuff. Abandoning rural areas because of forced displacement has ruined one of the most prosperous sectors of the economy.

Finally, there is not doubt that the main fuel of the war in Colombia is the drug trade, since it is the primary source of financing for both the subversives and the paramilitary groups. The objective of narco-trafficking is obvious. Its illegal business will prosper to the extent that the state is incapable of suppressing the cultivation of coca and poppy and the establishment of laboratories processing cocaine and heroin. For this reason, the geography of the drug trade coincides almost exactly with the geography of war. This is precisely due to the drug trade flourishing in isolated and sometimes inaccessible jungle areas.

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<sup>3</sup> Ibid.

## I. INTRODUCTION

Colombia has tolerated for almost fifty years the oldest subversive movements in the region, but at the same time the country has showed stable economic growth up until 1998. Now, in the face of an economic recession, which reached a negative GDP of -4.5 percent in 1999, the puzzle is to establish which of the following variables: guerrilla violence, illicit drug trafficking, or the 1991 Constitution, have most affected economical stability. The recession is defined by (a) a 20% unemployment rate (the highest in the Western Hemisphere), (b) a dramatic reduction of foreign investment, (c) socio-economic unrest (with the highest rate of violence in the world with close to 250,000 deaths in the last ten years of conflict (ANIF)<sup>4</sup>), (d) a severe brain-drain (almost three million Colombians left the country in the last decade, with 1.7 million as internal refugees), and (e) a state fiscal deficit that affects social security issues (especially in such areas as health, education, and regional pensions at the municipal level.)

This thesis will argue that guerrilla activity, reaching its peak of violence and terrorism in the last half of the 1990s, is the most important variable that impacts Colombia's economy. The guerrillas through criminal actions, such as drug-trafficking, kidnapping, extortion, war-tax, theft, and the constant attacks on the infrastructure's represent the loss of million of dollars in economic damage.

Illicit drug trafficking is the second most important variable that has affected Colombia's economy, causing an economic domestic boom from 1985 until 1995. During this period of the Cali and Medellin drug-cartels, money-laundry and fictitious business infiltrated the economy. After Colombia's military forces destroyed the drug-cartels, many businesses collapsed including real estate, construction, hotels, clubs, and luxurious stores serving as money-laundering centers, especially in Cauca Valley and close-by areas.

Finally, the 1991 Political Constitution, the third variable, established many new economic responsibilities at the state level, aggravating the state fiscal crisis. The following areas affected the economy:

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<sup>4</sup> ANIF. Data from National Association of Financial Institutions of Colombia.

- (a) A weak judiciary; the Courts fail at their basic functions of enforcing human rights and property rights but intervene at the highest levels of policymaking. Impunity, especially in homicides, provides Colombia with the highest murder rate in the world.
- (b) The conflict of interest between the law and the dynamics of the economy. The 1991 constitutional reform intended to insure independence of the monetary authority and exchange rate policy, but it did not become a reality due to political interests.
- (c) The separation of taxation and spending between different levels of government fuels severe problems of fiscal imbalance. This is due to the bulk of tax revenues collected by the Central Government but spent at municipal levels where subversion has intimidatory power to manipulate the way in which funds are spent.

From the analysis of these three interconnected variables (guerrillas, drugs, and 1991 Constitution), this thesis will identify the weight that each one represents in Colombia's economic crisis by establishing priorities and identifying possible alternatives or solutions to mitigate their economic impact. By identifying variable weight, the required domestic effort, and the external support needed for Colombia to build a stronger economy can be established.

The thesis' organization is as follows: Chapter II describes Colombia's economic behavior in the last half of the 1990s. The chapter provides a definition of the actual economic recession in Colombia, showing data and analysis in areas, such as employment, the fiscal state deficit, the social security system, migration, the justice system, and the impact of the economic cost of violence and crime. This chapter also shows how the recession affected the economic growth and the socio-economic well-being of Colombians. Chapter III provides a description and analysis of how Colombia's terrorist movements, Colombian Revolutionary Armed Forces (FARC), National Liberation Army (ELN) and Self-Defense Groups (AUC), permeated every aspect of Colombian government and civil society. This chapter also demonstrates how these organizations established broad-based underground economies with regular expenses, both in illicit economies and within Colombia's formal economy. Finally, the chapter

covers Colombia's economic impact which caused these terrorist organizations. Chapter IV presents economic events in Colombia before and after the collapse of the Cali and Medellin drug-cartels, and the impact of the related economic boom on Colombia's economy in areas, such as real state, construction, banking, and agro-industry through money-laundering operations. Chapter V will analyze the "economic" and "political" institutions established in the 1991 Constitution, and their impact on Colombia's economy. Additionally, the chapter will focus on those economic institutions that deal with the bureaucracy and provision of social service: monetary and fiscal institutions (Central Bank), and finally the local/central government relationships.

Using the data from Departamento Nacional de Planeacion de Colombia (The National Planning Department), Asociacion Nacional de Instituciones Financieras de Colombia-ANIF (National Association of Financial Institutions of Colombia), Federacion Nacional de Desarrollo-FEDESARROLLO, Defense Minister of Colombia-Reports-2000, and World Bank Country Study, the thesis will focus on the last half of the 1990s for its analysis.

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## II. WHAT IS THE NATURE OF COLOMBIA'S ECONOMIC CRISIS?

The economy of Colombia was especially recessive from 1998 to 2000, suffering at the same time from the intensification of its domestic conflict, the worst in the region. Colombia, like other countries in the region, has been confronting structural economic problems, such as the public sector deficit, the ballooning foreign debt, and, of course, the impact of globalization. However, violence and terrorism from guerrillas, paramilitaries, drug-traffickers and organized crime have been the key and the strongest factor in the recession.

In fact, the guerrilla's tactics of kidnapping, extortion, war-tax collection, and systematic attacks against the economic infrastructure (targeting cattle raising, oil, electrical-power, coal, gold mining, transportation, and distribution of goods) are disturbing factors that no other countries in the region tolerate. It is important to mention that from 1998 through half of 2001, 4,550 terrorist attacks were registered in the Colombian Army's database. These attacks have been against infrastructure, and have affected oil pipelines, the mining sector, electrical-power plants, refineries, and transportation. The FARC, ELN and AUC forces have caused all of these attacks.<sup>5</sup>

Moreover, the unpredictable outcome of the peace process with the guerrillas has caused a lack of domestic capital investments (because of uncertainty) worsening the economy of Colombia and putting its democracy in risk of collapse. The complex blend of drugs, guerrillas, and weak institutions, most of them incapable of enforcing the rule of law, represents a threat not only to Colombia's economy and its democracy but for the whole region as well.

This chapter will focus on describing the Colombian economic recession from 1998 to 2000 by facts and analysis of macroeconomic data. This chapter will be organized into the following sections: (1) Colombia's gross domestic product; (2) Colombia's unemployment rate; (3) Colombia's fiscal deficit; (4) Colombia's principal social indicators; and (4) Colombia's economic crisis from other perspectives.

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<sup>5</sup>< <http://cambio.com.co/web/interior.php?idp=47&ids=1&ida> >

Analyzing some data about Colombia’s socio-economics configuration is important to understand the crisis. In the case of this analysis, Colombia’s economy is broken into two periods during the 1990s. The first period, from 1990 to 1995, showed the end of the economic boom. The second period, from 1996 until present, showed the deterioration of Colombia’s economy having a great socio-economic impact on the quality of life. In this analysis, the different economic indicators are the Gross Domestic Product (GDP) and its evolution in the last decade, the comparison between the GDP with the compound social indicators, such as the “Insatiable Basic Needs” (IBN), the “Human Development Indices” (HDI), the “Poverty Line” (PL), and the “Employment Global Participation Rate” (EGPR).<sup>6</sup>

#### A. COLOMBIA’S GROSS DOMESTIC PRODUCT

The Gross Domestic Product (GDP) in the 1990s showed two definite periods as shown if Figure 1. The first period, from 1990 to 1998, indicated a positive and stable growth until a remarkable reduction in 1998. In contrast, the second period, which began in 1999 and characterized by its dramatic downward trend never seen before in the Colombia’s history, experienced a negative GDP of -4.5 percent. Consequently, in 1999 the GDP was negative and brought about Colombia’s socio-economic crisis.

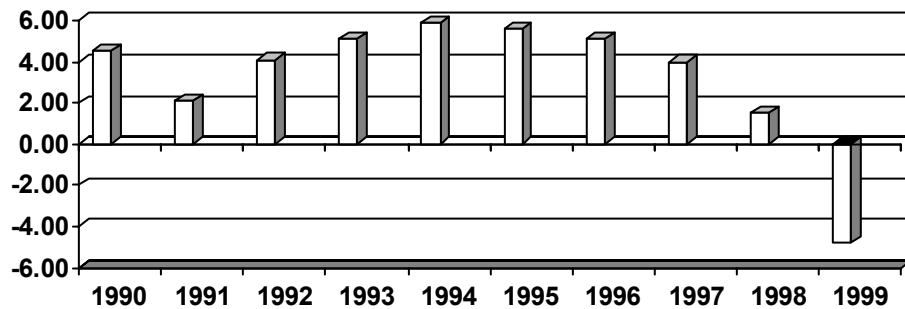


Figure 1. Colombia: The growth of its GDP in percentage (1990-1999)  
From: Departamento Nacional de Planeación de Colombia .

<sup>6</sup> Castro, de Posada Beatriz, “La Crisis Económica y Social de Colombia,” Departamento de Economía, Universidad Javeriana de Colombia, documento preparado para su distribución en XXIII International Congress of the Latin American Studies Association (LASA) 2001

## B. COLOMBIA'S UNEMPLOYMENT RATE

Lora Eduardo pointed out that until 1990 Colombia has had the most protected labor laws of Latin America; however with law No. 50 of 1990 these protective laws were destroyed. Some of the protections destroyed by law No. 50 were the two-month trial period during which a new employee can not be fired, the ban against part-time employment, and, especially, the double retroactive cost for retirement pensions (cessation), and the high costs for dismissed workers. Law No. 50 additionally contributed Colombia's recessive economy increasing the high unemployment rate due its extreme flexibility for hiring and firing. Figure 2 demonstrates the rate of unemployment in the 1990s.<sup>7</sup>

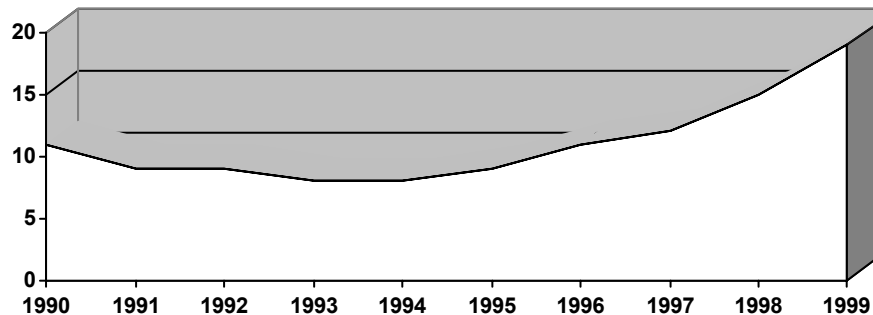


Figure 2. Colombia: Unemployment Rate 1990-1999  
From: National Data Department of Colombia

## C. FISCAL DEFICIT

During the 90s, the GDP and the unemployment rate have discouraged Colombia's economy. Colombia's fiscal deficit is another economic indicator that needs to be considered since it is the last macroeconomic indicator of analysis, showing two defined periods: a first period under acceptable standards, from 1990 to 1995, and a second period, from 1996 to 1999, which registered the worst indicators and grew without controls. In 1999, the fiscal deficit became exaggerated contradicting the government's efforts. The government carried out a contrary policy: instead of closing

<sup>7</sup> Lora Eduardo, Seminario Empleo & Economía, "Por que Tanto Desempleo? Que se puede Hacer?" Ponencia Seminario de Empleo & Economía, Bogota, Marzo 30, 2001

the fiscal gap, the government opened it in a disturbing manner.<sup>8</sup> Figure 3 demonstrates the fiscal deficit in the 90s.

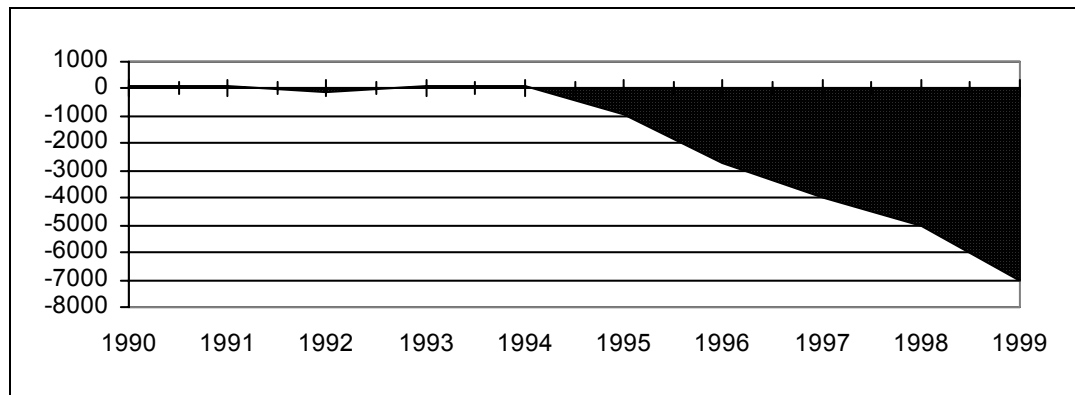


Figure 3. Colombia: Fiscal Deficit 1990-1999  
From: National Planning Department of Colombia

#### D. COLOMBIA'S PRINCIPAL SOCIAL INDICATORS

##### 1. The Poverty Line (PL)

The Poverty Line is the most alarming indices because it represents the percentage of the population that is living with an insufficient income unable to satisfy their basic food needs. In addition, the poverty line indicator shows a subdivision defined as the "Misery or Indigent Line". This represents the Colombian populations who have limited access to basic food supply, which is below the minimum required level. In the 1990s, any improvement in the poverty line was minimal. Any results of the government's efforts were perceived only after 1998. By 1999 the poverty line was going downward and showed indices equal to 1991 (53.8).<sup>9</sup> Figure 4 represents the tendency in the 90s.

<sup>8</sup>Castro, de Posada Beatriz, "La Crisis Económica y Social de Colombia," p. 07, Departamento de Economía, Universidad Javeriana de Colombia, documento preparado para su distribución en XXIII International Congress of the Latin American Studies Association (LASA) 2001

<sup>9</sup> Castro, de Posada Beatriz, "La Crisis Económica y Social de Colombia," p. 08, Departamento de Economía, Universidad Javeriana de Colombia, documento preparado para su distribución en XXIII International Congress of the Latin American Studies Association (LASA) 2001

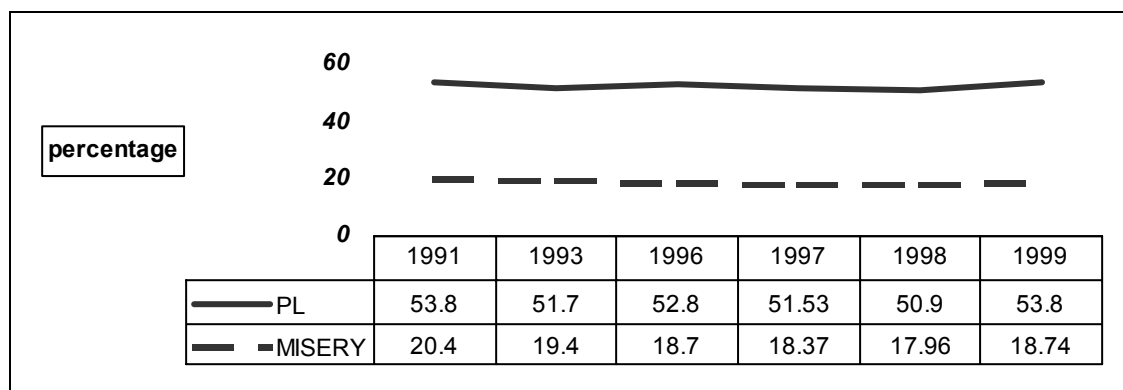


Figure 4. Colombia: Poverty and Misery Indices 1991-1999  
From: National Planning Department of Colombia  
Indicator System of Socio-Demography

## 2. Insatiable Basic Needs

The “Insatiable Basic Needs” (IBN) indicator measures the needs of the poor in relationship with five simple indicators: (a) School Absentism Rate (students between 7 and 11 years old that do not attend school); (b) Critical Overcrowding (three or more people living in one room used as a dining and bedroom); (c) Inadequate Basic Sewers, Water and Electrical Power Supply; (d) Inadequate Housing (precarious construction); (e) Economic Dependency (the relationship between the scholarly level and the head of the family’s income).<sup>10</sup>

<i>IBM Components</i>	<i>1985</i>	<i>1993</i>	<i>1997</i>	<i>1998</i>
<i>School Absentism</i>	<i>11.50</i>	<i>8.02</i>	<i>4.11</i>	<i>4.50</i>
<i>Critical Overcrowding</i>	<i>19.40</i>	<i>15.40</i>	<i>11.25</i>	<i>11.20</i>
<i>Inadequate Sewer, Water &amp; Electricity</i>	<i>21.80</i>	<i>10.52</i>	<i>4.76</i>	<i>5.00</i>
<i>Inadequate Housing</i>	<i>13.80</i>	<i>11.60</i>	<i>7.71</i>	<i>7.30</i>
<i>Economic Dependency</i>	<i>15.90</i>	<i>12.83</i>	<i>8.97</i>	<i>9.50</i>
<i>National Total</i>	<i>45.60</i>	<i>37.20</i>	<i>25.40</i>	<i>25.90</i>

Table 1. Colombia: Insatiable Basic Needs 1985-1998  
From: National Planning Department of Colombia

<sup>10</sup> Nina Esteba, Aguilar Anna and Amartya Sen. “Estudio de la Desigualdad Económica y la Pobreza Monetaria Colombiana: 1978-1997,” Cuadernos de Economía No. 29, pp. 213-214

The IBN in table-1 shows a considerable reduction between 1985 and 1997 where a 20 percent reduction was reached. In contrast, by 1998 the IBN indicator rose in almost all its components but specifically in ‘economic dependency’ and ‘school absence’. These were the results of Colombia’s economy crisis.

### **3. Colombia’s Human Development Indices**

The “Human Development Indices” (HDI) is the most accurate indicator. It makes a comparison among 174 countries enabling the analysis of Colombia’s situation in the overall context. The HDI is the relationship among (a) life expectancy; (b) educational achievements (it is a function of adult literacy and scholarly rate—elementary, high school, and university level); and (c) level of life (measure by the GDP per real capital). The indicator of HDI shows how much is needed for Colombia to achieve its defined goals, such as long life expectancy, total school national coverage, and high quality of life.<sup>11</sup>

By 1990, the HDI had had a high indicator but later on switched to a medium indicator in the three following years. The HDI finally recovered in 1994 with a high indicator of HDI lasting until 1998. In 1996 Colombia was ranked 49th in HDI among 174 evaluated countries by the United Nations. In 1996 Colombia’s HDI achieved its highest rating. By 1998 the HDI included a fourth dimension in its indicators: “social exclusion” affecting Colombia’s indicator in the next year.

In 1999 the HDI indicator was 0.764, which, in the concept of the United Nations Developed Program (UNDP), means that Colombia was ranked 68th among 174 countries evaluated. In other words, between 1997 and 1998 Colombia lost 11 ranking positions in the international arena. Several Latin American countries had a backward slide in HDI as a result of poor economic achievements.<sup>12</sup> For instance, in 1997 seventy-two people for each 100 people were studied, but in 1999 only 70 people for each 100 people were studied. This represents a backward trend in this necessary factor for achieving a better quality of life.<sup>13</sup>

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<sup>11</sup> PNUD. Informe sobre Desarrollo Humano para Colombia 2000, P. 44

<sup>12</sup> PNUD. Ibid, p. 45

<sup>13</sup> Castro, de Posada Beatriz, “La Crisis Económica y Social de Colombia,” p. 08, Departamento de Economía,

After evaluating the traditional economic indicators discussed so far, it is important to follow with an analysis of employment because it contributes to reducing the poverty indices (PI) and improving human development. In table 2 below, Colombia's "Global Rate of Participation" (GRP), compares the "Economic Active Population" (EAP) and the "Population with Legal Age to Work" (PLAW)—without regards to being employed.

	<i><b>GRP</b></i>	<i><b>Men</b></i>	<i><b>Women</b></i>
<i><b>1993</b></i>	<i>57.15</i>	<i>75.50</i>	<i>40.20</i>
<i><b>1994</b></i>	<i>56.40</i>	<i>74.60</i>	<i>39.60</i>
<i><b>1995</b></i>	<i>56.80</i>	<i>74.80</i>	<i>40.50</i>
<i><b>1996</b></i>	<i>56.30</i>	<i>74.10</i>	<i>40.00</i>
<i><b>1997</b></i>	<i>56.60</i>	<i>73.70</i>	<i>40.90</i>
<i><b>1998</b></i>	<i>58.60</i>	<i>74.30</i>	<i>44.00</i>
<i><b>1999</b></i>	<i>59.40</i>	<i>74.30</i>	<i>45.60</i>

Table 2. Colombia: Global Rate of Participation 1990-1999  
From: National Planning Department of Colombia

The GRP has been rising, especially for women who switched from 40.2 in 1993 to 45.6 in 1999. The men's participation, however, went down in the same period from 75.5 to 74.3. This explains an important link with Colombia's skyrocketing unemployment as well as the lack of new jobs due to the economic crisis.

Unemployment is not only a problem of supply but also is a problem of demand. The causes of the offer are migration, displacement by violence, demographic factors, and structural imbalance. The causes of the demand are microeconomic factors, wages, the high cost of dismissed employed, tax overload (Para-fiscal load) and economic growth.

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Universidad Javeriana de Colombia, documento preparado para su distribución en XXIII International Congress of the Latin American Studies Association (LASA) 2001

The labor market, and monetary and fiscal policies are other factors contributing to unemployment according to Villar Leonardo<sup>14</sup> from Colombia's Republic Bank.

From the point of view of demography, there is an incremental rate in the "Population of Legal Age to Work" (PLAW) that causes an incremental rate in the "Economic Active Population" (EAP), which has been rising swiftly since 1997. As a consequence the EAP, ready to work, rose to a 4.3 percent annual rate; nevertheless, between 1991 and 1997 the annual rate of growth was only 3.3 percent.<sup>15</sup>

These rates of population growth, linked to offer and demand causes, generated Colombia's highest unemployment rate. Unemployment has greatly affected the young people due to their difficulties in getting a job. People between 35 and 40 years of age aggravated with it their economic situation spend an average of 6 to 8 months finding a new job. In the first half of the 1990s the required time to get a job was 2 to 3 months; however today, the time has more than doubled. This indicator corroborated the worst social condition and the increment of economic dependency.<sup>16</sup>

The high unemployment rate started in 1996 but has been diminished by "the under-employment rate", which functions as a palliative of unemployment. The under-employment has grown reaching more than 20 percent. The under-employment corroborated the worst socio-economic condition for the Colombians because under-employment was neither a permanent palliative nor a temporary solution.

## **E. CONCLUSION**

Not only critical levels of violence and terrorism but also globalization impacted Colombia's economy in the last half of the 1990s. Globalization has had a significant impact on the national economy due to Colombia's uncompetitive, restricted markets and unstable commercial rules. Technology, human capital protection, and research and

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<sup>14</sup> Villar, Leonardo, "Indicadores de Política Económica," Seminario de Empleo y Economía, Banco de la Republica de Colombia, 2000.

<sup>15</sup> Lora, Eduardo, Seminario Empleo & Economía, "Por que tanto desempleo? Que se puede hacer?" Ponencia Seminario de Empleo & Economía, Bogota, Marzo 30, 2001

<sup>16</sup> Castro, de Posada Beatriz, "La Crisis Económica y Social de Colombia," p. 17, Departamento de Economía, Universidad Javeriana de Colombia, documento preparado para su distribución en XXIII International Congress of the Latin American Studies Association (LASA) 2001



development are practically absent from Colombia's perspective. Moreover, corruption is another of Colombia's key constraint to compete in open markets due to bribes and political interventionism in state contracts. To support corruption cases, managers, ministers, politicians and government officials siphoned off 365 billion Colombian pesos from 1994 to 2000 from different state institutions through contracts and loads, now in investigative trials.<sup>17</sup>

In the case of unstable commercial rules precipitated Colombia's housing crisis of 1998-1999; in which 8,104 real estate properties (houses, apartments, and condos) valued at 545 billion Colombian pesos,<sup>18</sup> were confiscated by the national banks. The decision by the Constitutional Court as well as high unemployment generated a collapse in the construction industry and in related businesses.

Finally, the Congressional Research Services of U.S. has condensed Colombia's crisis in these words:

The many weaknesses of Colombia democracy are regarded by many as contributing to the very problems the country faces.... Many also blame the intransigence of economic interest and a lack of political will in severe successive government for the failure of subsequent attempts at agrarian reform and other rural improvements which would extended a central government presence to the countryside, and incorporate it into the democratic system. More recently, drug corruption is seen as not only a product of a weak democracy, but also as a cause of its continuing decline, and a complicate factor in any attempts to strengthen democratic institutions. Some fear that the poor economy may increase the significance of the drug trade to Colombia's economy. According to a 1998 estimate, income from illegal narcotics brought some \$4 billion to Colombia, or 5 percent of the country GDP that year.<sup>19</sup>

In the next three chapters, I will address the following questions: a) How do Colombia's subversive movements affect the national economy? b) Is drug trafficking beneficial to Colombia? and c) Is the 1991 Constitution a real factor contributing to Colombia's economic crisis?

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<sup>17</sup>< <http://www.eltiempo.terra.com.co/11-06-2001>>

<sup>18</sup> Data from ICAV (Instituto Colombiano de Ahorro y Vivienda: Inmuebles entregados en dacion de pago por la incapacidad económica de pago de sus propietarios a los bancos.

<sup>19</sup> Serafino, Nina M., CRS Report for Congress, "Colombia: Conditions and U.S. Policy Options," p. CRS-5, upgrade February 12, 2001, Congressional Research Services, The Library of Congress.



### **III. HOW DO COLOMBIA'S SUBVERSIVE MOVEMENTS AFFECT THE NATIONAL ECONOMY?**

This chapter will provide a description and analysis of how Colombia's guerrilla movements –the Colombian Revolutionary Armed Forces (FARC), the National Liberation Army (ELN), and the Colombian Self-Defense Union (AUC)—permeate every aspect of the Colombian government and civil society. The chapter will also show how these organizations established broad-based underground economies with regular budgets, in both the illicit economy and within Colombia's formal economy. I will argue that the subversive economy has had a bigger impact on the national economy than previously to 1998.

The analysis will show how violence and terrorism carried out by subversive organizations through massacres, mass kidnappings, extortions, murders, infrastructure attacks, and indiscriminate attacks against towns and their police stations have induced economic recession. The recession was first perceived at municipal level because peasants and cattle farmers left their ranches for the big cities, looking for security and shelter. Peasants become incorporated in the poverty belt of the cities due to a lack of education and opportunities, triggering urban insecurity.

This chapter will also focus on the analysis and the implications of violence against Colombia's economic legal sectors, such as oil and mining, transportation, and cattle agro-industry (one of the most important Colombian economic activities given its impact on the lifestyle of thousand of peasants' families, and due to its nature as a primary food producers of beef as well as rice, cotton, coffee, bananas, and other staples). Additionally, this chapter presents data on the illegal activities conducted by subversive organizations, such as terrorism, sieged villages, massacres, murder and kidnappings.

#### **A. WHY HAS SUBVERSIVE ACTIVITY ESCALATED?**

A lot of facts need to be considered in order to understand the increase in violence and terrorism during the last half of the 1990s, and the reason this escalation impacted Colombia's economy. Different sources offer the following explanations:

The FARC controls about 50 small ports in the Gulf of Uraba in Northern Colombia, through which it smuggles weapons and precursor chemicals for

manufacturing cocaine and heroin from Panama. The FARC and ELN control and administer about half of Colombia's national territory. More than 57 percent of the country's major support them (David Spencer, "A Lesson For Colombia," *Jane's Intelligence Review*, vol. 9, No. 10, Oct. 1, 1997 p. 474)... They patrol the road and waterways, regulate fishing, and hold trials for suspected criminals. In some areas, they have created public services and agriculture credit banks and collect funds for road improvements at toll stations.<sup>20</sup>

This means that the FARC has a geostrategic concept about the meaning of these external logistic lines of communication through which cocaine is exported and weapons imported. The permanent battle over the Gulf of Uraba's control, between the FARC and AUC, explains the strategic value of this region. Moreover, it is not easy for the Colombia's police and military forces controlling this vast area and its border with Panama due to the presence of swamps and everglades with multiple approach and escape avenues. The control of this region means power either in FARC or paramilitaries hands.

- Since 1998, the intensity of Colombia's guerrilla war has increased. On February 26, 1998, a Colombian army brigade was dispatched to break up a concentration of 600 guerrillas reportedly ready to attack Cartagena del Chaira near the Caguan River. The guerrillas organized a successful ambush. After three days, 80 soldiers had been killed, 43 captured, and the rest dispersed in the jungle (David Spencer, "Bogotá Continues to Bleed as FARC Find their Military Feet," *Jane's Intelligence Review*, vol. 10, No.11, Nov. 1, 1998, p. 35). This was the first time the FARC defeated a large, elite Colombian army unit in maneuver warfare.<sup>21</sup>
- During the first week of August 1998, before Pastrana was inaugurated, the FARC and ELN launched at least 42 attacks in 14 different sectors. More than half of these attacks involved guerrilla units of 300 to 1,000 fighters. After two weeks of fighting, 104 military and police were dead and between 129 and 158 government troops had been taken prisoner; 243 guerrillas had been killed. On October 18, 1998, the ELN sabotaged Colombia's main oil pipeline, causing a huge fire that destroyed the small village of Machuca; 45 people were burned to death, and another 26 died later from several burns. (Radio Cadena Nacional, "ELN Rebels Continue attacks on Oil

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<sup>20</sup> Sweeney, John, "Tread Cautiously in Colombia's Civil War," March 25, 1999, p. 5, the Heritage Foundation Backgrounder," <<http://www.heritage.org/library/backgrounder/bg1264.html>>

<sup>21</sup> Ibid, p. 7

Facilities,” BBC Summary of World Broadcast, November 14, 1998). On November 2, 1998, the 120-man police detachment in Mitu, a town of 14,000 located about 400 miles from Bogotá near the border with Brazil, was assaulted by up to 1,000 FARC guerrillas who arrived by River. About 80 police and 10 civilians were killed, and 40 police were taken prisoner.<sup>22</sup>

This means that the successful guerrilla attacks, in 1998, generated doubts about capabilities of government military forces. The subversives capability for mass force concentration, in space and time, by 1998 developed a strong opinion that the guerrillas was in route to take the big cities and the political power by force. By 1999, as a product of small guerrilla’s victories, a large amount of financial capital flew looking for secure shelter due to economic uncertainties.

By 1998, Colombia’s armed forces—and particularly its army—grew significantly weaker due to First, the drug decertification of the Samper administration (1994-1998) that impeded the U.S. logistic military supplies needed for Colombian military forces to control the guerrillas and paramilitary escalation. This was a partial result of the Clinton administration’s refusal to provide military aid to Colombia’s military units if even one individual in a unit was suspected of abusing human rights. Thus, Samper’s administration was “a unique opportunity” for guerrillas to growth militarily, economically, and politically. Additionally, Samper’s ties to the Cali drug traffickers gave the FARC and ELN an excuse to declare his administration illegitimate and to refuse engaging in talks.

Second, as a result of not having a “National Defense Strategy” supported by Colombian Congress to confront the guerrillas’ escalation, Colombia’s army was weak in weapons, technology and in the number of fighters. The Colombian army was also fighting alone, since the civil society, the political parties, the Congress, and the media were simple observers of the confrontation against the FARC, the ELN and the paramilitaries groups. No real support was present for the army. Third, for a long time politicians and society believed that narco-guerrilla was not a matter for their concern; however, the escalation of kidnappings and systematic terrorist attacks against small

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<sup>22</sup> Sweeney, John, “Tread Cautiously in Colombia’s Civil War,” March 25, 1999, p. 7, the Heritage Foundation Backgrounder,” <<http://www.heritage.org/library/backgrounder/bg1264.html>>

towns (from 1998 to 2001) put a lot of pressure on the civil society and its political misperception. Finally, by 2001, the “National Defense Strategy” was approved by the Colombian Congress.

Given the lack of legal employment opportunities in rural colonized areas, official coca eradication ultimately provided the guerrillas with an army of unemployed young without prospects of future jobs. This is partly responsible for the increasing number of recruits to the FARC since its founding in 1964. In fact, the FARC has developed a perfect plan of doubling its military force by the years 1995 and 2000 through targeting unemployed and uneducated youth in colonized and other poor rural areas. Table 4 illustrates the increase in FARC’s military force.

Year	Number of fronts	Number of Members
1986	32	3,600
1995	60	7,000
2000	60	17,000

Table 3. The FARC’s growth from 1986 to 2000  
From: Ministerio de Defensa Nacional de Colombia

As Vargas points out “the situation is aggravated by the government loss of legitimacy, stemming from its lack of government presence in isolated regions, which prevents the development of the legal economy and establishes in its stead a propitious infrastructure for illicit crops. Through the taxation of illicit crops, the guerrillas have grown in number and financial power.”<sup>23</sup>

The bottom line is the historical inability of the Colombian government to be present in the rural sector where guerrillas organized. Another factor is the difficulties

<sup>23</sup> Vargas, Ricardo, “The FARC and The Illicit Drug Trade,” p. 6, (TNI) Transnational Institute, The Netherlands, Accion Andina, Cochabamba, Bolivia, Washington Office on Latin America (WOLA), Washington D.C., June 1999, <http://www.tni.org/drugs/pubs/farc.htm>

faced by approximately 150,000 soldiers to control a vast territory of almost 1,400,000 square kilometers, where rivers, jungle forest, huge valleys, high and abrupt mountains, and a poor net of communications isolated a multiethnic and multi-cultural society. This complex geography and culture made military operations difficult.

In the analysis of the subversive's underground economy, it is important to mention how this economy is synchronized with the citizen's lifestyle and their businesses; to do that, this thesis uses Alfredo Rangel's research—Colombia's Economy, "Parasites and Predators: Guerrillas and the Insurrection." In Rangel's viewpoint the recent economic prosperity of Colombia's guerrillas groups place them among the most outstanding examples, at the international level, of successfully self-financed insurgent groups. Colombia's guerrilla groups have established broad-based underground economies with regular expenses, coherent flows of income and systematized investments. In addition, the two main insurgent groups, the FARC and the ELN, have succeeded in designing and applying multiple strategies for acquiring and utilizing financial resources amounting to roughly \$1.5 million U.S. dollars a day.<sup>24</sup>

In fact, as much as 80% of the FARC and ELN resources are not spent immediately on combat activity but on investments through figureheads in activities like (1) towns and cities through investment in small business in order to create intelligence, support network, and revenues; (2) at the national level, investment in big business or in financial sectors providing steady and secure cash flow; (3) at the international level; deposits in hard currency, for accessing the international black market of weapons, for financing diplomatic activities, and for maintaining the strategic resources necessary for meeting the demands of internal warfare.<sup>25</sup>

What is the impact of the guerrilla economy and its symbiotic relationship with the national economy?

The guerrillas' movement develops its activities extend beyond the local level and enter into regional and national spheres, moving from predatory

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<sup>24</sup> Rangel, Alfredo, Colombia: Guerra en el fin de Siglo. (Bogota; Tercer Mundo Editores, Universidad de los Andes, 1998) p.29

<sup>25</sup> Rangel, Alfredo, "Parasites and Predators: Guerrillas and the Insurrection," p.580, Economy of Colombia, Journal of International Affairs, Spring 2000, 53. No. 2 The Trustees of Columbia University in the city of New York.

tactics toward parasitic forms. Parasitic form is the closest definition about guerrilla's economy. In fact, in territories where guerrilla groups have been settled for periods up to 20 years or more, and where, in some cases, they arrived before other agricultural settlers, the guerrilla groups have been the first to establish a coherent economy. Part of the guerrilla's success, entrenchment and longevity is attributable to its having been the first to build finished, politically –and administratively- delineated spaces in these territories, where population density is low, the state's institutional presence is weak, and where commercial relations with the formal economy are precarious.<sup>26</sup>

Such is the case in many coca –and poppy- farming areas. For instance, Caqueta, Putumayo, Arauca, Vichada, Amazonas, Vaupes y Guainia are the guerrilla's preferred states where the government presence has been historically weak. In fact, in 1985, the guerrilla groups were present in 75 out of 1,000 municipalities in Colombia and by 1998, their presence was felt in nearly 600 municipalities.<sup>27</sup>

In Rangel's point of view, the guerrilla groups act as parasites on business and industries of great national importance in terms of their contribution to the GNP (banana, oil, coal). In fact, the guerrillas have simultaneously entered into a symbiotic relationship, which means "the insurgent economy became an integral part of the regional economic dynamic, to the degree that the formal distinction between legal and illegal activity vanished. This is true even while it is also possible that the guerrilla groups simultaneously develop an economy parallel to, but not integrated into the formal economy, thus depriving both state and society of the benefits of that economic activity."<sup>28</sup> The symbiosis means the interaction between the regional economic dynamics, the illicit cocaine economy, and the legal sectors, such as banking and finance. The income of the Colombian guerrillas may be as high as \$600 million U.S. dollars a year, or \$1.5 million U.S. dollars a day.<sup>29</sup>

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<sup>26</sup> Ibid.

<sup>27</sup> Ibid.

<sup>28</sup> Alfredo Rangel Suárez, *Colombia: Guerra en el fin de Siglo*. (Bogota; Tercer Mundo Editores, Universidad de los Andes, 1998) p.582

<sup>29</sup> Comité interinstitucional de Lucha contra las Finanzas de la Guerrilla, "Informe 1998", Mimeo (Bogota, March 1999)



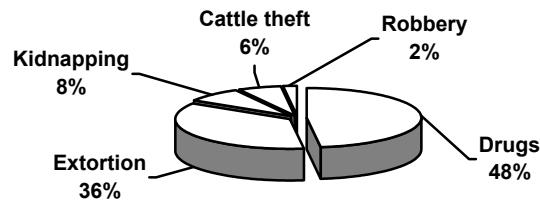


Figure 5. FARC's Sources of Income  
 From: Comité Interinstitucional de Lucha contra las Finanzas de la Guerrilla, 1998

In Figure 5, 48 percent of the FARC's revenues come from its involvement in drug trafficking. "The FARC's trafficking operation involves a taxation system which allows it to remove part of the economic surplus of regions where illegal drugs are grown processes and exported."<sup>30</sup>

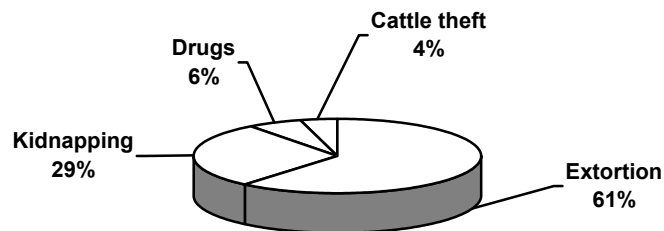


Figure 6. ELN's Sources of Income  
 From: Comité Interinstitucional de Lucha contra las Finanzas de la Guerrilla, 1998

<sup>30</sup> Rangel, Alfredo, "Parasites and Predators: Guerrillas and the Insurrection," *Economy of Colombia, Journal of International Affairs*, Spring 2000, 53. No. 2 The Trustees of Columbia University in the city of New York.

In Figure 6, the ELN obtained 61 percent of its income through extortion against the oil and mining sector, 29 percent from kidnapping, 6 percent from drug trafficking, and 4 percent from cattle theft.<sup>31</sup>

In regards to drug trafficking, it is estimated that the FARC manage to collect taxes on 80% of all cocaine production, close to \$140 million U.S. dollars a year, making this its primary source of income.<sup>32</sup> In fact, the FARC has established an entire taxation system, which allows it to remove part of the economic surplus of regions where illegal drugs are grown, processed and exported.

The taxation structure (the symbiosis between the insurrection and regional economies) functions as follows: (1) In the extensive areas where the coca plant is grown and cultivated (taxed according to the size of their crops); (2) At the entry of processing material where check-points on land and water in route to the refineries are taxed per ton or gallon of the materials used in the refinement process-- acetone, ether, sulfuric acid, gasoline, cement; (3) At the transportation-net on the final product. (air, land and water taxation); (4) At the control zones on the interior where cocaine is exported to the foreign market for consumption. How does the taxation process work? First, the refineries pay according to the weight of the product (heavier on the final product –pure cocaine). The tax is known as ‘gramaje’ that means 10% of the price of the product in the region: Second, there is a tax on the maintenance of the laboratories, on the landing strips, on the transit of aircraft carrying production materials or finished product itself (cocaine).<sup>33</sup>

Consequently, the group revenue of the FARC may be rising as a result of (1) their own coca growing activities; (2) their suppression of intermediaries; (3) the forcible monopolization of coca-leaf purchase; (4) the construction of their own coca-paste refineries; and (5) the construction on landing strips on the group’s own property. Moreover, the FARC established a minimum wage for coca leaf pickers, and a minimum price for the leaf, which middlemen and refiners must pay to farmers. In this way, the FARC are regulating the labor supply and setting prices on the coca-pasta for processing

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<sup>31</sup> Comité Interinstitucional de Lucha contra las Finanzas de la Guerrilla, 1998.

<sup>32</sup> Ibid.

<sup>33</sup> Rangel, Alfredo, “Parasites and Predators: Guerrillas and the Insurrection,” p. 528, *Economy of Colombia*, Journal of International Affairs, Spring 2000, 53. No. 2, Columbia University of New York.

cocaine. In sum, the guerrillas' ability to collect taxes depends upon their reaching equilibrium between public acceptance and the fear they instill by enforcing their rules and inflicting punishment. Penalties are typically fines, expatriation or death. Part of the FARC's successful tax collection depends on the community control exerted. Rangel states,

The FARC also have established community rules to which the public is subject, including regulating liquor sales, prohibiting drug use, setting hours of operation for businesses, rules and seasons for hunting and fishing and fixing a minimum of staple crops on coca farms. Likewise, the guerrilla groups have assumed the role of the police, monitoring adherence to these rules and arresting violators, as well as of the judiciary, resolving a wide spectrum of civil disputes among the populace, ranging from marital disagreements to disputes between landowners over property lines.<sup>34</sup>

On the other hand, how does extortion affect the extractive sector? The oil industry pays over \$40 million U.S. dollars a year in extortion to the Colombian guerrillas groups.<sup>35</sup> In the case of the ELN, a portion of these sums is collected in the form of infrastructure built by the civilian population and financed by the oil companies. The destruction of the pipelines that transport crude oil to shipping ports has been an effective tool in pressuring companies to pay. Interrupting the flow of crude oil can mean great financial losses or even expulsion from the market for non-delivery of orders. Between 1986 and 1996, the guerrillas have made 985 attacks on the infrastructure of the oil industry.<sup>36</sup>

In the gold mining sector, the guerrillas receive close to \$10 million U.S. dollars annually.<sup>37</sup> Payments are made monthly and the rates depend not on the quantity of production but on the type of equipment and machinery used by the mine, this is due to the large companies, small businesses, and small-scale miners operating simultaneously

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<sup>34</sup> Rangel, Alfredo, "Parasites and Predators: Guerrillas and the Insurrection," p. 528, *Economy of Colombia, Journal of International Affairs*, Spring 2000, 53. No. 2, Columbia University of New York.

<sup>35</sup> Comité Interinstitucional de Lucha contra las Finanzas de la Guerrilla, Informe 1997, Bogota, 1998.

<sup>36</sup> *Revista del Ejercito Nacional de Colombia*, Bogota, July 1999, p.13

<sup>37</sup> Comité Interinstitucional de Lucha contra las Finanzas de la Guerrilla, Informe 1997, Bogota, 1998.

in the same area. Shops, small mills, and cantinas in these areas are not exempt from paying taxes.

From the extortion in the coal mining industry, the guerrilla groups' income from coal mining areas total around \$120 million U.S. dollars.<sup>38</sup> Freight vehicles pay an extortion tariff according to the size of their loads and the number of axles of each truck. Every month, each mine pays a percentage of its total production.

However, the guerrilla groups extortive activities extend to other sectors also, such as the transportation industries, where those who operate on land or on Colombia's rivers (freight and passenger sectors) have to pay. Reluctance to pay these tariffs may be punished by destroying the company's vehicle, or occasionally, by impounding it. Shippers of food and beverages that regularly supply remote regions where guerrilla are present must pay an arranged sum in order to operate in those regions. Colombian commercial and manufacturing sectors are also the targets of pressure from the insurgent groups, not only in areas experiencing guerrilla control or expansion, but also even in urban areas where their presence is marginal and exists in the form of "small militias".<sup>39</sup>

The current Colombian domestic conflict is highly concentrated in farming areas. In these areas, violence is causing social disruption and vast economic damage in productive sectors such as livestock. This sector spreads out over 800,000 productive ranches. It has been the most affected business because of human rights violations, kidnapping, extortion, theft, and other forms of intimidation of subversive movements, which target the cattle ranchers.

In Bejarano's research, extortion is one of the guerrillas' main forms of parasitic activity against the formal economy. Bejarano points out about cattle extortion:

It is sometimes a step before kidnapping, if a victim does not pay the extortionist. If the owner decides to pay the extortionists, he receives in exchange a guarantee that his life will not be threatened and that his property will be protected against cattle theft, property invaders, and other thieves and extortionists. The extortion of cattle ranching and agriculture sectors known as "vacuna", or bovine extortion, is a result of an economic

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<sup>38</sup> Consejeria Presidencial para la Defensa y la Seguridad Nacional, "El Cesar: Una Comunidad Intimidada por la Guerrilla," Bogota, 1993

<sup>39</sup> Ibid

census to establish the tribute that rural owners must pay, depends upon the depth of patronage in the region, on the size and production of the state, on the degree of cooperation or antagonism between the owner and the local guerrilla fronts.... The methods of extortion are a fixed annual monthly sum or a function of sales or production. Paid at more or less predictable intervals this allowed the guerrillas' to budget their cash flow and resources through the year. ....this systematic cattle theft is another of the Colombian guerrilla steady sources of income. In 1994 the FARC stole over 125.000 head of cattle worth around \$60 million U.S. dollars. Cattle ranchers lost almost 1/3 of their annual production to the theft by guerrillas groups.<sup>40</sup>

The “Federacion Nacional de Ganaderos de Colombia” (Colombia’s National Federation of Cattle Ranchers) reported in the first half of 2001 that 19 cattle ranchers were assassinated, 319 were kidnapped, and 57 billion Colombian pesos ( \$26,7 million U.S. dollars) were transferred to guerrilla movements for intimidation purpose. In addition, the monthly extortion, “guerrilla vaccination”, cost for the cattle ranches to survive was raised 54 billion Colombian pesos for the first half of 2001.

Indeed, cattle theft and “cattle sacrifices” (a punishment against ranchers that refused to pay the monthly extortion) raised 48 billion Colombian pesos, the equivalent of 64,500 heads of cattle lost.<sup>41</sup> Therefore, the high cost is represented in lost competitive opportunities in the global market place. The ranchers who are away from their livestock --as a result of subversive intimidation-- are paying a high cost in productivity. The cattle raisers developed “the video-auction” technique for managing their livestock from the cities and for doing business under a favorable secured environment due to the intimidator presence of subversives around their properties.

Thus, the economic impact of violence is measured: by a dramatic reduction in livestock, lost job opportunities, less heads of cattle, higher mortality of cattle, less milk production, and the reduced supply for market needs. In the first half of 2001, the economic cost of all these factors was equivalent to 185 billion Colombian pesos. Finally, the total cost in the livestock sector due to violence and terrorism (from the

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<sup>40</sup> Bejarano, Jesús A, “Colombia: Inseguridad, Violencia y Desempeño Económico en Áreas Rurales,” (Bogota, Fonade, Universidad Externado de Colombia, 1997) p.166

<sup>41</sup> [www.eltiempo.com](http://www.eltiempo.com), “Costo del Conflicto Interno para la Ganadería Colombiana-Primer Semestre de 2001.”

subversive movements FARC and ELN) was 346 billion Colombian pesos (\$160,9 million U.S. dollars) by the first half of 2001.<sup>42</sup>

Figures 7 through 10 represent the economic cost in livestock in the last two years and first half of 2001. Factors are represented as kidnapping, extortion, theft, and the lack of administrative control over the cattle ranches. Between 1999 and 2000, there was an incremental cost of violence. The forecast for all of 2001 could be worse since the total expected cost for terrorism and violence could double.

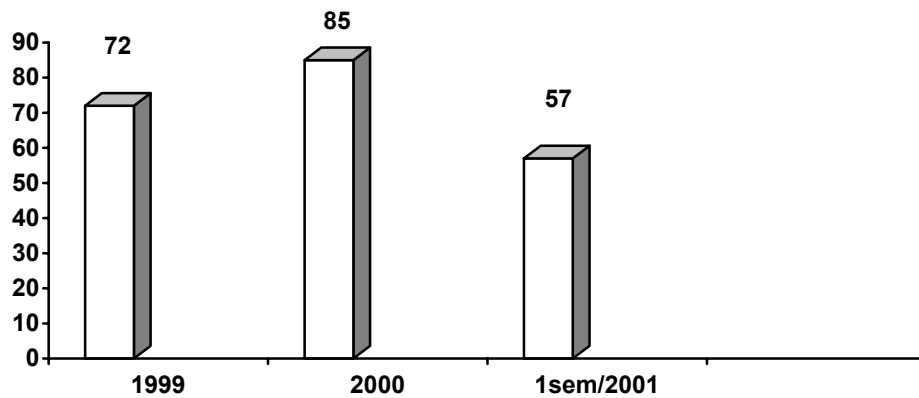


Figure 7. Economic Cost in Livestock as a Result of Kidnapping (Billion of pesos)  
From: Federación Nacional de Ganaderos de Colombia, 2001

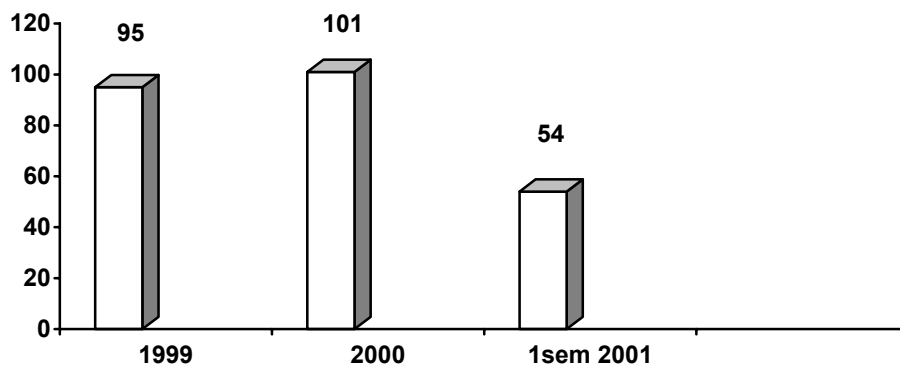


Figure 8. Economic cost in Livestock as a Result of Extortion (Billion of peso)  
From: Federación Nacional de Ganaderos de Colombia, 2001

<sup>42</sup> [www.eltiempo.com](http://www.eltiempo.com), “Costo del Conflicto Interno para la Ganadería Colombiana-Primer Semestre de 2001.”

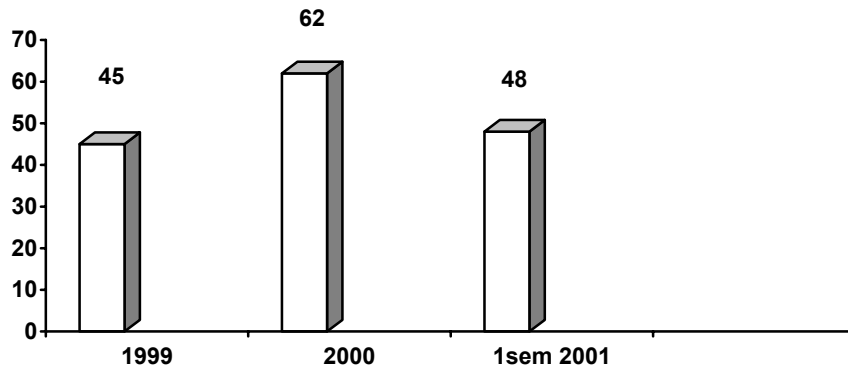


Figure 9. Economic Cost in Livestock as a Result of Theft (Billion of pesos)  
From: Federación Nacional de Ganaderos de Colombia, 2001

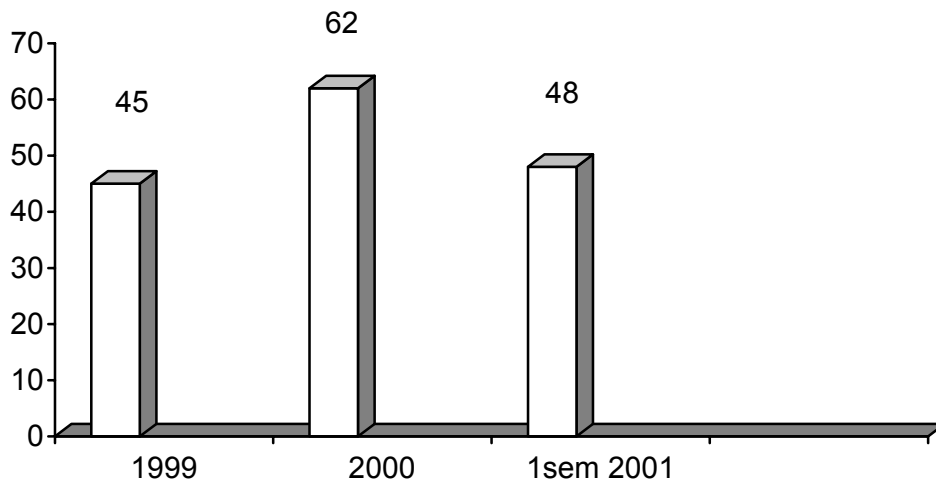


Figure 10. Economic Cost in Livestock as a Result of Lacking Administrative Control on Ranches (Billion of pesos)  
From: Federación Nacional de Ganaderos de Colombia, 2001

Furthermore, the public sector is not immune to extortion by the guerrilla groups either. The subversives' political strategies are to control small local government so the guerrilla groups are able to dictate the allocation of public funds and investments in the city. Often, the guerrillas decide which companies are to be given contracts for public works, such as bridges, roads, and the town square. These companies must pay the guerrilla groups as much as 10% of their contracts. Thus, a portion of the public funds

end up in the hands of the guerrilla, which may include as many as 20% of all city administration in the country. At last, the insurrection receives somewhere between 5% to 10% of funds destined for public works.<sup>43</sup>

The worst economic tactic of guerrillas is kidnappings. Today nearly half of all kidnappings in the world take place in Colombia, where guerrillas groups carry out over half of these kidnappings, and the rest are carried out by organized crime gangs. The Colombian case may be the only one in which insurgent groups have used kidnapping as a source of income in such a massive and systematic manner. In fact, the Colombian guerrillas groups gain almost 25% of their income through kidnapping. For the FARC, kidnapping is the third greatest source of income, after drug trafficking and extortion, whereas for the ELN, it is second only to extortion.<sup>44</sup>

However, the socio-economic status of targeted kidnapping victims has been gradually descending; today any member of the middle class can be a victim of some form of kidnapping. Advanced computer and communication technologies are used to select the victim, thanks to their consolidated financial structure, the guerrillas have been able to computerize their operations and employ the most advance communications technology.

Guerrillas also are able to access classified files from government offices that have updated their system in order to facilitate electronic processes as tax payment and notary transactions. There is evidence that the databases of Colombia's financial system and public records offices and even large supermarkets chains that use credit cards are being infiltrated by agents of the insurrection or by hackers who acquire the information and then sell it to the guerrilla groups.<sup>45</sup>

Another technique for getting guerrillas' ransom is to detain hundreds of cars on the highway outside of the big cities, and then use databases on laptop computers to select their victims one by one, based on the information at their disposal. The average ransom for individually selected Colombian victims is close to \$100,000 U.S. dollars, and

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<sup>43</sup> Rangel, Alfredo, "Parasites and Predators: Guerrillas and the Insurrection," p. 591, *Economy of Colombia*, Journal of International Affairs, Spring 2000, 53. No. 2, Columbia University of New York

<sup>44</sup> *Ibid*, p.592

<sup>45</sup> *Revista Cambio*, "Pesca Informática," No. 329, Bogota, 4-11 October 1999, p. 27



for foreigners the ransom can be up to 15 times that amount. It is estimated however, that the guerrilla groups have sufficient capacity to have nearly 500 people in captivity at any given time, so that even as ransom amounts are negotiated and people are set free, others are being capture in order to keep the operation running constantly at maximum capacity.<sup>46</sup>

## **B. THE GUERRILLAS' PROFIT**

The question now is where the guerrillas' profit is going? Guerrilla groups have at their disposal over \$300 U.S. million dollars a year for investing both inside and outside the country.. A large amount of money is sheltered by many sectors of the legal economy: the banks; commercial enterprises; the stock exchange; food suppliers; the cattle and food industries; small business, such as drugstores and groceries; food-related services, such as chicken rotisseries; gas stations for high cash-flow and money laundering. These businesses create intelligence and support networks for those collaborating with them.

These economic systems guarantee the security of the insurrection and its invulnerability from state action. The insurrection's clandestine political and illegal war against the state demands that the organization be hermetic in its affairs and that its financial activities keep a very low profile. In reference to guerrilla' investments, Rangel has pointed out

Over the last 15 years guerrilla groups have been developing a complex, sophisticated money-laundering structures of other crime organizations such as the drug cartels. This system affords the insurrection security and invulnerability to action by the state. The insurrection's clandestine political action and its illegal war against the state demand that the organization be hermetic in its affairs and that its financial activities keep a very low profile... In sum, it is estimated that the insurrection's bank accounts are worth millions of dollars at home and abroad and that the insurrection has probably acquired part ownership of large Colombian businesses through its activity in the stock market.<sup>47</sup>

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<sup>46</sup> Rangel, Alfredo, "Parasites and Predators: Guerrillas and the Insurrection," p. 593, *Economy of Colombia, Journal of International Affairs*, Spring 2000, 53. No. 2, Columbia University of New York

<sup>47</sup> Rangel, Alfredo, "Parasites and Predators: Guerrillas and the Insurrection," p. 597, *Economy of Colombia, Journal of International Affairs*, Spring 2000, 53. No. 2, Columbia University of New York

Even so, the Colombians and multinationals are paying those expenses destined exclusively for the maintenance of the FARC's terrorist forces through different intimidation taxes, such as kidnapping ransom, extortion, cattle theft, and others. The forcible tax contribution are financing the guerrilla's expenses, in areas like (1) the purchase and maintenance of their military gear; (2) the supplies and food for the fighters; (3) the maintenance of their infrastructure; (4) the military industry by establishing a workshop; (5) subsidized cost for the treatment and recovery for those guerrilla fighters wounded in battle; (6) pensions for retirement guerrillas, and financial assistance for their families; and (7) the maintenance and operation of the aircrafts for rapid deployment of the commanders.<sup>48</sup>

### **C. THE DATABASE OF COLOMBIA'S SUBVERSIVE VIOLENCE**

At this stage, we can identify the negative impact of the guerrilla's escalation on Colombia's economy by using the database of Colombia's National Police and the Joint Command of the Armed Forces. The two years of 1998 and 1999 are rising critical periods of violence and terrorism that contributed indirectly to a negative (-4.5%) GDP by 1999. Furthermore, linking this negative GDP with globalization difficulties (globalization from 1991 has devastated broad sectors of Colombian industry and agriculture by competitive pressures of the world market) are possible drawing Colombia's economic crisis map. Specifically, terrorist attacks, attacks on population, massacres, assassinations, and kidnappings will be analyzed from the database.

#### **1. Terrorist Attacks**

Terrorist attacks are a resource used extensively by insurgent groups with the purpose of bringing about economic and political destabilization. The guerrillas are, by far, the main agents responsible for the attacks against Colombia's economy, and power and road infrastructure. The ecological damage resulting from oil-pipeline infrastructure attacks is endangering the survival of many rural communities as a result of thousands of barrels of crude oil spilt into rivers and waterways. The guerrillas have also attacked the country's electric power infrastructure: 232 power transmission towers in 1999. Figure 11

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<sup>48</sup> Ibid, p. 595

shows that during the last five years, guerrillas have increased the number of terrorist actions three-fold, reaching the unprecedented record of 718 attacks in 1999. There have been 2,824 terrorist actions during the last five years, all related to the internal conflict. Of these, 98.5 percent or 2,784 actions, were undertaken by guerrilla groups and 1.4 percent or 40 terrorist acts, by illegal self-defense groups.<sup>49</sup>

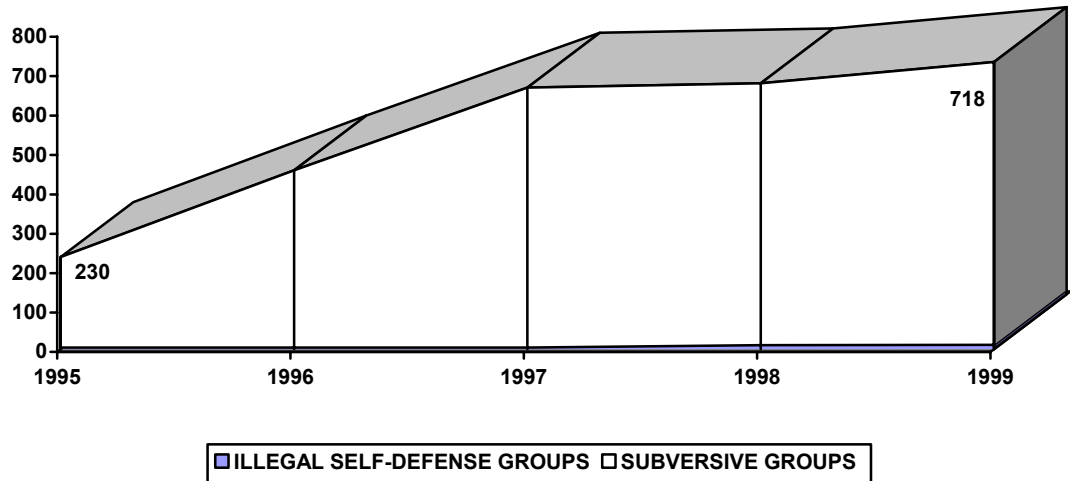


Figure 11. TERRORISM Number of cases: 98% by Subversive Groups, 2% by Illegal Self-Defense Groups  
From: Joint Chief of Staff, December 31, 1999

## 2. Attacks on the Population

The violent siege and taking of small rural populations by guerrilla fronts all over the country is one of the actions generating the highest risk and the vast majority of International Human Rights Law Violations. Attacks increased five-fold during the last five years with 106 in 1999, about 10 percent of Colombian municipalities, equaling one siege every three days. During the course of these sieges on the small rural population, the guerrillas use highly-inaccurate, oblique fire, which is a type of non-conventional weapons of mass destruction, causing dozens of casualties and wounded among the civil population. These weapons, additionally, caused the indiscriminate destruction of houses, schools, entire villages, health care centers, religious temples and other civil

<sup>49</sup> Republic of Colombia, Ministry of National Defense, "Public Force and Human Rights in Colombia, p. 18, March 2000.

infrastructure to provoke mass exodus. Illegal self-defense groups attacked 9 villages during 1999. Figure 12 shows that between 1995 and 1999, guerrilla and illegal self-defense groups combined attacked 260 groups in the population. The guerrillas were responsible for 246 (94.6 %) of the attacks, and the illegal self-defense groups for the remaining 14 (5.3%).<sup>50</sup>

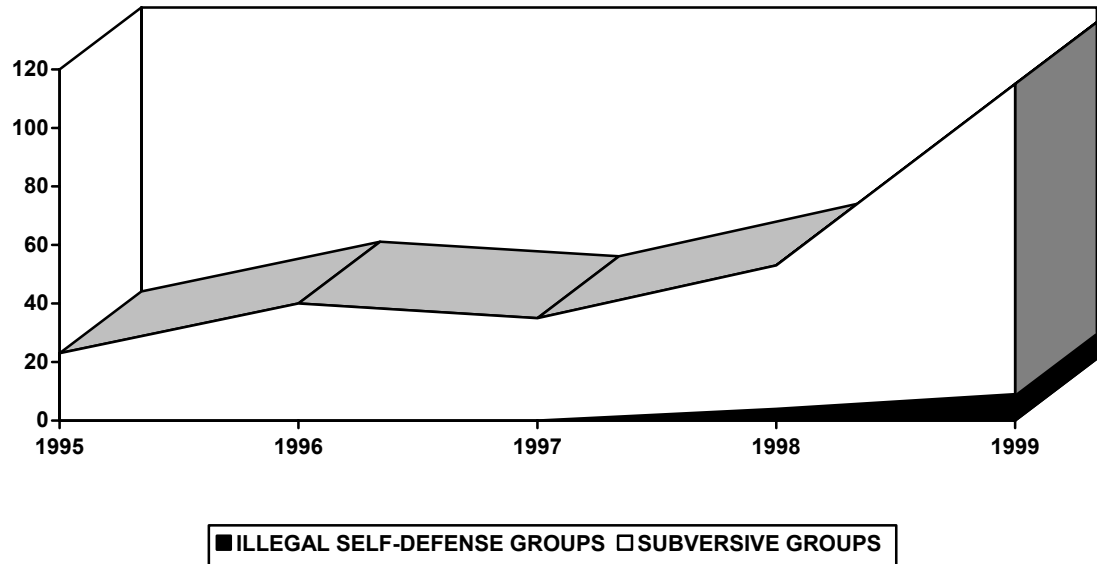


Figure 12. SEIGED VILLAGES Number of cases: 94% attacks by subversive, and 6% by Illegal Self-Defense Groups  
From: National Police, December 31, 1999

### 3. Massacres

In Colombia a “massacre” is defined as a homicidal action in which there at least four deaths. During the last five years, the number of massacres attributed to insurgent and illegal self-defense groups has increased 4.3 times, growing from 128 in 1995 to 551 in 1999. The main factor behind this growth rate is the illegal self-defense groups responsible for 74 percent of all massacres in 1999. Guerrilla groups were responsible for the remaining 26 percent. As a result of the dirty war between the guerrillas and illegal self-defense groups, during 1999, every two days three people were massacred, two by the illegal self defense groups and one by the guerrillas. During the last five years, the

<sup>50</sup>Republic of Colombia, Ministry of National Defense, “Public Force and Human Rights in Colombia, p. 19, March 2000.

guerrilla and illegal self-defense groups combined committed 1,253 massacres. Of these massacres 56.1 percent or 704 cases, are attributed to insurgent fronts and the remaining 43.8 percent or 549 cases, to illegal self-defense groups.<sup>51</sup> Figure 13 supports this data.

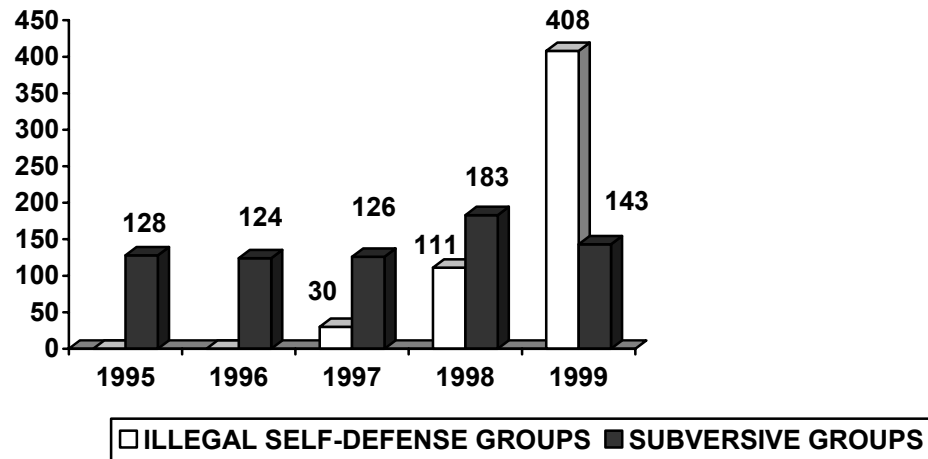


Figure 13. Number of massacres Casualties (Massacres over 4 casualties)  
From: National Police, December 31, 1999

#### 4. Assassinations

During the last five years, assassinations committed by groups living outside the law, and related to the internal conflict, have increased 3.5 times, growing from 485 cases in 1995 to 1,653 cases in 1999. Self-defense groups are the main reason behind the increasing number of assassinations. During 1999, guerrilla groups were responsible for 55 percent of the assassinations and illegal self-defense groups were responsible for the remaining 45 percent. Of the 3,903 assassinations committed during the last five years by these illegal groups, the rebels are responsible for 2,777 or 71.1 percent, and illegal self-defense groups are responsible for 1,126 or 28.8 percent.<sup>52</sup>

<sup>51</sup> Republic of Colombia, Ministry of National Defense, "Public Force and Human Rights in Colombia, p. 17, March 2000.

<sup>52</sup> Republic of Colombia, Ministry of National Defense, "Public Force and Human Rights in Colombia, p. 16, March 2000.

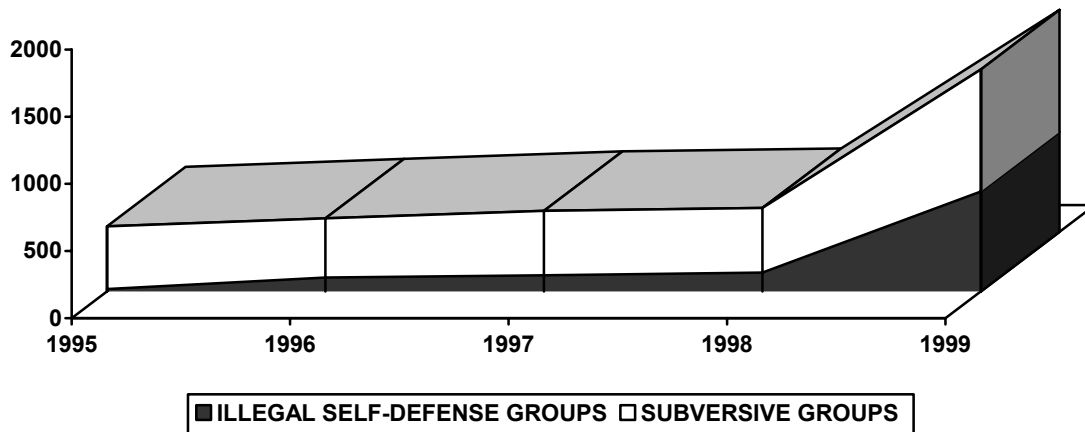


Figure 14. Civilian Killed  
From: Joint Chief of Staff, February 2000.

## 5. Kidnappings

The guerrilla is the main actor behind this growth rate. The number of civilians kidnappings by guerrillas increased 4 times its previous number with the purposes of extortion. Therefore, increasing its share of the total number of abductions occurring in Colombia from 35 percent to 53 percent. The FARC and the ELN are each responsible for 44 percent of the kidnappings while other dissident groups are responsible for the remaining 12 percent. Of the total number of kidnappings by the two largest groups, 95 percent of the victims are Colombian nationals, and 5 percent—about 72 people—are foreigners; that is, the guerrilla kidnaps four Colombians a day, and one foreigner every five days. Illegal self-defense groups started to kidnap for the purpose of extortion three years ago. They were responsible for 3.5 percent of the 2,991 abductions carried out during 1999 in Colombia. Common criminals were responsible for 42.5 percent of the kidnappings in the same year. During the last five years, illegal groups participating in the Colombian armed conflict kidnapped 5,862 people, guerrilla groups kidnapped 5,668

or 96.6 percent, and illegal self-defense groups 194 people or 3.3 percent.<sup>53</sup> Figure 15 illustrates the total numbers kidnapped.

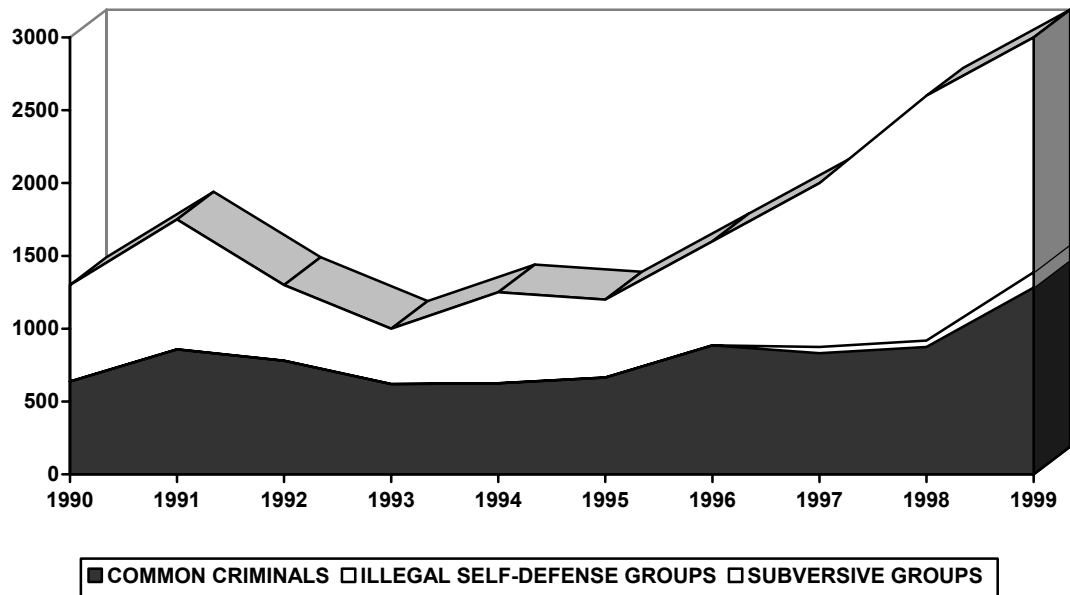


Figure 15. KIDNAPPING TREND IN COLOMBIA Number of Cases: 50% of Total Kidnapping Committed by Subversive Groups  
From: National Police, December 31, 1999

## 6. The War-Tax and Damage to the Rule of Law

There are 84 Colombian municipalities where businesses are not allowed by the FARC to market beer, sodas, and refreshment beverages because the enterprises that produce and distribute them reject paying the “FARC’s war-tax”. The war-tax was established in their law No. 002 payable by anybody (individual or enterprise) whose assets are valued up to one million dollars.<sup>54</sup>

Vargas points out the following about the FARC and its illicit economy:

One of the most significant changes in the guerrilla forces in the 1990s has been their increased control over local economic resources and increased economic reserves to fuel their war machine. Guerrillas have become

<sup>53</sup> Republic of Colombia, Ministry of National Defense, “Public Force and Human Rights in Colombia, p. 14, March 2000.

<sup>54</sup> < <http://eltiempo.terra.com.co/27-09-2001/reda106670.html> >

involved in the armed oversight of municipal budget administration, which has involved kidnapping and threatening mayors. They have also been active in gathering intelligence on resources administration at the departmental level. Kidnapping and extortion have become a major source of resources, targeting individuals such as politicians and executives from the petroleum, banana, commercial agriculture, and cattle industries. Finally, the FARC has profited tremendously from its multi-dimensional relationship with segments of the illegal drug circuit.<sup>55</sup>

The worst effect of the FARC's intention to balkanize the domestic conflict is in the rule of law. There are more than 164 remote municipalities in which judges have left by subversive pressure. Recently in a letter to Colombia's President the higher judicial courts demanded that protection for the judges be provided in these 164 municipalities where the application of the rule of law is practically impossible given subversive intimidation. In the regions where judges remain working, the capability of the state's protection is weak, and in some cases witnesses of criminal actions have been killed.<sup>56</sup> At the same time, the absence of rule of law is increasing the level of violence and Colombia's massive internal migrations. The uncountable massacres, resulting from a tit-for-tat spiral, are a nightmare in the countryside. These contributing facts are also increasing unemployment and the social unrest in the big cities.

#### **D. THE OVERALL IMPACT OF INSECURITY**

Figure 16 shows the impact of insecurity, including the activities of guerrilla groups and organized crime units, in the survey of entrepreneurs in different sectors: 31.4 percent of businesses polled have been victims of theft; 18.3 percent have suffered armed robberies; 13 percent have been victims of violent acts; 13.1 percent have been victims of threats against their "personal integrity; 12.5 percent have been offered bribes; 8.5 percent have had their property pirated; 4.0 percent have been extorted in some manner; and 2.8 percent have been subject to kidnappings."<sup>57</sup>

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<sup>55</sup> Vargas, Ricardo, "The FARC and The Illicit Drug Trade," p. 4, (TNI) Transnational Institute, The Netherlands, Accion Andina, Cochabamba, Bolivia, Washington Office on Latin America (WOLA), Washington D.C., June 1999, <http://www.tni.org/drugs/pubs/farc.htm>

<sup>56</sup> Ibid.

<sup>57</sup> Revista Poder y Dinero, Bogota, August 1997, p. 104



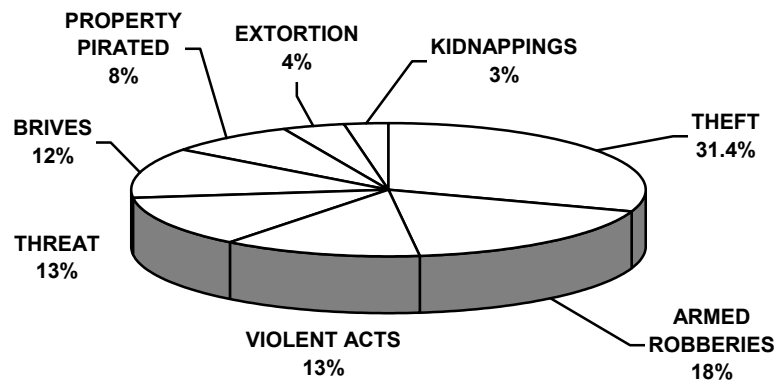


Figure 16. The Impact of Insecurity in Entrepreneurs of Defferent Sectors  
 From: Revista Poder y Dinero, p.104, Bogota, Colombia, 1997

## E. CONCLUSION

The negative macroeconomic effects on the insurrection are

- (1) the companies are forced to make additional efforts beyond what they would have under normal secure conditions in order to compete with foreign firms;
- (2) the illegal activities create greater uncertainty in terms of property rights and increase the cost of transactions in the economy, discouraging ongoing production;
- (3) the crime is an additional tax that reduces production incentives and brings with it an increase in production cost which, in the long term, reduces the volume of production;
- (4) the resources allocated to the protection of property have and adverse effect on total factor productivity;
- (5) every year Colombian society spends millions of pesos in private security to lower the risk of attacks on people and property;

- (6) part of the public spending must cover the additional cost of maintaining an active military to try to contain the expansion of the guerrilla groups;
- (7) the economic inefficiency caused by resulting uncertainty and risk;
- (8) the negative effects of insecurity on investments, technological changes, productivity and administration.<sup>58</sup>

As a final note, it is important to consider the indirect effects of subversion at the aggregated level which is estimated at nearly 4 percent of the Gross National Product or close to \$3.2 billion U.S. dollar a year.<sup>59</sup>

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<sup>58</sup> Rangel, Alfredo, "Parasites and Predators: Guerrillas and the Insurrection," *Economy of Colombia, Journal of International Affairs*, Spring 2000, 53. No. 2, Columbia University of New York

<sup>59</sup> Granada, Camilo and Rojas, L., "Los Costos del Conflicto Armado," *Planeación y Desarrollo*, DNP, Bogota, October-December, 1995.

## **IV. IS DRUG TRAFFICKING BENEFICIAL FOR COLOMBIA?**

This chapter presents an overview of how drug-cartels, specifically from the 1970s to 1990s, negatively impacted Colombia's economy. Drug-money has corrupted the Colombian social net, changed moral values, manipulated Colombia's Congress, executive and judicial system through bribes, fueled social tensions, and penetrated the traditional socio-economic "equilibrium" of the exclusionary Colombian democracy.

The chapter argues that drug-profit is inherently a criminal activity, without real output that is valuable for Colombian society. After more than thirty years of illicit drug trafficking Colombia is confronted with an economic recession and social turmoil. Contrary to this, the underground drug-economy production benefits those who engage in it: guerrillas, paramilitaries, smugglers, weapons' traffickers, landlords, and money-laundering enterprises; all of these have the power to intimidate Colombia's weak civil society. On the whole, it is estimated that drug-related violence currently accounts for a high proportion of the country's 30,000 annual murders, one of the highest rates of any country outside a war zone and more than double the number of murders recorded in the United States during 1998.<sup>60</sup>

The chapter analyzes: (a) the evolution of Colombia's drug cartels; (b) the drug trade's escalation and its relationship with the economy and narco-politics; (c) the size of the underground drug economy; (d) the national cost of the drug industry; and (e) Colombia's war against drugs: actions and results, concluding that after many historical efforts between the U.S. and Colombia to reduce the traditional drug-cartels' influence and power, the new drug actors; FARC and white-collar traffickers are, in fact, worsening the drug-war outcomes by conducting their businesses in a complex, bloody, and asymmetric fashion.

### **A. THE MEDELLIN AND CALI DRUG CARTELS: EVOLUTION AND THREAT TO COLOMBIAN GOVERNMENTS**

In the 1980s and 1990s the drug industry permeated Colombia's economy, imposed its criminal rules, and encouraged the collapse of institutions and the Colombian

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<sup>60</sup> RAND Corporation, "The Illegal Drug Trade in Colombia", Chapter two, p.17, 2001

civil society. From this moment, the oldest exclusionary democracy<sup>61</sup> in Latin America, Colombia has been under siege. In the last twenty years, Colombia's history of illicit drug trafficking has been an accumulation of corruption, terrorism, urban and rural violence, environmental damage, lawlessness, underground economy, smuggling, money laundering, paramilitary violence, internal refugees, increased political power of drug-kingspins, as landlords, against agrarian reforms, congressional political cynicism, loss of public confidence, a financial crisis, and a progressive intimidation of society by the drug-cartels and their clandestine power. The confluence of these intricate factors has impeded sustainable economic growth in Colombia, and denied the development of a prospective state vision, where medium and long-range national goals are achievable.

In regards to the evolution of the drug-trade, "the deployment of the U.S. Peace Corps contributed substantially to popularizing the use of marijuana and some varieties of mushrooms in Colombia during the 1960s. However, until the early 1970s the production and trafficking of these marijuana did not become significant."<sup>62</sup> Drugs became an issue in U.S. foreign policy in the 1970s, when President Nixon announced the first "war against drugs". At that time, the U.S. and Mexican government agreed to use the chemical "Paraquat" to destroy Mexican marijuana crops, creating a supply shortage. This operation raised the profile of Colombia as a new marijuana supplier and opened U.S. as a new market for Colombia's mafia –an early example of the balloon effect. By the 1970s Colombia produced and exported "Santa Marta Gold" marijuana --highly reputed in the U.S. streets.

If the Colombian economy during the administrations of Lopez (1974-1978) and Turbay (1978-1982) administration showed an important development, it was the rapid growth of the underground economy associated with the illegal drug industry. Since the Colombian legislation was prone to issuing flexible laws that allowed the return of "flight

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<sup>61</sup> Colombia the oldest exclusionary democracy of Latin America has two traditional right wing parties, the Liberals and Conservatives. These parties have been controlling Colombia's political outcomes through historical political agreements for almost a century. Their political strategy have been the operation of a clientelist machinery by the use of regional and local barons, which represent political and economic power elites. Thus, the space of maneuver for other political alternatives is minimal due to the historical polarization of the exclusionary radical right wing.

<sup>62</sup> Thoumi, Francisco, "Political Economy & Illegal Drugs in Colombia," Vol. II, P.126, Studies on the Impact of the Illegal Drug Trade, 1995, Lynne Rienner Publishers, London.

capital”, the drug-cartels exploited the opportunity by flooding the financial market, and domestic businesses with “dirty money”. The tactic used, with significant evidence, was export over-invoicing, import under- invoicing, and other forms of laundering illegal foreign exchange.<sup>63</sup> Ibanez (1974) states, “In a study of possible implications of the 1974 tax reform in Colombia, estimates about one-third of the states sales taxes had been avoided prior to the reform.”<sup>64</sup> Using estimates of the GDP and income distribution, Ibanez established that the income reported in tax return was only about one-third of the total reportable income. This means that, in the 1970s, Colombia did not have an efficient internal revenue service that allowed control over tax collection since neither central nor local control existed. For a long time evasion was Colombia’s economic rule of law.

Not only the lack of accountable systems and audit controls, but also the lack of punishment against tax-violations were its principal characteristics. Thus, Colombia was an “offshore fiscal paradise” due to the lack of financial and custom control, allowing money laundering and the growth of power for the drug-cartels inside Colombia’s economy.

The Turbay administration (1978-1982) took office in August 1978, when it confronted the U.S. over drug policy. President Carter pressured the Colombian government to spray “Paraquat” chemical over marijuana plantations. Instead, Turbay began a campaign of manual eradication and interdiction that avoided the use of defoliants and herbicides. The campaign was considered quite a successful alternative at that time. Since eradication and controlling drug production has been the preferential U.S. policy since this period. However the U.S. primarily prefers ‘aerial spraying’ as the most effective, but it has a high economic cost. Others have argued that ‘manual eradication’ is less expensive and adds social value. These techniques are still a controversial issue between Colombia and U.S. today.

In the 1980s, the U.S. and Colombian interest converged in fighting drug trafficking. In 1982, President Ronald Reagan declared another war on drugs and

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<sup>63</sup> Moraewz, David, 1981. “Why the Emperor’s New Clothes Are Not Made in Colombia.” N.Y. Oxford University Press.

<sup>64</sup> Thoumi, Francisco, “Political Economy & Illegal Drugs in Colombia,” Vol. II, p.96, Studies on the Impact of the Illegal Drug Trade, 1995, Lynne Rienner Publishers, London.

unveiled plans to “launch a ‘full-scale’ attack against abuse at home and production, processing, and trafficking abroad. National Security Directive 221 of April, 1986, states that ‘drug production and trafficking comprised a threat to the security of the Americas’.”<sup>65</sup> Clawson, Patrick and Lee, a research team on drugs, explained the relationship between drug-production and U.S. policy in the following way:

The growing U.S. demand for cocaine in the early and mid-1980s precipitated major organization changes in the Colombian cocaine industry. Production and transport were revolutionized. The “mule” system was discarded and replaced with fleets of aircraft that could carry loads of 400 to 1000 kilograms of cocaine. By the 1990s, traffickers were using merchant shipping, cargo jet aircraft, and semi-submersible vessels to export multi-tons load of cocaine to foreign markets.<sup>66</sup>

In Betancourt’s administration (1982-1986), the illegal underground economy had grown so much that it had to be recognized as a police issue for government security forces. This led to the involvement of Colombia’s military forces in anti-drugs operations, fueling social conflict especially in areas where marijuana was being planted. As Thoumi argues,

Unfortunately, the Betancourt’s administration is likely to be remembered not by the relative success of its economic policies but by increased general violence levels, including open conflict between the illegal drug industry, guerrilla organizations, and the state.<sup>67</sup>

One of the most violent episodes in Betancourt’s administration was the assassination of the Colombia’s Minister of Justice, on the orders of drug-kingpin Pablo Escobar. Another example was the dramatic takeover by the M-19 guerrillas of the Colombia’s Supreme Court building –where dozens of files that incriminated Medellin’s Drug-Cartel were stored, resulted in massive casualties among the Supreme Court members, and the burning of the judicial-files.<sup>68</sup> This was the first bitter episode where

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<sup>65</sup> Steiner, Roberto, “The U.S. and Latin America: The New Agenda. Hooked on Drugs: Colombian-US Relations,” Chapter 8, p. 161. Published by Institute of Latin America Studies, University of London and David Rockefeller Center for Latin America studies, Harvard University.

<sup>66</sup>Clawson, Patrick and Lee III, Renssenlaer, “The Andean Cocaine Industry,” p.38, 1996, St. Martin’s Press, New York.

<sup>67</sup>Thoumi, Francisco, “Political Economy & Illegal Drugs in Colombia,” Vol.II, P.56, Studies on the Impact of the Illegal Drug Trade, 1995, Lynne Rienner Publishers, London.

<sup>68</sup> Ibid. p.216

drug-cartels and guerrillas challenged Colombia's state through the use of violence and intimidation. Large that the alliance between drugs and guerrillas became evident when the M-19 guerrillas group took over Colombia's Palace of Justice on November 6, 1985.

The link between drugs and guerrillas is an on-going difference between Colombia's Military Forces and U.S. Congress because U.S. politicians have considered for a long time that drugs are not related with guerrillas' businesses. Therefore the U.S. military assistance for Colombian forces has been restricted to confronting the subversive threat. (The controversial issue finished on September 11, 2001 when Taliban's narco-guerrilla showed their power as intimidators by the terrorist attacks. The attacks could have been fed with "dirty money" from heroin trafficking, as intelligence agencies reported.)

On the other hand, Colombia's history shows that the economic policy of the Barco administration impacted money laundering and drug trafficking (1986-1990). This economic policy, an "economic opening" package, relies on a trade liberalization program as its most important element while granting, at the same time, amnesty to those who have illegally acquired assets and income abroad. Thoumi writes,

The international liberalization program lowered tariffs substantially and eliminating most non-tariff trade barriers. New policies also included the elimination of the "exchange control system" to free foreign exchange transactions and international capital flows, the weakening of restrictions on direct foreign investment, drastic changes in the labor code to make labor markets more flexible, and additional capital market liberalization measures.<sup>69</sup>

In sum, Barco's administration implemented another tax reform that simplified many taxes and eliminated tax biases against equity financing.

Thoumi characterizes Barco's policies as follows: "Amnesty provisions of this reforms were even more generous than those of the past, opening the door for the laundering of substantial amounts of illegal obtained funds. Those amnesties increased

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<sup>69</sup> Thoumi, Francisco, "Political Economy & Illegal Drugs in Colombia," Vol .II, P.57, 58, Studies on the Impact of the Illegal Drug Trade, 1995, Lynne Rienner Publishers, London.

short-term government revenues, but also legalized illegal income capital.”<sup>70</sup> The tax amnesties have generated an evasive culture in Colombia, as citizens realize that tax amnesties –especially in case of fiscal emergency--were the key tool for government revenue increases. Thus, citizens have violated tax laws looking for future personal benefits (amnesty). Citizens have also make it easy for drug traffickers to bring their drug-profits from foreign financial markets, because the new policies eliminate “the exchange control system” freeing foreign exchange transactions and international capital flows. Additionally, the weakening of restrictions on direct foreign investments by capital market liberalization measures, allows narco-traffickers to flood Colombia’s economy with ‘drug-money’, laundering it in the formal economy but without real capital investments. Thoumi’s argues this point:

Barco’s administration has clearly gambled on the success of market liberalization policies to restore GDP growth rates to the 5 to 6 percent level... while official data indicate that legal exports as a percentage of GDP declined secularly from the 1920s on, it is not clear that this was the case during the 1970s and 1980s when marijuana and cocaine exports grew dramatically....Foreign exchange revenues from these drug-exports that entered Colombia’s economy each year are likely to have been in the U.S. \$1.5 to \$2.5 billion range, indicating a substantial greater degree of international openness.<sup>71</sup>

Government policies and economic institutions have economically assimilated in the underground drug economy. In response to this interaction, Thoumi takes this position:

During 1970s and 1980s it [money-laundering] was facilitated by periodic tax amnesties and holidays that the various governments implemented to increase [increasing] tax base, and by frequent loosening [of] the requirements regarding the sale to the Central Bank foreign exchange earnings attribute to service exports. Then, the grown [growth] of the underground economy has made it difficult to separate “clean” and “dirty” illegal capital and income, to the point that any policy aimed at bringing above ground illegal “clean” capital opens the door for “dirty” capital legalization.<sup>72</sup>

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<sup>70</sup>Idem.

<sup>71</sup> Idem.

<sup>72</sup> Idem, p.161



However, in Gaviria's administration (1991), drug trafficking reached its maximum momentum in relationship with intimidation, corruption and threat. In his administration, the rule of law was abandoned--after several terrorist attacks-- for the convenience of the drug kingpin, Pablo Escobar, and the Medellin cartel:

In early September 1990, the Gaviria's government announced a major new peace initiative. The government would offer drug dealers the option of accepting sentences reduced by one-third and guarantees against extradition to the U.S. on the condition that they surrender to the authorities, confess to all their crimes in Colombia and abroad, and identify criminal assets and proceeds --laboratories and bank balances, for example. If they cooperate in the identifying the other perpetrators of or participants in the confessed crimes, and in revealing the value of the property reported to the judges, their sentences would be cut by an additional one-sixth.<sup>73</sup>

Thus, the legal and judicial institutions of Colombia were targeted by the corruption of Medellin cartel, the worst example of this occurred when Pablo Escobar surrendered under the following unorthodox conditions: (1) the prison being located in a city where the traffickers enjoyed great influence, in Envigado Antioquia; (2) Escobar himself contributing \$2 million US dollars to the construction of the prison's and the money being funneled through the Envigado municipal treasury; (3) Escobar and his representatives being allowed to screen the guards responsible for internal security in the prison; (4) The prison itself being equipped with fax machines, cellular telephones, and computer, allowing Escobar to manage bank accounts and business transactions, and communicate with subordinates.<sup>74</sup>

Through high-level corruption, Escobar escaped with nine of his fellow prisoners. This resulted in a government manhunt for Pablo Escobar, with in depth support from the Drug Enforcement Administration (DEA) of the U.S. Finally, in 1993 with valuable information from the Cali cartel, Gaviria's administration successfully liquidated Escobar, ten years after the trafficker had become a fugitive from justice. Then, in 1995,

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<sup>73</sup> Clawson, Patrick and Lee III, Renssenlaer, "The Andean Cocaine Industry," p.110, 1996, St. Martin's Press, New York.

<sup>74</sup> Ibid. p.112, 113,114.

the Cali cartel surrendered under Samper's administration, causing more political and moral damage than the terrorism of the Medellin cartel did.<sup>75</sup>

Nonetheless, the breakup of the Cali and Medellin drug cartels did not lead to a long-term decline in Colombian drug trafficking. In contrast, these drug syndicates have since been replaced by smaller, more vertically integrated trafficking organization whose lively, independent memberships are much more difficult to detect and infiltrate. These traffickers employ new and constantly changing shipping routes through Central America, Mexico, and the Caribbean for moving cocaine and, increasingly, heroin.<sup>76</sup>

Moreover, in addition to the small traffickers that appeared after the cartels collapse, the 17,000-member guerrilla army of the Revolutionary Armed Forces of Colombia (FARC), an organization that had protected drug-cartels' operations in plantations, laboratories and domestic routes, took final control over coca plantations in Colombia's southern jungle. Today, the FARC is considered the biggest drug-cartel of the world. In addition other criminal organization appeared having profited from narcotics in areas out off guerrillas control, including Colombia's Self-Defense Union (AUC) or paramilitaries. The Self-Defense Organization acts periodically as facilitators of the drug business to raise funds, or other times as drug producers.

Briefly, drugs have been an important foreign policy issue between the U.S. and Colombia since the 1970s. The controversy about eradication techniques subsists, as well as the controversy between U.S. advisors and Colombian security forces about the strategic focus that must be implemented in the drug-war; some argue that focus must be on the productive side, while others say that it must be on the demand side. On the other hand, Colombia's economic policy, due to historical ambiguity, has been contributed, in an indirect way, to money laundering and the prosperity of drug cartels.

## **B. DRUG TRADE ESCALATION: THE ECONOMY AND NARCO-POLITICS RELATIONSHIP**

The symbiosis between politicians and drug-traffickers has been very complex; it also involved the country's business elite who proved to be vulnerable and complicitous.

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<sup>75</sup> Ibid.

<sup>76</sup>[ [http://www.foreignpolicy-infocus.org/briefs/vol4/v4n30colo\\_body.html](http://www.foreignpolicy-infocus.org/briefs/vol4/v4n30colo_body.html)]

They often accepted payments in cash, facilitated money-laundering operations through legitimate businesses, and sold properties at exorbitant prices. Without the acquiescence of some business people elite with low profiles, the money laundering operations would have been impossible in Colombia's economy during the 1970s, 1980s, and 1990s.

Thoumi's research has pointed out that

Business associations in illegal contraband markets (known as "San Andresitos" shopping centers) have used the political clout afforded by their numbers to obtain from local government public services, and police protection despite the flagrantly illegal nature of their business. Their political strength is such, that politicians frequently seek their support, ignoring their illegal activities."<sup>77</sup>

For instance, donors from "San Andresitos" supported Samper's presidential campaign in 1994. The National Direction of Custom and Taxes (DIAN, Spanish acronym) had tried to bring these illegal businesses --where money laundering is central— under control without results. The Samper's questionable moral authority and his legislators impeded it.

As Thoumi argues the "San Andresitos" phenomenon allowed drug-profit to increase/spread in small amounts of income, without risks. Transactions using cash instead of checks or credit/debit cards are the best way to launder money, with no receipt being issued for future government tax control.

"Also services and non-durable consumer goods are attractive for laundry activities because they do not leave easily detected evidence of their use; assets for which the price is hard to estimates are also attractive, ."<sup>78</sup>

The narco-politics relationship is well explained by Clawson, Patrick and Lee:

The Cali drug lords asserted that the large number of political leaders were involved on some level with the drug trade and that the dons possessed evidence on [of] this involvement –tapes, documents, and photographs. The message was a clear blackmail threat. Apparently the threat did not succeed as the government achievement in putting Cali leaders behind

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<sup>77</sup> Thoumi, Francisco, "Political Economy & Illegal Drugs in Colombia," Vol.II, p.101, 1995

<sup>78</sup> Ibid. p.98, 1995

bars. Yet that achievement [achieved] was offset by a spate of accusations of political corruption against top Samper administration officials. “Moral terrorism” by the cartel was Samper’s explanation but the imprisoned Cali drug lords may have sought revenge against Samper and his colleagues leaking details of their financial contribution to the 1994 presidential campaign.<sup>79</sup>

Despite years of trying to crush drug power, Colombia remains the world’s largest exporter of illegal cocaine. What has turned this running wound in the heart of Latin America septic is the link between narcotics smugglers and political groups of the left and right. In blurring the line between criminal and political activity, they have made much of Colombia ungovernable. As a result the drug cancer is spreading around the region.<sup>80</sup> According to recent U.S. government reports, widespread corruption within all sectors of the Colombian government was a major factor affecting counter-narcotics operations.

### **C. ESTIMATES ON THE SIZE OF THE UNDERGROUND DRUG ECONOMY**

Measuring the size of the underground drug economy is not an easy task. The statistical data is a product of methods of estimating. In the case of estimating underground economies, Vito Tanzini a research in economic issues, states:

The estimates of the underground economy, expressed as percentage of GDP, provided by different studies using different methods, showed contradictory results, range from 1.4% to 31.4% for Canada, from 6.2% to 19.4% for the U.S., and for Germany from 14.5% to 31.4% of GDP.<sup>81</sup>

By the same token, overseeing Colombia’s drug profit is a complicated job, especially when account data lacks accuracy, and where small and medium private businesses, out of government tax control, have allowed for a long time drug-money overflow, and laundering activities.

Evaluating the potential production of drugs in Colombia is key in estimating the size of the underground’s economy. To estimate, a useful toll is the data from Colombia’s

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<sup>79</sup> Clawson, Patrick and Lee III, Renssenlaer, “The Andean Cocaine Industry,” p.121-122, 1996, St. Martin’s Press, New York.

<sup>80</sup> <http://www.mapinc.org/drugnews/v99.n800.a10.html>. “Drugs and Politics Are a Lethal Mix in Colombia.”

<sup>81</sup> The Economic Journal, “Uses and Abuses of Estimates of the Underground Economy,” 109 (June) F338-F347, Royal Economic Society, 1999, Published by Blackwell Publishers.

Minister of Defense (2000 Report). The National Anti-Narcotics Direction of Colombia concluded the following about cocaine activities: Coca growers pick up a harvest four times per year. Each harvest produces 1,350 Kg. of coca leaves per hectare, which produces 1.6 Kg. of coca base, and finally converts to 1.45 Kg. of pure cocaine.

The production of cocaine depends on coca plantation hectares. In 1991 Peru produced 520 tons. of coca, Colombia produced 60 tons. and Bolivia produced 220 tons. This indicates that Colombia's participation in production was only 8 percent. But in 1999 Colombia reached 520 tons. of production, switching to first place followed by Peru with 175 tons. and Bolivia with 70 tons. of coca.<sup>82</sup> As a result of the pure and quality of Colombia's cocaine, one cocaine gram exported from Colombia through international traffickers represents four cocaine grams on the demand side. Thus, the profit for producers and traffickers is highest. For the Colombia's producers one kg of cocaine is worth at home \$1,600 US dollars. The price is expanding through the chain of traffickers. Then, one cocaine-Kg. in the U.S. markets range from \$25,000 to \$30,000 US dollars. In Europe, the price ranges from \$45,000 to \$50,000 US dollars per kilogram of cocaine.

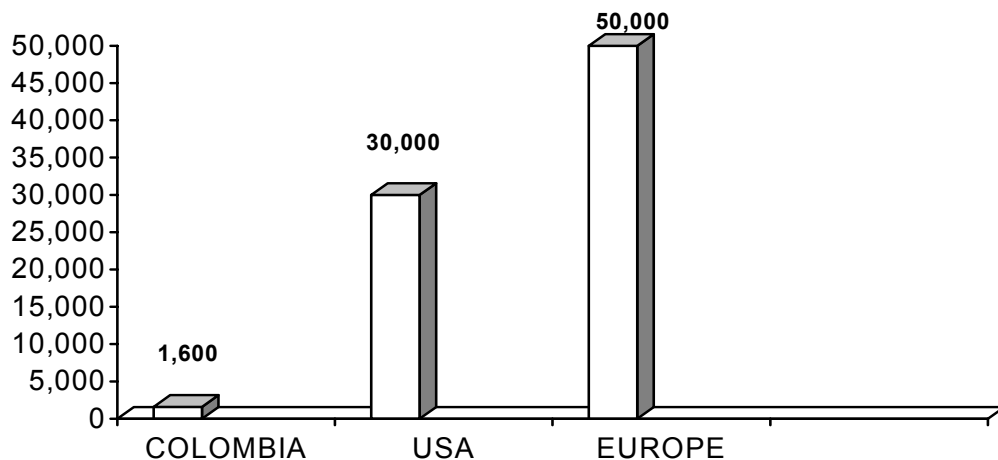


Figure 17. Cocaine Average Value (U.S. \$ per kg.)  
From: Dirección Nacional de Estupefacientes, Diciembre 1999

<sup>82</sup> Ministerio de Defensa Nacional de Colombia, "El Narcotráfico: Una amenaza para la Seguridad Nacional," Noviembre 2000, p.11, 30.

The estimated cocaine potential production for the last five years was 2,447 tons. minus 627 tons. destroyed by aerial spraying, minus 217,1 tons. seized by government forces, and, finally, 1603 tons. was available for marketing. This means that the Colombian forces seized and destroyed 35 percent of potential cocaine production for markets.

In the case of Colombia’s heroin, one-kilogram ranges from \$10,000 to \$ 12,500 US dollars at home. In the international market, its price reached \$70,000 US dollars for the US, and \$80,000 US dollar for Europe.<sup>83</sup>

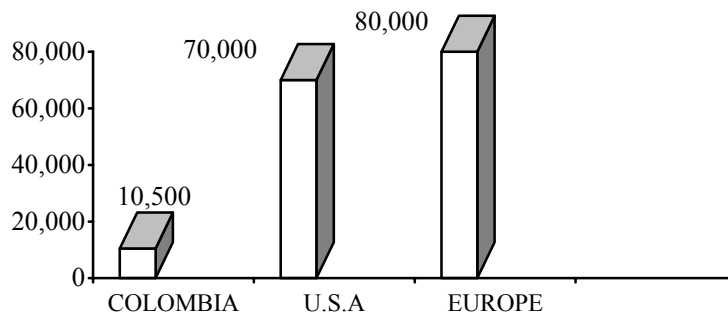


Figure 18. Heroin Average Value (U.S. \$ per kg.)  
From: Dirección Nacional de Estupefacientes, 09 Diciembre 1999

In order to hamper production the government use to destroy 34,915 Kg. of heroin, and also Colombian forces seized 1,376 Kg. of heroin. These figures indicate that heroin production in the last five years is approximately 71,163 kg. In total official forces destroyed and seized 50 percent of potential heroin production.<sup>84</sup> According to the National Anti-Narcotics Direction of Colombia, more than 80 percent of drug profit remains in the U.S. and Europe financial markets, and the remaining 20 percent returns to Colombia as contraband, weapons and dollars fueling the domestic drug operation.<sup>85</sup>

<sup>83</sup> Ministerio de Defensa Nacional de Colombia, “El Narcotráfico: Una amenaza para la Seguridad Nacional,” Noviembre 2000, p.13, 14.

<sup>84</sup> *Ibíd.* p.41, 42.

<sup>85</sup> *Ibíd.* p.13

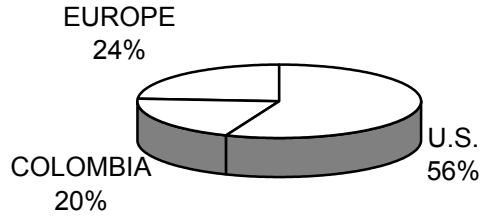


Figure 19. Cocaine Profit Distribution  
From: Direccion Nacional de Estupefacientes de Colombia

Research from “United Nations, Division of Drug Control, Crime Prevention, Money Laundry, and Financial Sanctuaries” (New York, 1999, p.106) claimed that money laundering from the drug business is estimated at \$ 200 billion of US dollars per year.<sup>86</sup>

For Roberto Steiner, two reasons are important to estimate the income of Colombians involved in the drug trade: (1) It is valuable information for Colombia’s economic authorities, and (2) It is important for multilateral anti-drug efforts.<sup>87</sup>

Additionally, Steiner’s research discovered and analyzed these figures:

It is thought that at least \$7 billion per annum eventually returns to Colombia from drugs (Whynes, 1991, p.484), but this amount falls short of the one reported by MacDonald (1989) according to whom drugs could be Colombia’s biggest source of national income –nearly 36 per cent of its total gross national product. With a GDP in 1988 of around \$50 billion, MacDonald is suggesting that Colombia receives \$18 billion a year from drug export. Indeed, Andelman (1994, p.98) went even further, implicitly suggesting that yearly revenues for the Colombian cartels in the U.S.A. could reach \$25 billion, i.e. 50 per cent of GDP. In none of the above estimates is there an explicit methodology; in most cases there is no mention of the reference period; and in several instances we have estimates based on other estimates.<sup>88</sup>

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<sup>86</sup> Ibid. p.17

<sup>87</sup> Steiner, Roberto, “The U.S. and Latin America: The New Agenda. Hooked on Drugs: Colombian-US Relations,” p.166, Harvard University Press.

<sup>88</sup> Steiner, Roberto, “The U.S. and Latin America: The New Agenda. Hooked on Drugs: Colombian-US Relations,” p.167, Harvard University Press.

In connection with drug trade, Steiner additionally offered his viewpoint:

Colombia's net total income from illicit drugs –i.e. including marijuana and heroin – could have been 7 percent of GDP and 70 per cent of exports at its peak during the first half of the 1980s. For the recent past it represented close to 3 per cent of the GDP and around 25 percent of legal exports. Even though these estimates give no support to the claim that the Colombian economy has been taken over by the drug trade, it is still the case that small group of outlaws is receiving yearly income to the tune of 3 per cent of GDP. While yearly revenues from coffee also stand around 3 per cent of GDP, they provided for the livelihood of 300,000 families. It seems fair to conclude that, while drugs do not seem to represent crucial element in Colombia's economic well-being, they have implied a huge transfer of power to a small group of individuals involved in organized crime.<sup>89</sup>

In giving his opinion, Thoumi's focused on some facts that define Colombia's underground economy:

*First*, the underground economy is large and, while there are no accurate measures of its size, it has clearly grown faster than the formal economy since the mid-1970s. *Second*, the state's ability to enforce its laws, and the respect and loyalty it commands are extremely weak, having decline through time. *Third*, most illegal economic activity in Colombia does not carry a social stigma, and in many cases has been institutionalized in a process in which the government itself has frequently participated, at least passively. *Fourth*, the country's laws, regulations, and institutions made some assets, especially real estate, a good vehicle for hiding capital. *Fifth*, many economic transactions in Colombia [‘s] “dirty” money –that is, convert legally earned income capital into illegal and hidden forms. In short, many of these actions are simply the accepted way to do business and government policies have contributed to such an environment.<sup>90</sup>

Other Colombian government actions have also contributed to economic law-breaking, from Thoumi's perspective: (1) The black market exchange rate was below the official one for substantial periods of time, and the purchases were seen as part of the

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<sup>89</sup> Steiner, Roberto, “The U.S. and Latin America: The New Agenda. Hooked on Drugs: Colombian-US Relations,” p.168, Harvard University Press. and Data from U.S. Department of Justice, Drug Enforcement Administration, National Narcotics Intelligence Consumers Committee, and U.S. Department of State.

<sup>90</sup> Thoumi, Francisco, “Political Economy & Illegal Drugs in Colombia,” Vol.II, P.101, Studies on the Impact of the Illegal Drug Trade, 1995, Lynne Rienner Publishers, London.



exchange rate policy followed by the Colombian government. (2) Until 1991, it was illegal for Colombian residents to hold foreign exchange or other financial assets in or outside the country. Thus, the restricted government policy led the businessmen to negotiate foreign exchange in the black markets, increase their profit for buying dollars below the official rate, circumvent taxes, elude accountable registers, and hide their assets from custom and internal revenue services oversight.

Briefly, during the last twenty years, the growth of Colombia's underground economy, from smuggling to drug trafficking, has been one of the most remarkable issues. Given its size, government policies accepted its importance and impact on the national economy. For Thoumi, ascertaining to what degree the illegal drug industry-generated capital has been invested in Colombia's economy is not possible; even though real estate has been a favorite sector for industry investments. Another area of investment is in soccer teams, which provide money-laundering channels. For example, altering gate receipts can be used to launder dirty money, and the players' salaries can be paid in under-the-table dollars.<sup>91</sup>

In order to summarize the size of the drug economy, some data need to be considered: (1) Colombia's National Association of Financial Institutions (ANIF) reported that worldwide street sales of Colombian cocaine, heroin and marijuana totaled \$ 46 billion US dollars in 1999. Based on the assumption that less than 10 percent of total sales are repatriated to Colombia each year, ANIF estimated that the country's total earnings from the illicit drug trade amounted to approximately \$ 3.5 billion US dollars in 1999. This figure placed drug earnings close to the \$ 3.75 billion US dollars from oil--the country's top export—and more than two and one half times earnings from coffee exports in 1999.<sup>92</sup> (2) The estimate of contraband and other types of unregistered trade presents a much greater difficulty. As an illustration, the estimates for contraband vary between \$ 1.8 billion US dollars annually, as calculated by the Office of Taxes and National Custom

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<sup>91</sup> Ibid. p.162, 1995

<sup>92</sup> Asociación Nacional de Institutos Financieros, "La Economía de la Cocaína: La Clave para Entender Colombia," Bogota, ANIF, 2000.

in 1992, and \$ 5.5 billion US dollars, as calculated by the National Comptroller in 1995.<sup>93</sup>

#### **D. THE NATIONAL COST OF THE DRUG INDUSTRY**

The drug industry has impacted several areas in Colombia. Drug trafficking involves political cost by weakened legal and judicial institutions with terrorism, intimidation, and corruption. However, economic, social and ecological costs are the most expensive due to the difficulty in quantifying the real damage and its future impact on the upcoming Colombian generations.

The economic cost of the cocaine industry is measured in several ways: First, for the national budget allocated a quantity of money each year to conduct anti-narcotic operations. For instance, the budget has allocated in 1995 by Colombian government for enforcing the drug laws, and prosecuting drug kingpins was more than \$990 million US dollars, or almost 2 per cent of the nation's GDP.<sup>94</sup> Second, the economic cost of security measures is preventing Colombian businesses from being involved in the narco-traffickers' web. Third, national manufacturing is suffering from imports made cheap with "dirty money". Fourth, the property values are collapsing after the artificial coca-financed boom, collapse that started in 1995. And fifth, the government is losing control over economic policy, because the vast size revenues of the cocaine industry reduce its ability to control the economy.

On the other hand, if businesses are paying additional cost, they must take extraordinary precautions to protect their export containers from becoming instruments of drug smuggling. These businesses run the risk of a shipment being confiscated or at least delayed if drugs are found. Additionally, more money needs to be spent by private security firms to control export processing. For Colombia's enterprises competing in the global market under these circumstances is hard.

Nazih, in a research of Colombia's political economy and violence, has pointed out the cost of private security measures:

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<sup>93</sup> Bergquist, Penaranda and Sanchez, "Violence in Colombia 1990-2000: Waging War and Negotiating Peace," p. 79, SR Books, 2001

<sup>94</sup> Guevara Gil, Jacqueline, "Narcotráfico Falsea la Economía," El Tiempo, October 9, 1995, p.1B

By 1997, the number of security companies has grown into a highly profitable sector in the business community. Today there are approximately 385 private security agencies, with 104 branches spread throughout 627 departments; there are 7 agencies that specialize in the protection of securities, with 49 branches. At last count, the total number of people employed by these agencies numbered 89,159 operatives, plus 5,210 administrative personnel. It has been estimated that private groups (both businesses and individuals) spend about \$150 million (0.3 percent of the GDP) to protect their properties and ensure their personal safety.<sup>95</sup>

Clawson, Patrick and Lee offer this analysis:

Colombia manufacturing has suffered because of imports made cheap by the overvalued exchange rate and by widespread smuggling, perhaps for sale at a loss, as [a] way to launder narco-dollars. Low cost contraband imports have seriously hurt the textile industry, the centerpiece of Medellin's economy. A General Electric factory producing portable radios in Colombia in the 1980s, went out of business because its products could not compete with a flood of illegal imported radios.<sup>96</sup>

In other words, neither large, medium nor small enterprises can easily survive in an unfair market environment, following government regulations and labor codes. The bankruptcy of small and medium Colombian enterprise is the real damage from narco-dollars because money laundering through contraband impedes enterprises in competing in open markets.

In reference to money laundry activities, Thoumi states:

The Medellin cartel has shown preference for urban estate investments, and has purchased large tracks of land in rural areas of the country. The Cali and other small traffickers group have invested more in urban enterprises and, utilizing the widespread social tolerance for contraband imports, have apparently been the main source of what is sold in the "San Andresitos", found in almost every Colombian city. The combination of the lack of long-term financing, a net worth tax, and a capital gains tax that was primarily a tax on inflation made real estate an ideal sector to hide drug-profits. By extension, real estate became the prime vehicle for money laundering and a favorite investment of illegal psychoactive drug entrepreneurs. Arango (1987) found that: for 45 percent of the illegal drugs entrepreneurs surveyed, urban and rural real estate was their first

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<sup>95</sup> Richani, Nazih, "The Political Economy of Violence: The war-system in Colombia," p. 15, 1997, *Journal of Interamerican Studies and World Affairs*, Beverly Hills.

<sup>96</sup> Clawson, Patrick and Lee III, Renssenlaer, "The Andean Cocaine Industry," p.202, 1996, St. Martin's Press, New York.

investment choice, for 20 percent it was cattle raising, and for 10 percent construction. None of the entrepreneurs considered manufacturing as his first investment choice.’ Indeed, Sarmiento (1990) pointed out about the penetration of the money laundry in the Colombia’s economy and its repercussion: ‘clearly, if the illegal drugs industry were to disappear, Colombia would run a risk of having a recession for a couple of years.’<sup>97</sup>

In regards to the current recession, the crackdown on the Cali cartel hierarchy during 1995 has had negative economic repercussion, at least locally. Construction activity in Cali dropped 10.7 percent in the first four months of 1995, and retail sales declined 3.2 percent in the first semester of that year. Real estate dropped by one-third between January and November. Cali unemployment rate rose from 6.9 percent in December 1994 to 11.3 percent in June 1995 –an increase of 64 percent. For a long time, money laundering through construction activity was a labor factor that contributed to the basic needs of blue-collar workers. After the Cali cartel collapsed the government did not institute plans to help these poor workers. From 1995 until today, the workers’ labor condition remains unchanged.

The cartel’s influence on the Colombian economy also spans many activities:

Cali enterprises span many economic sectors: banks, communications, construction, urban transport, light industry, agribusiness, and retailing. Some 30 to 40 percent of the building construction in Cali was financed by Cali drug money. The cartel maintains extensive real estate and business holding outside of Cali, for example, in or near the Pacific Coastal port of Buenaventura and on the island of San Andres (actually in total administrative bankruptcy). Cali traffickers own at least fifteen five-start hotels, as well as several casinos and boat rentals in San Andres Island. In Buenaventura, they have invested in shipping and construction enterprise and have establishing [ed] large supermarket chains. Cali cartel business compromise pharmaceutical companies, investment corporations, and dozens of interrelated businesses.<sup>98</sup>

Undoubtedly, the narco-traffickers’ laundering activities drive up prices in ways that endanger legal investors. “Drug[s] has [have] funded a construction boom in Cali,

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<sup>97</sup> Thoumi, Francisco, “Political Economy & Illegal Drugs in Colombia,” Vol.II, P.161, 199, 249, Studies on the Impact of the Illegal Drug Trade, 1995, Lynne Reinner Publishers, London.

<sup>98</sup> Idem, p.60

including shopping centers, hotels, and luxury apartment buildings. Urban property prices rose 50 to 60 percent a year from 1991 through 1994. The artificial coca-financed property boom was followed by a collapse in property values. Salomón Kalmanovitz, with the Colombian Central Bank Research claimed that such a collapse resulted from the Colombian government's crackdown on the Cali cartel in early-mid 1995.”<sup>99</sup> This led to the high rate of unemployment in the Cauca Valley, and the paralysis of the related construction businesses in the region. Thus, after the collapse, the properties value was more realistic without the speculative narco-factor that allowed money laundering for a long time.

In fact, most of the cocaine income has been of dubious benefit. Some of the money has been wasted in low-profit (or unprofitable) investments undertaken to hide the funds from the law. Traffickers imported goods legally and sold them at prices even lower than paid in the foreign markets.

Clawson, Patrick and Lee's research discovered that money laundering techniques in Colombia involved substantial international interchange:

Cali organizations have converted cocaine cash to Russian commodities such as diamonds and non-ferrous metals that can be resold for “clean” hard currency in the West. In general, international narco-cooperation opens new markets for narcotics and other illegal products, exploits economies of scale in selling to those markets, finds new laundering outlets for illegal drug capital and diminishes criminal formations' vulnerability to prosecution by national governments.<sup>100</sup>

Further comments by Clawson, Patrick and Lee regarding the social cost of the cartel's influence described the power “landlords” possess over displaced peasants in Colombia:

The situation (of peasants) changed as Colombian cocaine barons invested some of their profits in vast tracts of land –reportedly at least 1 million hectares in the mid-to late 1980s in Cordoba, Antioquia, Meta, and other Colombia departments [states]. For example, in the Middle Magdalena

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<sup>99</sup> Clawson, Patrick and Lee III, Renssenlaer, “The Andean Cocaine Industry,” p.203 1996, St. Martin's Press, New York.

<sup>100</sup> Idem, p. 41

Valley town of Puerto Boyaca, which became the paramilitary movement in Colombia, drug trafficking purchases raised the price of a hectare of land from \$100,000 in the early 1980s to \$1 million in 1989. Many of the recently purchased tracts of land lay in 'red zones', where predatory guerrillas maintained a strong presence.<sup>101</sup>

Consequently, peasants abandoned their lands because they were targets between guerrillas and paramilitaries confrontation. In 1999 alone at least 225,000 people were driven from their homes, communities and livelihoods by political and drug-related violence. The vast impoverished majority of displaced Colombians have found themselves condemned to roam the country as internal migrants in search of food, work, shelter and safety.<sup>102</sup> This majority is in contrast to the privileged 1,072,449 Colombians that have managed to immigrate from 1996 to 2000 to the U.S., Venezuela and Ecuador. This period (1996-2000) represents Colombia's national crisis, triggered by skyrocketing kidnappings, guerrillas and para-militarism escalation, and coca and poppy crops expansionism. In the last period in comment, most of the wealthy people left the country with their financial capitals fueling unemployment, the real estate and land collapse, and the social security system faltered due to the lack of investment and economic contributions to the social system. Between 1985 and 2000, the country's guerrilla and drug conflict displaced some 3.3 million Colombians from their places of origin (7.8 percent of the total population).<sup>103</sup>

Another important impact due to drug operations is the socio-economic cost, deriving from the threat by the U.S. to decertify Colombia in 1995:

The U.S. was dissatisfied with Colombia on a number of counts: its failure to capture major drug kingpins, the increase of money flows into Colombia in the 1990s, and allegation of drug-related corruption at high political levels (Samper's administration). U.S. perceptions of the weakness of Colombia's criminal justice system prompted Washington's decision not to grant Colombia full certification in early 1995 for its counter-narcotics efforts. Full desertification would have exposed

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<sup>101</sup> Idem, p.185

<sup>102</sup> Bagley, Bruce, "Drug trafficking, Political Violence and U.S. Policy in Colombia in the 1990s," p. 18, School of International Studies, University of Miami, Coral Gables, Fl. February 7, 2001

<sup>103</sup> ANIF, "Los Números del Éxodo," Informe Semanal No.565, Enero 22, 2001

Colombia to U.S. economic retaliation, including the loss of most foreign assistance and possible increase tariffs on Colombian products.<sup>104</sup>

Samper's administration feared U.S. retaliation through the certification process. For this reason, all military and national police capability was directed at the search and capture of Cali-cartel traffickers. At the same time, the FARC, ELN and AUC increased their influence and power by taking opium poppy and coca-growth plantations under their control. These new actors imposed taxation, protection and control over small cocaine producers. As a result, small narco-traffickers were spreading across the country without notorious links between them (there have not been any up until today), making enforcement law more difficult. The drug production and its trafficking continue to contradict Colombia's counter drugs efforts.

The question now is why did the activity of the drug traffickers replacing the cartels not have a positive impact on the economy Nina M. Serafino from the Congressional Research Services gives her point of view on this question:

For one, the large Medellin and Cali cartels have been replaced by smaller independent traffickers and splinters from the Cali cartel. As of mid-1998, the Colombian Police had counted some 43 independent trafficking groups, about half of them based in the Antioquia, of which Medellin is the capital, and the others in the northern Cauca Valley, around Cali. Several groups of independent cocaine traffickers from the northern Cauca Valley had expanded their activities through the sale of cheap high quality heroin. (Heroin became a significant export from Colombia after 1990, when substantial opium poppy cultivation in Colombia was first reported, and Colombia traffickers are now the largest suppliers of heroin to the eastern U.S.) The rise of independent traffickers has complicated efforts to reduce trafficking, according to some analysts. Because they adopt conservative lifestyles, and work in groups of 10 to 20, using small legitimate businesses as fronts, independent traffickers are hard to identify.<sup>105</sup>

In sum, the economic cost to the Colombia's economy from drug trafficking is described as follow:

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<sup>104</sup> Clawson, Patrick and Lee III, Renssenlaer, "The Andean Cocaine Industry," p.120 1996, St. Martin's Press, New York.

<sup>105</sup> Serafino, Nina. CRS Report For Congress, "Colombia: Conditions and U.S. Policy Options", p. CRS-1, Updated February 12, 2001, Congressional Research Services, The Library of Congress.

- (1) The illicit drug business has had a negative impact on the rest of the economy by driving the exchange rate lower. A type of Dutch disease, which some analysts call the Andean disease, has resulted. This phenomenon results in a loss of competitiveness of those sectors of the economy that produces goods for export or goods that substitute for imports, because of the tendency for the peso to be overvalued.<sup>106</sup>
- (2) Much drug-trafficker spending is on luxury goods that are generally imported without aggregated value to the other sectors of the economy. Drug traffickers have little interest in investing their money in the industrial sector; the overall result is limited economic growth.
- (3) An immense proportion of the best lands in the country have landed in the hands of the drug traffickers. This process has translated into a general displacement of agricultural activity, both because the lands in question are now devoted to pasturages or recreational farms, or because, if they are dedicated to productive activities, technological improvements are introduced that result in bankrupting the competition. The high cost of land generated by the drug traffickers' limitless demand has worsened the problems of poverty, unemployment, and productivity in the Colombian countryside.<sup>107</sup>
- (4) The drug trafficking effects on national production are devastating, at least in terms of products with clearly distorted prices that in no way reflect the cost of production. In their operations, drug traffickers do not mind losing money on underinvoicing an import or selling a contraband product below its real value.<sup>108</sup>
- (5) Drug trafficking has also negatively affected the Colombian economy through its chilling effect on foreign investment; potential investors are put off by the violence associated with the drug trade. Such violence, coupled with the violence

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<sup>106</sup> Bergquist, Penaranda and Sanchez, "Violence in Colombia 1990-2000: Waging War and Negotiating Peace," p. 82, SR Books, 2001

<sup>107</sup> Ibid. p. 85-84.

<sup>108</sup> Ibid. p. 84



engendered by the guerrillas, severely compromises the sense of security of foreign investors.<sup>109</sup>

#### **E. DAMAGE TO THE RULE OF LAW**

In Colombia, drugs are associated with the degradation of the judicial sector and with the increasing ineffectiveness of the court system in resolving civil disputes. Such judicial failures are eroding the morale of ordinary Colombians and are threatening the country's future, altering the status quo of the society. "Cocaine traffickers have perverted Colombian politics, distorting public debate by using violence and money to silence opposition. The cocaine industry has undermined the rule of law, which is the foundation of a civilized society."<sup>110</sup>

The question is how the drug cartels undermined the rule of law? Clawson, Patrick and Lee have offered this explanation:

In 1980s and early 1990s, leaders of Medellin and Cali cartels negotiated as a group with the Colombian government in an effort to obtain collective judicial benefits such as sentences reductions, and end to extradition, and even amnesty for their crimes. At the moment, there are differences related to the cartel's political style and its impact in the rule of law that facilitate it: (a) Medellin traffickers used their vast fortunes to bankroll political movements and (in 1980s) to seek elective office directly; (b) Cali leaders have stayed out of politics, except for buying politicians or contributing to political campaigns; (c) The Medellin coalition unleashed violence against Colombia state institutions and against Colombia's political elite, and also financed an armed crusade against the revolutionary left; (d) The Cali cartel does not generally use violence as a political tool."<sup>111</sup>

In fact, "the Medellin drug cartel succeed [ed] in demolishing the U.S. Colombian extradition treaty; reportedly Escobar had spent vast sums on bribes to members of the 1991 Constitutional Assembly to accomplish this objective."<sup>112</sup> The Colombian Constitution banned extraditing its citizens; however, in December 1997 after the US

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<sup>109</sup> Ibid. p. 85

<sup>110</sup> Clawson, Patrick and Lee III, Renssenlaer, "The Andean Cocaine Industry," p. 1996, St. Martin's Press, New York.

<sup>111</sup> Clawson, Patrick and Lee III, Renssenlaer, "The Andean Cocaine Industry," p. 47, 1996, St. Martin's Press, New York.

<sup>112</sup> Idem, p.48

pressured Samper's Administration Colombia reinstated extradition at the request of US. Since then, some Colombians have been extradited to the US.

## **F. COLOMBIA'S WAR AGAINST DRUGS: ACTIONS AND RESULTS**

The U.S. through military assistance and funds supports Colombia's war against drugs. The strategic theory of Plan Colombia links economic development and security to the peace process. The overall strategy to achieve this goal is by controlling funds for the narcos and negotiating with fighting actors out of law.

Drug money feeds the coffers of the guerrillas, whose attacks give rise to the self-defense organizations (paramilitaries). If the money going to the narcos is taken away, the guerrillas cannot mount the attacks, they become less threatening, and the paramilitaries have less reason for being. The prospects for bringing the guerrillas and the paramilitaries to the table for serious peace negotiations are enhanced because they have less justification and less ability to wage war against the state and against each other. Plan Colombia endeavors to strengthen the state, reenergize an economy with deep unemployment, generate the conditions necessary for the pursuit of peace, control the expansion of illegal crops and drug trafficking, and restore civil society. The Plan is a great strategy for the remarking of the nation into a secure democratic society freed of violence and corruption.<sup>113</sup>

After three years of implementing Plan Colombia, supporters and detractors are questioning the Plan's efficiency because cocaine production has continued to rise without any regard to violence escalation, economic crisis, internal migration and unemployment. Despite the widespread use of glyphosate and large scale-damage to the Colombian ecosystem—aerial spraying has not reduce the production of coca, which more than double between 1992 and 1998.<sup>114</sup> Some tactical and operational facts are still controversial about the anti-narcotics agenda between the U.S. and the Colombian government, such as the aerial spraying of defoliants.

Most certainly, the fear of losing "Plan Colombia" put Pastrana's administration in conflict with Colombia's southern peasants. Furthermore, Pastrana's administration is under pressure of Non Government Organizations and international environmental

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<sup>113</sup> Marcella, Gabriel, "Plan Colombia: The Strategic and Operational Imperatives," p. 7, 8, April 2001, Strategic Studies Institute, U.S. Army War College.

<sup>114</sup> Bergquist, Penaranda and Sanchez, "Violence in Colombia 1990-2000: Waging War and Negotiating Peace," p. 270, SR Books, 2001

organizations, which resist aerial chemical fumigation and biological warfare for anti-drug-operations.

The environmentalists argue that “the practice of aerial spraying sets in motion a destructive cycle of chemical pollution, livelihood destruction, migration into more vulnerable areas, deforestation of the Amazon, displacement and expansion of the areas of illicit crop cultivation, which then are again fumigated.”<sup>115</sup>

In the opinion of the Washington Office on Latin America (WOLA), fumigation has failed to achieve its objectives. Fumigation campaigns targeting peasants growers actually work to the guerrilla’s advantage by further exacerbating social tension. In addition, a lack of regional development programs and the failure of the Colombian government to provide basis services have also worsened social tensions.<sup>116</sup>

The contradiction between repressions without development has been the FARC’s motivation for violence escalation. The guerrillas are looking at coca-plantation as the defenders of small peasants farmers against government intimidator forces.

Another policy has faltered. The expropriation of many assets associated with drug industry leaders failed, because the judicial system could not find a legal basis for many seizures. Properties titles given to other individuals, because the power and bribes of the accused kingpins. Nevertheless, as an illustration of the government’s effort, from 1997 to 2001, Colombia’s Anti-Narcotics Agency through the General Prosecutor Office has confiscated 7,994 real estate properties, and 2,425 vehicles (between aircrafts, ships and trucks). Additionally through judicial actions, 347 enterprises and 103 commercial businesses has been confiscated and put on judicial trials. Most of these properties belong to drug-lords like Pablo Escobar, Helmer Herrera, and criminal organizations of Cali, Medellin, Leticia, Llanos Orientales, Northern Cauca Valley and the Atlantic Coast, which had been holding their properties through figurehead.

From the regional perspective, the U.S. anti-drug offensive in Colombia has been adding tension along the borders, with reports of refugees crossing into Ecuador for

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<sup>115</sup><http://www.tni.org/drugs/research/dpcol.htm>. “Drugs and Peace in Colombia,” Program of the Transnational Institute and Action Andina. Jalsma, Martin and Vargas, Ricardo.

<sup>116</sup> [http://www.foreignpolicy-infocus.org/briefs/vol4/v4n30colo\\_body.html](http://www.foreignpolicy-infocus.org/briefs/vol4/v4n30colo_body.html) “Colombia’s Role in International Drug Industry.”

safety. Ecuadorians are clamoring to the government to tighten security along a 375-mile (600-km) border that stretches from the Amazon jungle across the Andes mountain range to the Pacific Coast. Ecuadorians plead with the government to clamp down on migration, blaming the surge in violence on an agreement that allows Colombians to travel freely in Ecuador for up 90 days without a passport. <sup>117</sup>

The results of the “Colombian Plan” against drug production was summarized by Colombia’s President Pastrana, as follows:

- (1) The Colombian Plan has produced few victories because the conclusions are that drugs are still the first-or second-biggest business for mankind.
- (2) Pastrana urged president Bush to help organized an international narcotics conference in order to make an evaluation –and not only for the policies of fumigation and interdiction.
- (3) A global narcotics industry worth \$500 billion exist today with drug-lords seeking out new markets in Europe, and the former Soviet Union.
- (4) Pastrana said that the U.S. and Europe should stem the laundering of drug money and control the export of chemicals used in Colombia to process cocaine.
- (5) He expressed that more can be done to crackdown on money laundering, pointing to growing demand in consuming countries and adding that European nations and Mexico (one of the major drug smuggling transit routes) should attend in drive to boost international anti-narcotics cooperation. <sup>118</sup>

In summary, this means that new white-collar trafficker organizations, with low profile, continue to run drug business operations in Colombia, keeping their properties out of the reach of the enforcement agencies. To prevent the detection and the tracking of their illicit activities traffickers are not using banking operations any more; instead of banking; they are keeping the drug profit in middle-income housing —using it as a bank. Recently, Colombia’s national police discovered and confiscated \$35 million US dollars in cash in two-upscale apartment in Bogotá, Colombia—possibly one of the largest

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<sup>117</sup> <http://www.aol> news: “Ecuador, Colombia seek Cooperation over Border,” August 06, 2001

<sup>118</sup> Andrew Selsky, The Associate Press, “Colombia Calls for Drug War Review,” August 2001.

seizures ever of drug money. The confiscated money was packed in more than 300 bundles of \$100,000 each, in \$20, \$50 and \$100 denominations.<sup>119</sup>

In relationship with the government actions against the white-collar traffickers new generation, the Colombian government through its General Prosecutor is attacking the challenge that money laundry represents. The General Prosecutor has created a net of institutions to detect property and profit of these new white-collar traffickers. This net is integrated with the Colombian Stock Market, the Financial Bank Institutions, the National Superintendent of Banks, the National Direction of Custom and Taxes (DIAN Spanish acronym), the National Anti-Narcotics Agency, the Export and Commerce Institute (INCOMEX Spanish acronym), the Notary Offices and Real Estate Register, and with some advisor companies of financial institutions which store a financial database of customers (DANCOOP, DATA CREDITO, COVINOC Spanish acronyms). Thus, in response, these criminal organizations are not making capital investments in Colombian enterprise to prevent their detection and capture.

#### **G. CONCLUSION**

After many historical efforts between the U.S. and Colombia to reduce the traditional drug-cartels influence and power, the FARC and the new white-collar traffickers are presently worsening the drug-war by conducting their business in a complex, bloody, and asymmetric fashion. The outcomes are:

- (1) Drugs through terrorism, corruption and threat have diminished the mobility of the civil society and its institutions to enforce the law.
- (2) The foreign exchange rate system has allowed the black market (casas de cambio de divisas) as well as the San Andresitos shopping centers to become key units for stimulating money-laundering, contraband and tax evasion.
- (3) The benefits for Colombia after 20 years of drug intimidation have been counterproductive. The underground economy generated a temporary economic boom in businesses without real capital investment value. Money laundering was the tactic used through the formal economy but with the alternative of siphoning-off funds when the law enforcement reacted. After cartels collapsed, drug-capitals flew

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<sup>119</sup>< <http://www.washingtonpost.com/ac2/wp-dyn/A62782-2001Aug25?> >

to other offshore fiscal paradises. The only things remain are: (a) Thousand of luxuries apartments and houses, storages, farms and other properties confiscated by Colombia's Prosecutor, but with the added of burden high administrative costs for protection. (b) The atomization of small narco-traffickers that complicate anti-drugs operations, allowing them to raise their clandestine power with a low profile (c) The social-net damage cause by the lack of moral constraints after the development of a culture of rapid wealth by the use of intimidation, bribes, and violence. (d) The fear of the judges applying justice due to the intimidator capacity of drug-kingpins. (e) The increase of paramilitary groups, which are protect landlords involved in drug-trafficking operations, causing internal migration and refugees.

- (4) On the other hand, the main constraint on the counter-narcotics policy is the traffickers' ability to corrupt and intimidate the political system because drug-power undermines the rule of law. The solution of Colombia's drug problem depends on transnational agreements, which must compromise all states sharing the same policy and goals.
- (5) Until the development of Colombia's economy provides enough legal options to absorb the underemployed who are now streaming out of the highlands and into the cities, crops substitutions could just be farmers rotating –some leave coca, others enter. A similar problem exists with the aerial chemicals being sprayed for eradication, which are causing more forest devastation. If the defoliant destroys one hectare, then the peasants will open a new one in the depth of the forest. Undoubtedly, the Bolivian crisis of 1985 and the Colombian crisis of 1998-2000 have a similarity in how this crisis fueled coca production. Clawson, Patrick and Lee look at the Bolivian crisis:

An explanation would be that the Bolivian cocaine boom was caused in part by the crisis in the legal economies. That is, because of the crisis, thousands were through out of work (as when the Bolivian government dismissed 30,000 miners in 1985) and thousands of young men looking for their first job were unable to find any productive employment. So, the jobless moved to the coca-growing regions, where land was readily available. Their labor made possible an expansion in coca production.<sup>120</sup>

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<sup>120</sup> Clawson, Patrick and Lee III, Rensselaer, "The Andean Cocaine Industry," p. xi, 1996, St. Martin's Press, New York.

In sum, the intimidating power of the drug industry has prevented Colombia from negotiating lasting peace, neither allowing the country to be in the globalization track, nor building a participatory democracy. Socio-economic improvements remain without solutions in Colombia's aspirations since the 1950s until today.

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## **V. IS THE 1991 CONSTITUTION A REAL FACTOR CONTRIBUTING TO COLOMBIA'S ECONOMIC CRISIS?**

Many problems that Colombia faces today are a product of its new institutions and outcomes following the implementing of the 1991 Constitution. This instrument envisions ruling a peaceful country through a participative and pluralistic democracy, fiscal decentralization, an egalitarian society with a total social security coverage, open markets and a neoliberal economic policy. After 10 years, some achievements of institutions created by the 1991 Constitution are being seriously questioned, such as the judicial system, where the rule of the law fails to be enforced, and the conflictive decentralization process at the municipal level, where rampant corruption and fiscal unbalance affect regional development. Undoubtedly, the weak state institutions, and civil society with its difficulties of pursuing its national goals are the key barriers that have contributed to the economy's recession, especially in the last half of the 1990s. Therefore, the 1991 Constitution is the third variable indirectly contributing to the present recession.

This chapter argues that; (1) after the enactment of the 1991 Constitution Colombia faces more complex domestic problems due to the exclusionary process carried out in the design of the new constitution, where the traditional elite parties and their clientelistic machinery were excluded as well as the subversive actors (FARC-ELN-AUC); (2) the checks and balances of the institutions created by the 1991 Constitution are not the best due to many institutional weakness: the judicial system, the exchange regimen system, the fiscal decentralization and tax reforms failed, therefore, affecting national economic stability, and foreign and domestic investment confidence; (3) the judicial system needs to be protected, and the independence of the Central bank and its oversight responsibility over the banking system is necessary to prevent corruption and siphoning off of state funds by political manipulations. The implementation of a fair fiscal decentralization process preventing subversive inherence and corruption, at municipal level, is also necessary.

## **A. THE PROCESS OF ENACTING THE CONSTITUTION**

Colombia's history shows that after bloody civil wars, political riots, peace negotiations with guerrillas and agreements between liberal and conservative political parties, the constitution has been changed six times. Most of the constitutional changes were made to ease the reincorporation of guerrillas to civilian life. Other changes addressed not only the possibility of citizens being present in Congress with their initiatives for reform, but also the possibility of referendums to approve constitutional reforms. However, after many political proposals and intentions Colombia's socio-economic situation, has not change much.

The political constitution of 1991 was writted by the Asamblea Nacional Constituyente (National Constitutional Assembly). The Assembly was integrated by: (1) the Democratic Alliance M-19, which appeared in March of 1990 after the reincorporation of the M-19 guerrilla movement to civilian life; (2) the independent political movement "Movement of National Salvation" (a dissident faction of the traditional Conservative Party, which was trying to attract dissident right sectors from Liberal and Conservative parties); (3) the "Popular Liberation Army" (EPL) and the "Revolutionary Workers' Party" (PRT) guerrilla groups that were concluding a negotiation and reincorporation process with the Gaviria's administration; and (4) ethnic and religious minorities, such as the indigenous people, the Christians, and the Afro-Colombian Communities.

In contrast, the powerful subversive movements, FARC, ELN and AUC, were absent from this historical constitutional change, as well as the "traditional political elite" of the liberal and conservative parties whose clientelist machinery was not present. In fact, the National Constitutional Assembly's wanted to conduct the reform of the rules of the political game without the parties because the traditional political class was considered visibly corrupted, anti-reforming and self-serving—today Colombians are paying today the cost of this exclusionary decision. Ana Maria Bejarano explains the reason for this:

The politicians (elite) have taken their revenge by recovering their control of the Congress, blocking the implementation of the Constitution of 1991,

or regulating it in a spirit openly contrary to that which was intended. Since 1991, political competition in Colombia has been viewed as 'progressive politicians versus traditional politicians' the first understood as being proponents of the constitution of 1991, the second as their enemies, carriers of the worst vices of the Colombian political class. In such a polarized environment, it is difficult to coordinate within Congress itself the necessary actions for the legal instrumentation of the Constitution.<sup>121</sup>

This means that the weak legislation of the Colombian Congress is not a matter of the debate of ideas, it is a matter of the retaliation between movements and fragmented traditional parties, which considered themselves enemies. This affected coalitions, alliances, transactions and, finally, the well being of the citizens. Constitutional projects like the reform of the Social Security System and Pensions, the Regional Development and Administrative Decentralization, the Peace Process among the violent actors. These actors, FARC, the ELN and the AUC, as well as the creation of a true 'civil service'--the best antidote against clientelization of state--are difficult to reach under such circumstances. In fact, Bejarano has pointed out that the atomization of Colombia's political forces influenced the writing of the 1991 Constitution because it was finally no more than a "patchwork" of articles unconnected and contradictory. In Bejarano words

The fragmentation, weakness, and volatility of the many forces that participated in the fashioning of the Constitution limited the ability of these forces, such as the Democratic Alliance M-19 and the Movement of National Salvation, disappeared from the political scene shortly thereafter. One observer has reasonably commented that the Constitution of 1991 does not have 'mourners'. That is to say, it lacks the backing of political forces, which, going beyond the formal process of putting the Constitution into effect, actually incorporated it into real political life, converting the written text into a living, functioning guide for the practices of politicians, public officials, and citizens.<sup>122</sup>

The next step is to determine at what level the 1991 Constitution produced the desired effects and at what level it generated unanticipated consequences?

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<sup>121</sup> Berquist, Charles, Penaranda, Ricardo and Sanchez, Gonzalo, "Violence in Colombia 1999-2000: Waging War and Negotiating Peace," p. 57, Scholarly Resources Inc, 2001

<sup>122</sup> Ibid, p.59.

## **B. THE CHECKS AND BALANCES OF THE 1991 CONSTITUTION**

It is important to consider some positive effects of the 1991 Constitution such as its relative success in improving the role and power of the judiciary by creating new institutions (without regards of the impunity levels achieved until today). For instance, the Public Prosecutor's Office, the Superior Council of the Judiciary, the "Accion de Tutela"-- have the capacity to protect the fundamental rights of citizens, when citizens believe public officials have violated their rights--and the Constitutional Court, which rules on the constitutionality of actions taken by the legislative and executive branches, making for a more balanced relationship among the powers.<sup>123</sup>

Expectedly, decentralization constitutes one of the most important but poorly implemented successes reached by the 1991 Constitution. The distribution of resources and the decentralized taxing authority has had a negative effect on the finances of the central government. The government receives numerous critiques due to excessive corruption and inefficient expenditures at the municipal level. The other factor that contradicts the intention of the municipal fiscal decentralization is the noxious influence of the guerrillas and paramilitaries groups over the mayors' outcomes. The subversives through extortion and intimidation influence the municipal expenditures looking for political benefits.

Eliminating many restrictions inherited from the National Front that inhibited open competition among diverse political forces and that guaranteed the monopoly of the Liberal and Conservative parties was considered another relative success of the 1991 Constitution. Moreover, the greatest innovation in the political control was that Congress could exercise over the executive, contained in the power to censure cabinet ministers. Additionally, Congress recovered certain budgetary powers, as well as powers to intervene in decisions made by the executive during periods of national emergency.

Nevertheless, in the viewpoint of Bejarano, the achievements of the Colombian Congress after the enactment of the 1991 Constitution lack strength and autonomy to legislate because factors such as corruption, clientelism and the enormous fragmentation

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<sup>123</sup> Berquist, Charles, Penaranda, Ricardo and Sanchez, Gonzalo, "Violence in Colombia 1999-2000: Waging War and Negotiating Peace," p. 61, Scholarly Resources Inc, 2001

of the parties inhibit the ability of Congress to control the executive. Bejarano has pointed out the negative effects of implementing the 1991 Constitution resulting in the atomizing political life in Colombia, with these comments:

The impact of these reforms on party organizations and the party system has been contradictory, inefficient, and ineffective. The traditional parties not only have resisted the change, but they have also rapidly accommodated themselves to the new institutional situation without modernizing, democratizing, or strengthening themselves. On the contrary, in this process of accommodation, they have intensified their historical tendencies toward pragmatism, fragmentation, and clientelism. ...Finally, it is necessary to note the resounding failure of the creation and consolidation of a political opposition in Colombia. This has occurred despite constitutional recognition of the legitimacy of political opposition and the inclusion of a series of rights that should guarantee its operation.<sup>124</sup>

The 1991 Constitution was designed for citizens' participation that permits vigilance over public affairs at different administrative levels. However, Colombia's civil society is practically non-existent. Colombian society is a multi-ethnic mass (whites, afro-Colombians, Indians, mestizos, llaneros, peasants) with different cultural profiles and personal interests that do not match with each other. The lack of citizens' participation, as a democratic oversight, reflects the gap between the text and reality... "It is worth remembering that citizenship, participation, and representation do not only depend on the 'effectiveness of a complex web of legal relationship' but also on 'state organizations willing and able rights affirmed in pertinent laws effective.'<sup>125</sup>

Overall, in Bejarano's view there are three vulnerabilities in the Colombian state that impede the implementation of its Constitution: (1) The way the civil services operate has not been modified and, as a result, corruption, clientelism, and all manner of particularism practices that contradict the democratic character of the reforms are perpetuated; (2) The state continues to demonstrate that it is incapable of providing basic public goods: defense, security, and justice. For this reason, peace continues to be an elusive proposition, and the armed actors who often violate the fundamental rights of Colombians, especially the right of life, continue to exist; and (3) Colombia is not a state

<sup>124</sup> Berquist, Charles, Penaranda, Ricardo and Sanchez, Gonzalo, "Violence in Colombia 1999-2000: Waging War and Negotiating Peace," p. 65, 66, Scholarly Resources Inc, 2001

<sup>125</sup> Ibid, p.70

capable of supporting and enforcing constitutional norms. The efforts to democratize the state were not simultaneously accompanied by parallel efforts to strengthen it. For example, the administrative-bureaucratic apparatus and the armed forces were not touched by the Constituent Assembly (whether for good or bad reasons is not known.)<sup>126</sup>

According to Alberto Alesina, the need for institutional reforms in Colombia is quite self-evident:

Violence, crime and terrorism are rampant; the “social contract” is threatened. The Judicial system is incapable of effectively persecuting crime, while at the same time the Constitutional Court is too “pro-active” in economic areas better left to the market or policymakers. The parliament is fragmented, subject to a myriad of lobbying pressures and its relationship with the government is strained. The traditional macroeconomic stability of Colombia is threatened by institutional shortcomings. In fact, the process of decentralization has led to large fiscal imbalance and inefficiencies in the central/local government relationship. The budget process is chaotic and non-transparent. Improvements in the development of social services and poverty reduction programs are still lacking because of an inefficient use of limited resources. Monetary and financial stability require a firmer commitment to inflation control.<sup>127</sup>

The judicial system is considered the great weakness of the 1991 Constitution due to Colombia’s crime situation; Colombia suffers a level of violence that is among the highest in the world. Clearly corruption and intimidation on the part of armed groups and drug cartels currently interferes with effective enforcement of law. In fact, the “*Fiscales*”—powerful prosecutors—are in control of justice files, which involve preparation for bringing a case to trial. Therefore, the primary bottleneck in achieving more convictions does not appear to lie with the judiciary, but rather with the fiscalia bringing only a limited number of cases. The table 5 shows a huge and growing backlog of unsolved cases emerged. The introduction of the “investigative judges” institutionalized the policy that persists to this day: hopelessly overloaded, the criminal

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<sup>126</sup> Berquist, Charles, Penaranda, Ricardo and Sanchez, Gonzalo, “Violence in Colombia 1999-2000: Waging War and Negotiating Peace,” p. 70, Scholarly Resources Inc, 2001

<sup>127</sup> Alesina, Alberto, “Institutional Reforms in Colombia,” p. 4, FEDESARROLLO, Working Papers Series, November 2000, No. 21

justice system focuses its meager resources on crimes that are easily solved, even if such crimes are minor and murderers and kidnapers go free.<sup>128</sup>

	All Crimes	Robbery	Homicides Injuries	Sexual Assault	Kidnapping	Other
Crime	100.0	100.0	100.0	100.0	100.0	100.0
Reports	14.9	7.4	96.8	27.7	21.7	76.5
Investigation	9.9	3.3	37.9	24.3	8.6	68.8
Trials	2.8	1.0	11.2	17.2	2.5	49.8
Sentences	1.7	0.6	6.8	10.4	1.5	30.2

Table 4. Judiciary Performance 1995  
From: Policia Nacional, DANE:ENH and Estadísticas de Justicia.

### C. ECONOMIC INSTITUTIONS

In Alesina's analysis, the formidable barrier that impeded even relatively small changes in economic institutions or even economic policy is the 1991 Constitution because it is very detailed in its prescription, and it almost demands the maximum amount of legislative transactional cost.

According to Alesina's research team, some institutional aspects of economic policymaking that affected Colombia's economy are the decentralization and fiscal federalism, the budget institutions, the bureaucracy, the civil servant and teachers, the provision of social services and, finally, the Central Bank. With regards to decentralization and fiscal federalism, in the opinion of Alesina, Carrasquilla and

<sup>128</sup> Levitt, Steven and Rubio, Mauricio, "Understanding Crime in Colombia and What Can Be Done About It," p. 34, FEDESARROLLO, Working Papers Series, Agosto 2000, No. 20

Echavarría, (economic research team of FEDESARROLLO) Colombia has become the most decentralized Latin America country, among the federal ones (i.e., Argentina and Brazil); even though, the process of decentralization had started earlier, the 1991 Constitution has vastly accelerated the process. However, there are some difficulties that impeded Colombia in improving socio-economic conditions in its regions, for example: “Tax collection remains vastly centralized, but spending is decentralized. This arrangement creates risk of fiscal imbalance, since the level of government that spends, does not fully internalize the cost of its spending. An additional problem stems from the fact that localities can borrow from banks, thus creating dangerous links between fiscal imbalance and financial stability of the banking system.”<sup>129</sup>

In this case, some Colombian municipalities (i.e., Chocó, San Andrés and Providencia, Cauca, Tolima) are registering serious fiscal imbalance--close to bankruptcy-- because neither enforcing fiscal responsibility nor real oversight have been established by local authorities. Imposing the efficient use of resources for localities is the only way to prevent bankruptcies such as in comment. Not to mention the negative results for allowing mayors to borrow from the public by issuing bonds, or from private or public financial institutions, domestic or foreign. Mayors that acquire financial compromises for large investment projects requiring multi-year financing leave office without assuming future responsibilities for the borrowed money.

In sum, as Alesina, Carrasquilla and Echavarría have pointed out, the decentralization systems fail to impose tight budget constraints at the regional level and are prone to create fiscal imbalances, transmitted to the central government.

The fiscal stability of Colombia was jeopardized soon after the 1991 Constitutional issue, largely as the result of problems with the decentralization process. Furthermore, given the rigidity of the rules about the allocation of government spending at the local level, it is not clear to what extent the fiscal decentralization of 1991 has reached the goal of tailoring spending to local needs and improving efficiency in the delivery of social services... the excessive imbalance of social spending on health

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<sup>129</sup> Alesina Alberto, Carrasquilla Alberto and Echavarría José, “Institutional Reforms in Colombia: Decentralization in Colombia,” p. 13, FEDESARROLLO, Working Papers Series, Nov. 2000, No.21



and education has interfered with an efficient use of resources to reduce poverty.<sup>130</sup>

In Alesina's team research, while the share of Central Government expenditure in GDP has increased by 9 percentage points, the share of revenue has increased by only 4. Consequently in terms of GDP, the stock of debt has doubled and interest payment have tripled, as table 6 indicates:

	Revenue	Expenditure	Surplus	Total Debt	Interest
1990	10.3	9.7	-0.8	14.9	1.1
1991	10.4	10.6	-0.2	12.9	1.2
1992	10.8	12.5	-1.7	13.6	1.0
1993	11.6	12.3	-0.7	13.45	1.1
1994	11.4	12.8	-1.4	12.0	1.2
1995	11.3	13.6	-2.3	13.2	1.2
1996	12.0	15.7	-3.7	13.9	1.9
1997	12.6	16.3	-3.7	17.5	2.0
1998	11.9	16.8	-4.9	21.6	2.9
1999	13.4	19.3	-5.9	29.6	3.3

Table 5. Colombia: Central Government Finances (GDP ratios)  
From: Departamento Nacional de Planeacion de Colombia

Moreover, in the concept of Acosta and Borjas (a research economic team of FEDESARROLLO), several problems have affected Colombia's public spending in education as a consequence of the new rules imposed by the 1991 Constitution. The

<sup>130</sup> Alesina Alberto, Carrasquilla Alberto and Steiner Roberto, "Decentralization in Colombia" p. 04, FEDESARROLLO, Working Papers Series, Agosto 2000, No.15

reorganization of the education system was developed in the context of a general decentralization of public administration. However, there has been confusion as to which level of government is best suited to administer the public education system. The overlap of responsibilities are generating confusion because there are teachers funded by municipalities (law 60 of 1993), by the central government (law 115 of 1994), and by both institutions because the Constitution emphasizes the role of the department level through the transfer of central funds.

The other problem is that Colombia's teachers (there are about 310,000 teachers equal to 26 percent of the total number of public employees), thanks to a very powerful union, are an overly protected category that, by and large, receives a very favorable treatment both in terms of salaries and, especially, in terms of pensions. These privileges including: (a) public teachers do not have to contribute to the funding of the system in order to receive a pension; (b) teachers qualify to receive a special pension at 50 year of age; (c) the pension is based on the average basic monthly salary of the last year employed at the time of retirement, including bonuses and other benefits; (d) the pension regime grants teacher the right to receive several of these pensions simultaneously; (e) teacher salaries are set by the Central government, with little input from municipal and departmental level, which end up paying the bill; (f) the inefficient appointment process allows the department and municipalities to create temporary teaching positions (by law of 1979), putting additional pressure on the Central government to increase its monetary transfers (opened more the fiscal deficit).<sup>131</sup>

Consequently, in Alesina's research team holds this point of view:

With unchanged legislation, public finances appear in even worse shape in the long run, given the expected evolution of the social security system and of the projected public intervention in the financial sector because the pension system is currently very distorted; it is very generous for a small fraction of the labor force, especially public employees. Furthermore, the tax code has been changed very frequently—nine tax law reforms in the last six years--, seriously compromising the stability of the system and, thus the incentive to invest. Many observers agree that a permanent resolution of the increasing problem of fiscal imbalance in Colombia

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<sup>131</sup> Acosta, Olga and Borjas, George, "Public Education in Colombia," Working Papers Series, FEDESARROLLO, Institutional Reforms in Colombia, November 2000, No. 21

requires a revision of the arrangement concerning the relationship between Central Government and the local Governments. In fact, an increasing share of central Government outlays is in the form of transfers to the departments and municipalities, as mandated by the 1991 Constitution. In 1999, for instance, transfers to the regions amounted to over 27 percent of total central government expenditures.<sup>132</sup>

Several factors greatly contribute to the lack of transparency in fiscal policy, for Ayala and Perotti these are (1) not even the entire amount of national public pensions is covered in the budget (Territorial Entities and the rest of the Non-Financial Public sector are excluded); (2) the frequent use of non-standard accounting practices where the national deficit is hidden. Therefore, without a long and detailed analysis of both the revenue and spending sides of the budget it is an idea of the deficit impossible. In addition, without that, it is difficult to conceive the budget; and (3) the proliferation of the budget's documents (the National Plan of Development, the National Plan of Investments, the Financial Plan, the Annual Operative Plan of Investments, and so on) many of these with multi-year horizon, reveals that the requirement of consistency can easily lead to mistakes. In addition, even though the Colombian Constitution attributes a strong role to the Finance Minister in the preparation of the budget, the multiplication of documents and agencies involved tends to obfuscate and reduce his role.<sup>133</sup>

Ayala and Perotti point out the following in regards to the budget institutions:

The public should have a clear and transparent view of the fiscal policy run by the government. In Colombia instead, the preparation, discussion and implementation of the budgets is not transparent. As a result, the average citizens, journalist and even trained economist would have a hard time understanding the Colombian budget documents. In recent years, international organizations have put a lot of emphasis on improving transparency.<sup>134</sup>

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<sup>132</sup> Alesina Alberto, Carrasquilla Alberto and Steiner Roberto, "Decentralization in Colombia" p. 05, FEDESARROLLO, Working Papers Series, Agosto 2000, No.15

<sup>133</sup> *Ibid.*, p.16, 17.

<sup>134</sup> Ayala, Ulpiano and Perotti, Roberto, "Budget Institutions in Colombia", FEDESARROLLO, Working Papers Series, November 2000, No. 21

On the other hand, the labor rules established in the Constitution of 1991 created many new economic responsibilities at the enterprise level. This meant that businesses were forced to pay for many additional benefit programs for workers. The economic overload for enterprises is represented in “retirement pensions” and its interest rate, and in “fire-workers compensation”(the enterprises must put on reserve one monthly-payment for each year-worked, with the banking interest rate, when dismissing any employed). The labor rules also demand the constitution of “labor-risk insurance and health,” a monthly economic contribution for “Instituto Colombiano de Bienestar Familiar” (“Family Welfare Institution”), a monthly economic contribution for the “Servicio Nacional de Aprendizaje (“National Services of Technical Skills School”), a monthly economic contribution for “Cajas de Compensacion Familiar ” (“Moral and Welfare Institutions”), and finally a vacation wage-compensation for each year worked. All of these worker benefit programs result in each enterprise spending an additional U.S. 56 cents for each \$1.00 U.S. dollar paid to any worker for doing any job. The economic overload that the enterprises must assume destroys incentive for capital investment or business expansion. The impact is measured in the high unemployment rate due to ‘the cost of opportunity lost’ for putting U.S. 56 cents for each dollar out of capital investment or out of production line. Labor rules like these make Colombian enterprises less competitive in confronting the challenge of globalization.

#### **D. THE EXCHANGE RATE REGIMEN**

Alesina, Carrasquilla and Steiner’s research has found that the 1991 Constitution was particularly concerned about keeping the government involved in the choice of exchange rate regimes. However, for a small open economy like Colombia the exchange rate is a tool that cannot be detached from an inflation control policy package. The unclear status of the Central Bank stemming from the 1991 Constitution, showed its consequences in a couple of occasions. In 1997 an over exposition of monetary policy in response to a downturn in 1996 contributed to monetary and financial turbulence in the ensuing year. In early 1997, the Samper government had the opportunity of appointing three new members of the board, all of them recruited within the ranks of the government. Recent intervention in the banking sector has led to a Government/Central

Bank coordinated effort to bail out banks which seem to have gone beyond a temporary provision of liquidity.<sup>135</sup>

By 1998, as a result of not having a political oversight interest and clear policy about who is responsible for supervising the financial sector, many state banks collapsed, such as the “Banco Central Hipotecario”, the “Banco Caja Agraria”, the “Banco del Estado”, and some “Cooperative Banks of Workers”, where blue-collared workers put their savings. Illustrating the depths of the corruption in the bank sector, a February 2000 report of the so-called “Truth Commission” on corruption in the state-banking sector revealed that over 7.2 billion pesos had been systematically siphoned off from six different state-owned banks. As a result of this huge financial scandal, more than 1,200 criminal proceedings against bankers, congressmen, former ministers, labor leaders, businessmen, and high-level bureaucrats have recently been launched. In the words of Colombia’s Attorney General, such public/private sector corruption... “is even more dangerous (for the country) than the armed groups operating outside the law”. In fact, according to Transparency International, in 1999 Colombia ranked as one of the most corrupt countries on the planet.<sup>136</sup>

The Alesina’s team recommendation is to fortify the Central Bank to take charge of supervising the financial system; this proposal for reform has the goal of subtracting this control from the Treasury given the possible conflict of interest between the goal of financial solidity and that of financial government spending (many times targeted by political manipulations).<sup>137</sup> In Alesina’s team conclusion is, the 1991 reform of Colombia’s central bank law has produced less than satisfactory institutional arrangements. The reform intended to insure independence of the monetary authority in the conduct of monetary and exchange rate policy. That goal has not been completely achieved. The teams recommendations are (1) the central bank should be in charge of the role of controller of the financial and banking sector through supervision and regulation; (2) the central bank should be in charge of exchange rate policy because Colombia is an

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<sup>135</sup> Alesina Alberto, Carrasquilla Alberto and Steiner Roberto, “Institutional Reforms in Colombia: The Central Bank in Colombia,” p. 25, FEDESARROLLO, Working Papers Series, Agosto 2000, No.13

<sup>136</sup> Bagley, Bruce, “Drug Trafficking, Political Violence and U.S. Policy in Colombia in the 1990s,” p. 09, School of International Studies, University of Miami, February 7, 2001

<sup>137</sup> *Ibid.* p. 26

small open economy and the exchange rate is a critical variable linked to inflation and monetary policy; (3) the definition of goals of monetary policy must be a balance between the goal of democratic control over monetary policy and that of policy independence; (4) the executive should not be allowed to nominate anyone who currently holds an executive position in the Central bank, so the Congress must do it.

## **E. CONCLUSION**

The intention of the 1991 Constitution was to end the old model of political behavior, but soon after the National Assembly drafted the new Constitution, parliamentary elections took place, and the results strengthened traditional political class again, unfortunately this elites are the only capable of effective mobilization through clientelist and political manipulation. Without a doubt, the fragmentation of parties opens the door for individual dealings, secret pacts, shady deals and business negotiations.

There is a need to re-establish governability in areas of the country controlled by criminal influence in order to guarantee the future success of the fiscal decentralization process. Due to the popular election of mayors, drug money allows guerrillas forces to make significant territorial gains; this has led in turn to a greater division of interest among guerrillas, narco traffickers and paramilitaries. The building up scenario of the 1991 Constitution has therefore been interpreted as an armistice with the narco traffickers because it did not allow extradition, while the guerrillas and paramilitaries found it to be a tool for escalating and challenging the Colombian state.

The judicial system continues to be weak showing high levels of impunity due to widespread intimidation and corruption by narco traffickers and terrorist organizations undermining the basement of Colombian institutions. Establishing the rule of law is the bottom line for overcoming Colombia's economic crisis.

The central bank needs to exercise independent oversight in the financial sector to fit the new framework, with an independent monetary board not easily influenced by political manipulation. To guarantee that Colombian economy changes from a closed, provincial system, to one capable of competing in oversea markets, it is important to

allow changes in the financial sector and reform in the public sector to increase productivity and confidence in the economic programs.

Finally, the weakness of the 1991 Constitution can be summarized in these words:

The result of the 1991 Constitution was an enormously long document that attempted to reassure all sides that the future would be to their liking by introducing article after article with explicit provisions for all, followed by a general disclaimer of possible inapplicability in extenuating circumstances. The Constitution attempts to be a document of rigid micromanagement (such as indexation of pensions, setting targets for inflation and the allocation of regional public expenditures) rather than one that establishes basic institutions for democratic decision-making in a dynamic world. Moreover, written at the time when many nations in the world were emerging from state socialism and moving to market capitalism, the 1991 Constitution commits and creates expectations of a welfare state.<sup>138</sup>

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<sup>138</sup> Kugler Maurice and Rosental Howard, "Checks and balances: an Assessment of the Institutional Separations of Political Powers in Colombia," Working Papers Series, Agosto 2000, No. 17, FEDESARROLLO.

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## VI. CONCLUSION

After analyzing these three interrelated independent variables (subversive terrorism, drugs, and 1991 Constitution), this thesis concludes that the accumulated terrorism and violence generated by the Army Revolutionary Forces of Colombia (FARC), the National Liberation Army (ELN), and the Self-Defense Organization (AUC)—called paramilitaries—are the heaviest factors that contributed to Colombia's economic recession in 1999. This recession is considered the most critical event in the twenty-century in Colombian history.

The thesis determined that the lack of domestic and foreign economic incentives for investment are due to terrorism and violence, which continue spreading its ruin over national territory. In this case, terrorism is fueling unemployment, economic uncertainty, and the loss of confidence for new businesses or for starting joint ventures, especially in the agricultural, cattle, and mining sector. These sectors are important for peasantry stability and preventing migration to the metropolitan areas where urban violence is rising.

With regards to the oil and mining sector, Empresa Colombiana de Petroleos Nacionales (ECOPETROL) and its joint ventures with the British Petroleum Company (BP), and Occidental Oil Company negatively impacted the economy due to the thousand of compound criminal attacks against its infrastructure. The lost of profit derived from these attacks also affect domestic investment, especially in those areas where exploration and operation are functioning; in fact, the Colombian government is losing its opportunity to make investments in other sectors of the national economy to incentivize employment, and development, and to improve conditions for its weak social security system, specially in health and education.

The Colombian history shows that Samper's Administration was unwilling to confront the subversive organizations with enough political and military power. Thus, the intense use of violence and corruption has accumulated finally impacting Colombia's socio-economic well-being fueling the economic crisis until it reach a negative (-4.5) percent of GDP in 1999, never seen before in the national's economic history.

Furthermore, some Colombian experts estimate that the conflict cost the country from 4 percent to 9 percent of growth per year.<sup>139</sup>

Drug trafficking, the second heavy factor feeding terrorist violence, continues spreading its criminal power through its atomization in small white-collar organizations, complicating law enforcement's ability to track and detect its operations due its low profile. In addition, the drug-profit that continues returning to Colombia (it is no more than 20 percent of the total foreign drug-markets earnings) has a high probability of being converted in weapons, ammunitions and logistic supplies for the terrorist actors. Thus, the aggregate value for Colombia's economy sector is minimal. Money-laundering in the informal sector continues feeding smugglers and contraband businesses, worsening the economic situation of medium and small Colombia's enterprises due to unfair market competition, and causing unemployment and social unrest.

The 1991 Constitution, the third factor in order, has indirectly contributed to the economic recession due to the lack of power to guarantee connivance, justice, peace, development and economic growth. The institutions developed after the 1991 Constitution continue functioning with the same clientelistic political behavior where patronage and rent-seeking are the bottom line. The corruption survives because no ex-ante oversight was established. In fact, "the civil society", who was willing to do that, does not exist in real terms. Moreover, the terrorist escalation has impeded the fiscal and municipal decentralization process with its power of intimidation and manipulation over almost 600 municipalities and the decisions by the majors' outcomes. Additionally, the social security system continues to run with a serious fiscal imbalance. The system could collapse due to the lack of political consensus among labor unions, congressmen, and enterprise owners.

Moreover, these three factors are not isolated from the international economic crisis as a product of the globalization. The imbalance accumulated for several years before 1999 pushed Colombia's economy for drastic adjustment. Next, the private sector caused a backlash in their economic activity, and balanced their external debt (valued 4

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<sup>139</sup> In World Bank, "Violence in Colombia: Building Sustainable Peace and Social Capital," Washington D.C., 2000, 4 percent of GDP is considered. A report from the Colombian Department of Planning, September 9, 1999, 9 percent of GDP is considered.

percent of the GDP). In order to get an adjustment, in the government sector, through agreements with the International Monetary Funds (IMF), the Colombian government set economic policy goals to be reached between 2000 and 2002. The agreement with the IMF comprises (1) fiscal deficit reduction; (2) inflation rate reduction; (3) financial sector recovery, and (4) structural reforms to guarantee the financial viability of the public sector.

#### **A. COST OF VIOLENCE**

It is not easy to quantify the cost of violence and terrorism for Colombia, and especially, the indirect cost. Between 1990 and 1998 the gross direct cost of violence reached \$3.2 billion US dollars a year, meaning 4.5 percent of the GDP. Perhaps, this estimate does not consider facts, such as the loss of confidence in the judicial system, the loss of the monopoly in the legitimate use of force by the state, the loss of the well-being for the population, and the opportunity and business transaction cost for the society. In other words, the real cost of terrorism and violence are underestimated due to difficulties in calculating the cost.<sup>140</sup>

In regards to opportunity cost lost, if this 4.5 percent of the GDP is oriented in population needs, it will be possible to accomplish the following: (1) in one year to give educational coverage to 1,118,000 elementary students under 10 years of age out of the educational system today; (2) in three years to solve the national housing deficit; or (3) in only two years to reach the goal of exploration, development and oil production needed for the next four years.<sup>141</sup>

One of the most difficult issues in estimating the real cost of violence and terrorism is the inability to understand the progressive weakness of government institutions, and the loss of the state's reaction capacity, which finally leads to guerrillas and paramilitarism escalation as in the Colombian case. From 1994 until today, due to the weakened Colombian government institutions, the terrorist actors have strengthened their economic system to maintain and improve their military apparatus

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<sup>140</sup> Castro Manuel, Wartember Jorge and Celis Andres, "El Conflicto Armado: La Estrategia Económica de los Principales Actores y su Incidencia en los Costos de la Violencia, 1990-1998," Essay, Grupo de Desarrollo y Paz de la Unidad de Planeación Rural y Urbana del Departamento Nacional de Planeación de Colombia, 2000.

<sup>141</sup> *Ibid.*

through drug trafficking, systematic extortion and kidnappings. These activities represent, for terrorist organizations, 90 percent of their income and, explain the permanent conflict among these organizations in taking regional control over those areas where coca and poppy crops are growing. The increase in kidnappings is a mechanism of economic compensation due to the failing marginal income--a result of Colombia's economic crisis.<sup>142</sup>

## **B. COST OF GUERRILLA ACTIVITY**

The cost of guerrilla activity can be measured as follow:

- (1) The increasing number of armed-fronts (close to 70 with almost 17,000 fighters) that spread all over the country has allowed its national-wide armed struggle against the state.
- (2) The intimidating political influence through violence is operating in almost 600 municipalities over 1,085 Colombian municipalities.
- (3) The symbiotic relationship established inside the local, regional and national economy through figureheads, has reached a very well-designed flow of cash. The established economic and intelligence net has allowed maintaining the guerrillas' logistic lines of communication for drug exports and weapons imports.
- (4) The capability of causing imbalance in Colombia's national economy through uncounted terrorists attacks on the economic infrastructure, as well as through many sieges against small towns and villages causing internal migration, and fueling social tensions and instability in the big cities. Colombia has passed from being an exporter to an importer of six million tons of foodstuffs. Abandoning rural areas because of forced displacement has ruined one of the most prosperous sectors of the economy. Even the mining and hydrocarbon sector, which has enormous potential, has declined substantially. Projections indicate that in the next five years the nation will drop from exporting 500,000 barrels of oil a day; therefore, becoming a net importer of oil and gasoline.<sup>143</sup> Without a doubt in the

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<sup>142</sup> Ibid.

<sup>143</sup> Ramirez-Ocampo, Augusto, "Peace in Colombia: Future Prospects," p. 63, National Conciliation Commission. Latin America Program, Woodrow Wilson International Center for Scholars, May 2000, No. 246 "The Peace Process in Colombia and the U.S. Policy."

last 16 years, the oil sector has suffered 5,343 terrorist attacks. Although, the worst history of attacks is registered in the last three years, in 1999 728 attacks occurred, and by October 2001, the total attacks were 1,587. On the other hand, the theft of gasoline siphoned off from the pipelines registered a loss of 4,501 barrels per day. Moreover, gasoline contraband from Venezuela, due to subsidized prices, is estimated in 9,800 barrels per day crossing the Venezuelan border in the direction of Colombia. Another seriously impacted sector is electrical power, where from 1999 until today, 916 towers of the interconnected electrical system by the terrorist attacks have been demolished.<sup>144</sup>

- (5) The “brain-drain” of almost 1.1 million of well-educated Colombians, who left the country with their “know-how” and financial capitals to look for security and shelter.

Briefly, the strategic goal of these Colombian terrorist organizations is condensed in Gaviria and Velez research, as follows:

As long as rich and middle class Colombians continue feeling defenseless outside their homes and poor Colombians experience similar feelings inside theirs, the possibility of recovering economic prosperity in an atmosphere of peace is seriously compromised.... The concentration of violence [through terrorist tactics] beside its effects on the well being of the victims, deteriorates the quality of family life, increases the probability of behavioral problems among youths, and ultimately reduces socio-economic mobility and contribute to perpetuate poverty.<sup>145</sup>

In other words, perpetuating poverty is a very useful tool for small elites to get control and power over resources and population. Labor supply for the drug production and for the maintenance of military ranks inside the guerrillas and paramilitaries is a good example.

The subversive and terrorist escalation also is measured in military spending by the state to support its military forces through additional economic resources. For instance, between 1994 and 1998, Colombia’s military spending increased 44 percent in

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<sup>144</sup> [http://eltiempo.terra.com.co/30-10-2001/prip\\_pf\\_0.html](http://eltiempo.terra.com.co/30-10-2001/prip_pf_0.html)

<sup>145</sup> Gaviria, Alejandro and Velez, Carlos, “Who Bears the Burden of Crime in Colombia?” p. 22, January 2001, Associated Research FEDESARROLLO, Colombia and the World Bank/LAC/PREM.

real terms; that is 0.9 percent of the average GDP in relationship with military spending in Latin America for the same period. On the other hand, the terrorist's capability to get enough profit through drug trafficking, extortion, kidnapping, war-tax, and theft easily overcomes the state budget's capability to get revenues in a legal fashion.

From this perspective, the question is who will be the first to achieve the limit of its economic possibilities for feeding its military apparatus? Or, in other words, who will collapse first? Anyway, Colombians continue to assume the total cost of the conflict either through government taxes or through terrorist illegal taxation (ransom for kidnapping, war-tax, extortion, and so on).

### **C. COST OF DRUG TRAFFICKING**

There is no doubt that the main fuel of the war in Colombia is the drug trade, since it is the primary source of financing for both the subversives and the paramilitary groups. The objective of narco-trafficking is obvious. Its illegal business will prosper to the extent that the state is incapable of suppressing the cultivation of coca and poppy and the establishment of laboratories to process cocaine and heroin. For this reason the geography of the drug trade coincides almost exactly with the geography of war because the drug trade flourishes in isolated and sometimes inaccessible jungle areas.

Finally, after the September 11<sup>th</sup> attack on the U.S., 2001 differentiating between drug trafficking and subversion is not complicate since the first is feeding the terrorist actions of the second. The profit of drugs is spreading and fueling other terrorist movements through training, intelligence, weapons, and money-laundering. Today, any democratic government and even non-democratic government would find it difficult to give political status to Colombian terrorist organizations, as happened in the past.

Briefly, the International Community has moved way from the perception that the domestic violent conflict is between the Colombian civil society and its armed forces against the narco-terrorist organizations (FARC, ELN and AUC) only. The International Community is aware that they have a responsibility (due to demand of drugs and money-laundering) to help construct Colombian peace.

Indeed, if 96 percent of the Colombian population, according to opinion polls,<sup>146</sup> repudiates the actions of the terrorist groups due to the inability of building a stable political base, its time for the Colombian government and for the International Community to obligate the Colombian subversive organization (FARC, ELN, and AUC) and to negotiate a durable peace or to surrender via enough military force in a well-coordinated military campaign. If the only option is the second one, after exhausting the peace negotiation process, the support of the International Community must be focused on satellite surveillance and intelligence, support mobility, communications and logistic supply as well as political lobby in the international arena.

Finally, the situation of thousands of peasants in these isolated regions needs to be addressed because the solidarity that exists among them with the subversive is the product of intimidation or passive acceptance. Moreover, most of these peasants join the guerrillas or paramilitaries to survive as fighters or as field hands picking the illicit crops. Thus, alternative economic programs for these peasants will be the best option to eradicate the cocaine industry and its corrupted impact on the economy.

#### **D. COST OF THE 1991 CONSTITUTION**

The cost of the 1991 Constitution can be measured as follow:

- (1) The judicial system continues to be weak showing high levels of impunity due to widespread intimidation and corruption. However, it is not possible to articulate the judicial system with its prison system yet.
- (2) There is not an effective oversight system over government institutions and its budgets, the audit system is functioning ex-post and sometimes after the state funds have been siphoned-off, and there are no real controls to impede it.
- (3) The 1991 Constitution is a rigid micro-management tool that hampers globalization and the flexibility that is needed for opening markets, labor supply,

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<sup>146</sup> Ramirez-Ocampo, Augusto, "Peace in Colombia: Future Prospects," National Conciliation Commission. Latin America Program, Woodrow Wilson International Center for Scholars, May 2000, No. 246 "The Peace Process in Colombia and the U.S. Policy."

and domestic and foreign investments. The 1991 Constitution criteria of pensions indexation, inflation goals, and the allocation of regional public expenditures (as a welfare state) complicate the flow of capital investments, services and goods in an open and competitive market.

- (4) As a result of few constitutional restrictions on the political parties, the atomization of parties is opening the door for individual dealings, secret pacts, and dark negotiations that block options for new political projects and ideas of national benefit.
- (5) Finally, the weak state institutions created with the 1991 Constitution demonstrated their incapacity to provide basic public goods: justice, security and defense. For this reason peace continues to be an elusive proposition, and the criminal actors who often violate the fundamental rights of citizens, especially the right of life, continue to exist.

#### **E. CONCLUDING REMARKS**

The economic crisis of Colombia, that reached its peak in 1999, after Samper's questionable administration, stems from the interaction and resulting synergies of an underground criminal drug economy and the growth of the FARC, ELN, and AUC challenge to the state's authority. Notwithstanding, the downturn in the Colombian economy was a sharp reversal from the record of the previous half-century. The economy began to unravel in the last half of the 1990s as a result of the complex blend of terrorism, political crisis, contraction in the construction sector (due to drug-cartels neutralization), decertification by the U.S. that reduced business confidence and contributed to the sharpening of the economic crisis.

The confluence of the three interrelated variables subversion, drugs, and weak institutions has exacerbated even deeper problems in Colombian society, including the loss of central government authority, economic deterioration, and social disintegration.



The drug-trafficking and subversive problems continue intertwined and growing fast, so that effectively dealing with one will likely involve dealing with the other. Additionally, it is not easy after the lessons of September 11, 2001 to separate drugs from subversion, especially in the Colombian case.

The ongoing violence and terrorism involved substantial economic cost. In a World Bank Research-2000 it has been estimated that between 4 and 9 percent of the Colombia's GDP is lost each year as a result of criminal actions.

Law enforcement and effective judicial institutions are the bottom line for dealing with the violence because violence has reduced Colombia's social capital by eroding the effectiveness of free press, businesses, and security institutions. The Colombian state needs to build confidence in its judicial and security institutions in order to minimize the atomization of society and the growing chaos.

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